S&P Global
Ratings

Research

New Issue: Lugo Funding DAC

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New Issue: Lugo Funding DAC

Ratings Detail

Ratings

Class	Rating*	Amount (€)	Available credit enhancement (%)§	Interest	Step-up margin	Step-up date	Legal final maturity
A	AAA (sf)	520,725,000	20.50	Three-month EURIBOR plus 1.00%	Three-month EURIBOR plus 2.00%	February 2030	May 2066
B-Dfrd	AA (sf)	23,253,000	16.95	Three-month EURIBOR plus 1.50%	Three-month EURIBOR plus 2.50%	February 2030	May 2066
C-Dfrd	A (sf)	24,235,000	13.25	Three-month EURIBOR plus 2.0%	Three-month EURIBOR plus 3.0%	February 2030	May 2066
D-Dfrd	BBB+ (sf)	13,100,000	11.25	Three-month EURIBOR plus 2.50%	Three-month EURIBOR plus 3.50%	February 2030	May 2066
E-Dfrd	BBB (sf)	6,550,000	10.25	Three-month EURIBOR plus 3.0%	Three-month EURIBOR plus 4.0%	February 2030	May 2066
F-Dfrd	BB- (sf)	6,550,000	9.25	Three-month EURIBOR plus 3.5%	Three-month EURIBOR plus 4.5%	February 2030	May 2066
Z	NR	72,303,000	0.00	N/A	N/A	N/A	May 2066
Y	NR	2,000,000	0.00	N/A	N/A	N/A	May 2066

Note: *Our ratings address timely receipt of interest and ultimate repayment of principal on the class A notes and the ultimate payment of interest and principal on the other rated notes. Our ratings also address timely payment of interest due when the deferrable notes become the most senior outstanding class. Any deferred and unpaid interest is due by the legal final maturity. §Credit enhancement only includes collateralization. EURIBOR--Euro Interbank Offered Rate. NR--Not rated. N/A--Not applicable. Dfrd--Deferrable.

Overview

- S&P Global Ratings assigned its credit ratings to Lugo Funding DAC's class A, B-Dfrd, C-Dfrd, D-Dfrd, E-Dfrd, and F-Dfrd notes. At closing, Lugo Funding also issued unrated class Z and Y notes.
- Our ratings address the timely payment of interest and the ultimate payment of principal on the class A notes. Our ratings on the class B-Dfrd, C-Dfrd, D-Dfrd, E-Dfrd, and F-Dfrd notes address the ultimate payment of interest and principal on these notes, and timely payment of interest when they become the most senior class of notes outstanding. Unpaid interest will not accrue additional interest and will be due at the notes' legal final maturity.
- Credit enhancement for the rated notes comprises collateralization and the reserve fund. The reserve fund was fully funded at closing and provides mainly liquidity support for the payment of senior fees and interest due on the class A notes. Any excess of the cash reserve over its required amount provides credit support.
- Lugo Funding is a static RMBS transaction. The pool of €651,789,337 comprises 7,736 loan parts originated by Catalunya Banc, S.A., Caixa d'Estalvis de Catalunya, Caixa d'Estalvis de Tarragona, and Caixa d'Estalvis de Manresa. The assets are primarily first-ranking loans secured against properties in Spain. The portfolio is concentrated in Catalonia, where 71.29% of the portfolio's property valuations are located. The portfolio also contains 80% restructured loans and 71% that have been restructured before 2020, which did not attract our

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reperforming adjustment. At the same time, 19.11% of the portfolio is currently at least one month in arrears.

- The class A to F-Dfrd and Z notes' issuance proceeds were used to purchase the "participaciones hipotecarias" (PHs) and "certificados de participacion hipotecarias" (CPHs) from the seller. We consider the issuer to be a bankruptcy remote entity, and we have received legal opinions that indicate the sale of the assets would survive the seller's insolvency.
- Banco Bilbao Vizcaya Argentaria, S.A. (BBVA) is limited to a master servicer role without prejudice to those non-delegable duties as issuer of the PHs and CTHs, while Pepper Spanish Servicing S.L.U. (Pepper) is the servicer. Pepper conducts all servicing activities including primary and special servicing: arrears management, restructuring, recoveries, and real estate owned (REO) management.
- The application of our structured finance sovereign risk criteria does not constrain the ratings.

