

Home Repossessions in Spain: A Legal Perspective

The amount of bank loan delinquencies has soared over the last months and it's at levels unseen in more than 8 years, according to the latest figures of the Bank of Spain. The underlying causes are related to the economic crisis we are in: high levels of unemployment, the inflation rising, and the Euribor (used as a reference index in most of the Spanish mortgages) at peak levels not seen for many years, something which translates into higher monthly repayments. Also, the strengthening of the Euro against other currencies such as the Sterling Pound or the US Dollar makes it harder for these currency holders to meet the monthly mortgage repayments in Euros. Falling property prices have also discouraged many potential purchasers as well as making it difficult for people to borrow against their properties through equity releases or life-time loans.



Euro vs. GBP historic data (24-06-2008).

[This fall in value](#) means some people are not interested in continuing to service their mortgages as they have *run into negative equity* (meaning they owe the bank more than what their property is worth). It is a **common misconception to believe that handing over the keys for the property will settle with the lending bank**. Although some Spanish banks have accepted this in the past (depending on each particular case and providing the borrower is not in negative equity) most do not any longer. In many cases, on doing this, many banks will be losing money as they realise your property is not worth in a public auction the value of the outstanding mortgage loan. This is basically what running into negative equity means.

Foreign home owners are concerned with what will happen to their assets back in their home countries if the bank refuses to accept the keys in exchange of the cancellation of the mortgage. While it used to be uncommon for Spanish banks to **pursue debts abroad**, on the wake of this new grim economical environment we are in, they are now forced to do it due to the alarming surge in delinquencies.

Exactly How Can One Run into Negative Equity?

We have witnessed in the last months how some banks are actually just accepting the return of keys and keeping the property as repayment. However, this will only happen **if there is no significant negative equity** on the property. In this case you will have to sign before a Notary a deed by which the loan is terminated. It's much more cost efficient for banks to just repossess the dwelling without having to go through the hassle and costs of a public auction which could take a couple of years. Avoiding a Public Auction also allows banks to waive setting-up financial provisions on their books to off-set the loss which doesn't look good in the eyes of shareholders and investors.

Although it may seem difficult at first, the truth is that running into negative equity is surprisingly easy. In the following lines we explain how this can happen.

Drop in Property Prices

The bank, on deciding if they will grant you a loan, will command an appraisal of the property to issue their Binding Offer. This property will act as collateral of the loan. If this value is unrealistic and is above the actual market value of the property should there be a fall in house prices, such as now, then **this property can be worth less than the loan it is guaranteeing**.

All mortgage contracts in Spain have a clause by which if the value of the property falls below 20% of the appraisal value the bank may request at their own discretion additional collateral to offset the financial shortage. In practice banks seldom opt to enforce it but they could legally.

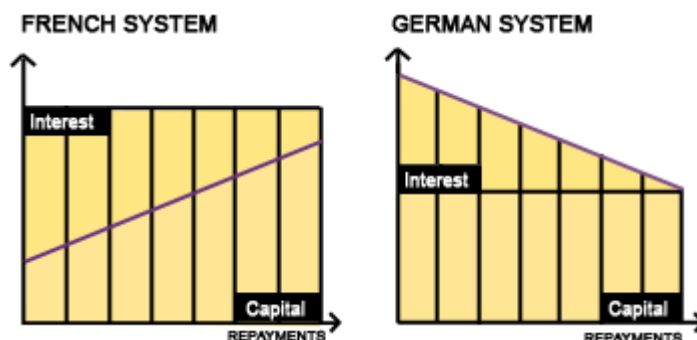
In the event the bank seizes the property, it can auction it in a Public Auction.

Public Auctions Mean a Further Drop in Property Prices

As the influx of repossessed properties increases in the near future banks will eventually be forced to go through a Public Auction. In these auctions the value fetched by properties can **easily fall below 50% of the market value**, which would mean that even if the bank sells the asset in the auction the debtor will **still owe the bank the balance** of the loan. To this balance the legal fees of the bank's lawyer and the associated costs of the seizure process must be added.

But wait, I have already paid X% of the mortgage capital during the equivalent period of time!