Transaction key features*

Closing date	November 2024
Note payment frequency	Quarterly
Collateral	Predominantly reperforming Spanish first-lien
Sources of credit enhancement	Collateral and reserve fund
Outstanding principal of the pool (mil. €)	651.8
Country of origination	Spain
Concentration	Catalonia: 71.29%
Deferral if not the most senior	Class B-Dfrd to F-Dfrd notes
Interest rate type	Variable: 98.78% Fixed: 1.22%
Weighted-average S&P Global Ratings original LTV ratio (%)§	77.94
Weighted-average S&P Global Ratings current LTV ratio (%)§	45.97
Weighted-average seasoning (months)	176
Reported arrears greater than or equal to one month (%)§	19.11
Restructured loans (%)	9.03
Asset redemption profile	8.51% geometric, 91.49% French amortization
Liability redemption profile	Fully sequential
Reserve fund	2.25% of initial class A notes, amortizing and floored at 0.5% of the class A notes' balance at closing.
Margin step-up date	February 2030
Optional redemption date	February 2030

*Data is based on a pool as of Oct. 31, 2024. §Calculations are according to S&P Global Ratings' methodology. LTV--Loan-to-value.

The Credit Story

Strengths	Concerns and mitigating factors
The capital structure provides 20.50% of available credit enhancement for the class A notes through subordination. The class Z notes provide 9.25% credit enhancement to the rated notes.	Although the loans in the pool were originated as prime mortgages, about 80% of the portfolio has been restructured at least once. We have accounted for this in our analysis. There are no loans under the Code of Good Practices in the pool.In a stressed economy, these borrowers are more likely to go back into arrears. In our analysis, we have applied our reperforming adjustment to those loans that were restructured or were at least three months in arrears in the past 60 months and are currently (9.03%).

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The Credit Story (cont.)

Strengths	Concerns and mitigating factors
A fully funded amortizing liquidity reserve fund (2.25% of the class A notes' outstanding balance) covers the class A notes' interest, as well as senior fees. The reserve fund is floored at 0.5% of the class A notes' initial balance. Any excess of the cash reserve over its required amount provides credit support to the notes.	Within the pool, 19.11% of loans currently have arrears exceeding or equal to one month (14.09% are more than three months in arrears). We view these borrowers as having a higher risk of default. In line with our global RMBS criteria, we have increased our weighted-average foreclosure frequency (WAFF) estimates accordingly to address this risk.
The application of principal proceeds is fully sequential. Credit enhancement can therefore build up over time for the rated notes, enabling the capital structure to withstand performance shocks.	About 8.51% of the portfolio is currently paying geometric installments. This is not common in the Spanish market. We have considered this point in our credit and cash flow analysis.
Despite the portfolio's high arrears and high restructuring share, it has maintained a strong payment rate (weighted-average rate of approximately 99%). This indicates a relatively high willingness of borrowers to pay following a restructuring arrangement, even for those in long-term arrears. The portfolio's high seasoning and relatively low loan-to-value (LTV) ratio are strong incentives for borrowers to pay their installments.	We have not received loan-by-loan data for borrowers' employment status, the number of times that each loan has been restructured, or loan purpose information. We have considered this missing information while assessing our originator adjustment.
BBVA and Pepper are servicers for the transaction. Both are well-established servicers in the Spanish market, and we consider them adequate for their roles given their experience on residential mortgages. In addition, BBVA is the master servicer.	Most loans in the portfolio are variable rate linked to 12-month Euro Interbank Offered Rate (EURIBOR; 98.78%) while the notes pay three-month EURIBOR. The transaction does not have a basis swap to mitigate the basis risk between the loans and the interest on the liabilities. We have accounted for this basis risk in our analysis.
The subordinated tranches have performance-based interest deferral triggers, which protect the senior notes if their performance deteriorates. Additionally, deferred interest will not accrue additional interest.	Although the portfolio's weighted-average seasoning is considerable (176 months), we only give full seasoning credit to 71.8% of the portfolio. We do not give any credit to loans that are currently in arrears. Similarly, for those loans that are current but have been restructured or have been more than 90 days in arrears in the last five years, we apply seasoning from the date of the restructure or from the date the loan became current again.
The interest rate cap hedges the exposure to liquidity risks in a rising interest rate scenario.	The class B-Dfrd to F-Dfrd notes do not benefit from an external liquidity source. However, the transaction benefits from a combined waterfall which mitigates liquidity risk once the class B-Dfrd to F-Dfrd notes become the most senior class.
	Of the pool, 5.33% and 9.92% of the loans were granted to non-Spanish citizens resident in Spain and for the acquisition of second homes, respectively. We consider that these loans have a higher default probability. We have, therefore, adjusted our foreclosure frequency to account for them.

Environmental, Social, And Governance

Our analysis considers a transaction's potential exposure to environmental, social, and governance (ESG) credit factors. For RMBS, we view the exposure to environmental credit factors as average, social credit factors as above average, and governance credit factors as below average (see "ESG Industry Report Card: Residential Mortgage-Backed Securities," published on March 31, 2021).

In our view, the exposure to social credit factors is in line with the sector benchmark. Social credit factors are generally considered above average because housing is viewed as one of the most basic human needs. Conduct risk presents a direct social exposure for lenders and servicers, particularly as regulators are increasingly focused on ensuring fair treatment of borrowers. This is particularly the case in Spain, where Government aims to protect weaker borrowers under the Code of Good Practices, recently updated. For RMBS, social risk is generally factored into our base-case assumptions.

In our view, the exposure to environmental credit factors is in line with the sector benchmark. Physical climate risks

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could severely damage properties and reduce their value, affecting recoveries if borrowers default. We believe that well-diversified portfolios reduce exposure to extreme weather events.

In our view, the transaction has a relatively higher exposure to governance credit factors than our sector benchmark. We have not received certain information within the loan-level data that we typically receive. Although the data provided meets our minimum requirements, we have accounted for the limitations in loan-level data provided in our originator adjustment.

Collateral Description

As of the Oct. 31, 2024 pool cutoff date, the pool of €651,789,338 comprised 7,736 loan parts originated by Catalunya Banc, Caixa d'Estalvis de Catalunya, Caixa d'Estalvis de Tarragona, and Caixa d'Estalvis de Manresa. The collateral comprises first-ranking mortgage loans secured against residential (96.55%) and commercial (3.45%) properties in Spain.

The assets in the portfolio were originated as prime collateral. However, Spanish mortgage performance was significantly affected by rising unemployment in the aftermath of the global financial crisis, and the performance of the loans originated as prime collateral deteriorated. They are now mostly reperforming. There are no loans under the Code of Good Practices in the pool.

The collateral loans were previously securitized in Miravet S.a r.l., Compartment 2020-1 (Miravet 2020-1) (c. approximately 65%) and Miravet S.a r.l., Compartment 2019-1 (Miravet 2019-1) (approximately 35%). The securitization consists of the same portfolio without including additional assets.

Data adequacy

We have received historical arrears performance data for the loans in the portfolio since 2017, the latest restructuring or 90+ days arrears date, and payment rate data since 2017. The historical data span a relatively benign economic environment. We have considered this in our credit analysis by increasing our originator adjustment.

In addition, a third-party due diligence provider audited the Miravet 2020-1 pool. In September 2023, we received an audit report performed only on dynamic fields as of July 2023 portfolio compared with the information in their system. The scope and results were in line with what we typically see in the Spanish market.

Most of the original property valuations were conducted pre-global financial crisis. In the market, we have observed some volatility when we compare updated and original property valuations from those years. We accounted for this in our analysis through a 10% haircut on the original valuations.