Well, I'm afraid you haven't! If your mortgage uses the *French repayment system* (as most of the mortgages granted by Spanish banks do), then you will only have paid a small fraction of the mortgage capital. The reason is that with the French system you pay interest-only during the early stages of the mortgage, and it gradually shifts to capital-only following a lineal sliding scale. This system allows having monthly payments that are invariable throughout the life of the mortgage.



French vs. German Repayment System. Source: [De Finanzas](#)

Extent of liability

Following article 1911 of the *Spanish Civil Code* on signing a mortgage deed you will be held liable with all your current and future assets. The mortgage is only a guarantee subject to the financial loan acting the property or underlying asset as collateral.

The above has huge legal implications which borrowers ought to understand fully on signing a Spanish mortgage deed. This would mean that if you default on servicing your Spanish mortgage, the bank can actually seize the property acting as collateral. If you fall into negative equity it, **the bank is entitled to pursue you for the outstanding debt even in your home country.**

Unlike in the UK and the US, most of the time handing back the keys to the bank will not stop them chasing you for the outstanding debt.

The Six Stages of a Home Repossession

Not all properties end in a public auction, especially in those cases in which the borrower is not in negative equity. The bank may reach an out-of-court-settlement on the matter by means of the borrower basically signing over in a public deed to the bank the ownership of the property. The bank agrees in this deed not to pursue the debt any further in return of the ownership.

In those cases in which this agreement is not possible, the repossession procedure is approximately as follows:

- **The borrower falls into arrears** - The borrower fails to service their mortgage repayments. Delay interests rates (*"intereses de mora"*) are applied. The bank contacts the borrower and may attempt to settle the matter out-of-court.
- **In technical default** - This happens 90 days as from the first arrear. The client file is passed onto the bank's debt collection department which tries in a last attempt to recover the debt. The bank is forced to set aside a provision to offset this potential loss. That is why many banks are open to negotiate before a default because these compulsory provisions that must be deposited before the Bank of Spain undermine the Lender's liquidity ratios something which banks with the ongoing current credit crunch will try to avoid.
- **Foreclosure and notary intervention** - Depending on the chances of a debt recovery, 15 or 20 days after the technical default. A registered communication is sent by a Notary Public with acknowledgement of re repossession procedure is imminent.

- **Repossession order** - The matter is brought forth to be trialled. The judge communicates the borrowers of the mortgage repossession. The value of the asset in the public auction can be either the one that is lodged at the Land Registry or else the bank may command an updated appraisal. This updated appraisal will also be useful for the bank to decide on whether it is worthwhile or not to proceed with the repossession as it has high associated expenses.
- **The Court sets a date for the Public Auction** - Normally between 6 to 12 months after the start of the Executive Procedure. The judge decides on the date of the auction. If no one bids for the property the bank will keep it. The bank tries to offset the outstanding loan debt with this auction. However, it may happen that after the property has been assigned to a winning bidder the amount raised is not enough to cover the debt plus all the associated repossession expenses (i.e. because the borrower had run into negative equity). The bank is entitled to pursue the rest of his assets even if abroad. Should there be a guarantor in the mortgage deed the bank will chase their assets. The property will now be lodged under the name of the new owner.
- **Eviction** - In the event the owner is still in the property, after a period that normally spans six months, the Police will arrive at their door step with a locksmith to evict them by force. There are a number of cases in which this may not be possible for legal reasons.

What to do if you cannot pay your Mortgage?

If you are struggling to meet your monthly mortgage repayments, and selling your property in time to raise the money to cancel the mortgage seems an impossible task, do not wait until you have fallen into arrears to start **negotiating with your bank**. After 3 months of mortgage arrears Spanish banks start to take legal action, so even if you manage to reach a settlement with them after said time (something which is very unlikely, as the bank sees you now like a defaulter) you will still have to pay not only the owed amount albeit all the legal expenses borne due to said default.

Negotiations with the lending bank include extending the mortgage period, reducing the interest rate or moving on to an interest-only mortgage for a few years until your economic circumstances improve. If after applying any of these options, you still cannot meet your monthly repayments, it is better to try to agree the handing over of the keys than to just let the bank unilaterally repossess the property.

Conclusion

Defaulting on a Spanish mortgage is a serious affair that may affect both your assets in your home country and your credit rating as the debt will be against you personally. If everything else fails, the only option left is to try to negotiate with your bank. **Banks are open to renegotiate the lending terms providing you are not in arrears with them.**

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