Table 1

Collateral key features*

	Lugo Funding DAC	Fondo de Titulizacion RMBS Miravet 2023-1 (Miravet 2023-1)	Miravet 2020-1	Clavel Residential DAC
Pool cutoff date	Oct. 31, 2024	Oct. 31, 2022	Oct. 31, 2020	Jan. 31, 2022
Jurisdiction	Spain	Spain	Spain	Spain
Principal outstanding of the pool (€)	651,789,338	307,621,542	619,669,061	175,596,642

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Table 1

Collateral key features* (cont.)

	Lugo Funding DAC	Fondo de Titulizacion RMBS Miravet 2023-1 (Miravet 2023-1)	Miravet 2020-1	Clavel Residential DAC
Number of loans	7,736	3,704	13,107	2,832
Average loan balance (€)	84,254	83,051	47,278	62,004
Weighted-average indexed current S&P Global Ratings LTV ratio (%)	45.97	70.68	56.4	58.44
Weighted-average original LTV ratio (%)	77.94	68.90	76.2	79.7
Weighted-average seasoning (months)	176	178	152	61
Non-Spanish citizens (%)	5.33	5.61	5.4	6.4
Concentration per current balance (%)	71.29 (Catalonia)	29.84 (Galicia)	73.5 (Catalonia)	73.51 (Catalonia)
Geometric loans (%)	8.51	65.1	9.0	3.1
Jumbo valuation (%)	12.36	11.58	8.0	4.4
'AAA' RMVD (%)	53.2	52.5	57.6	52.5
Current reported arrears greater than or equal to one month (%)	19.11	35.37	16.1	25.0
Historical restructures (%)	80	52.58	78.9	92.0

*Calculations are according to S&P Global Ratings' methodology. These amounts are based on the available data. LTV--Loan-to-value. N/A--Not applicable. ND--No data, assumption made. RMVD--Repossession market value decline.

Asset performance

Historically, 80% of loans in the portfolio have been restructured. We classify 9.03% of the loans as reperforming under our criteria, and we increased our WAFF assumptions for these assets based on the date when the loan was last 90 days or more in arrears and is now current or restructured over the last 60 months, in line with our criteria.

When a restructuring arrangement occurred, it included a full reassessment of the borrower's affordability. We have therefore calculated our seasoning credit on these loans based on the date a loan was last 90 or more days in arrears or restructured.

Although the pool has historically experienced a significant number of restructurings, arrears performance has remained relatively high but stable in recent years. Arrears have not fallen mainly due to borrowers not being able to pay previously unpaid amounts, while paying their current installment.

Most of the restructurings took place before 2020 (see chart 1).

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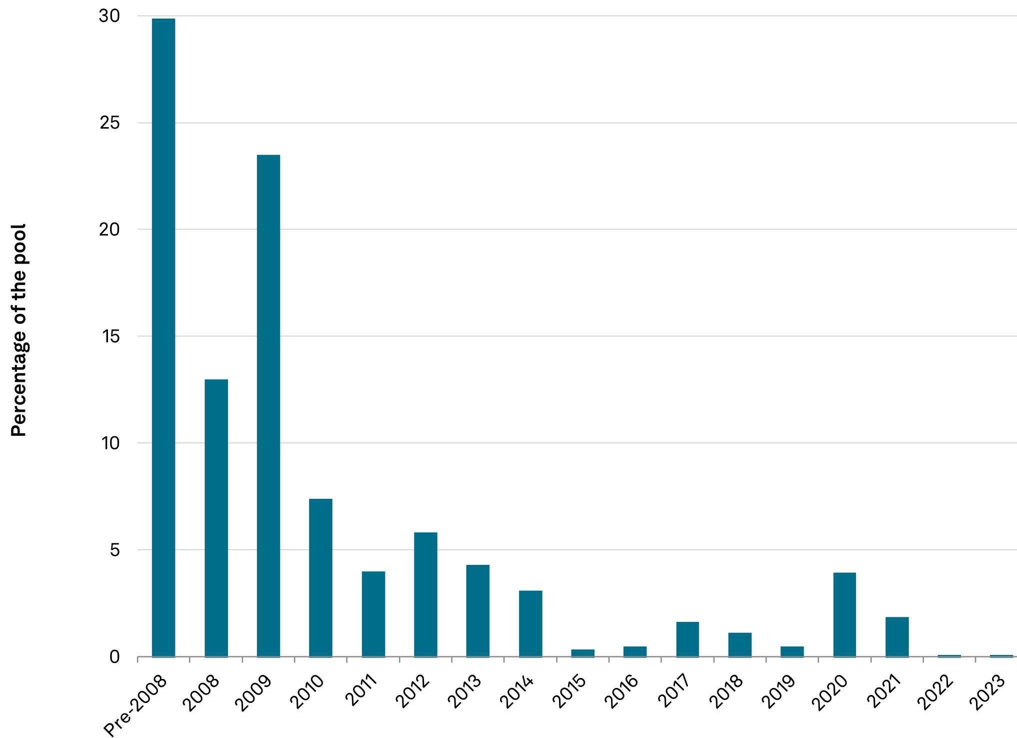
Chart 1

Latest loan restructurings



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The pay rates of loans in severe arrears have been declining since 2017. The average pay rate over time was 45%, while in the last two years the average pay rates decreased to 40% (see chart 2). Loans in 90+ day arrears with pay rates above 90% and 70% in the last two years are 2.44% and 3.83%, respectively. Considering higher pay rates for 90-180 day and 180-360 day arrears, we gave benefit to pay rates for those loans at rating levels of 'A' and below (see charts 3 and 4).

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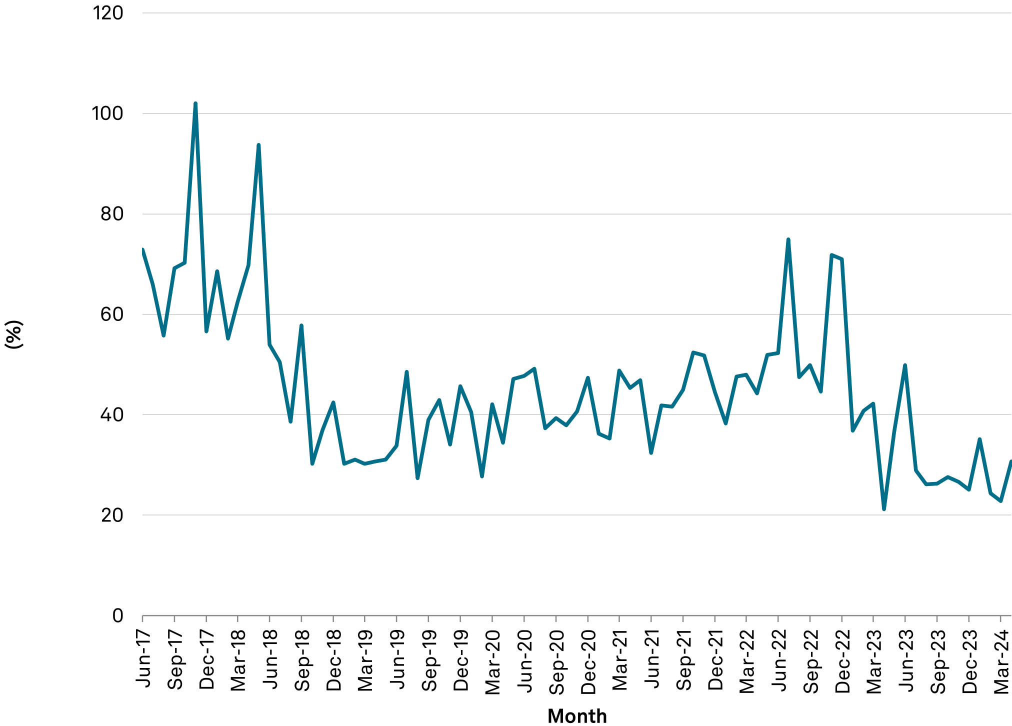
Chart 2

Historical payment rate for loans 90+ days in arrears



Source: S&P Global Ratings.

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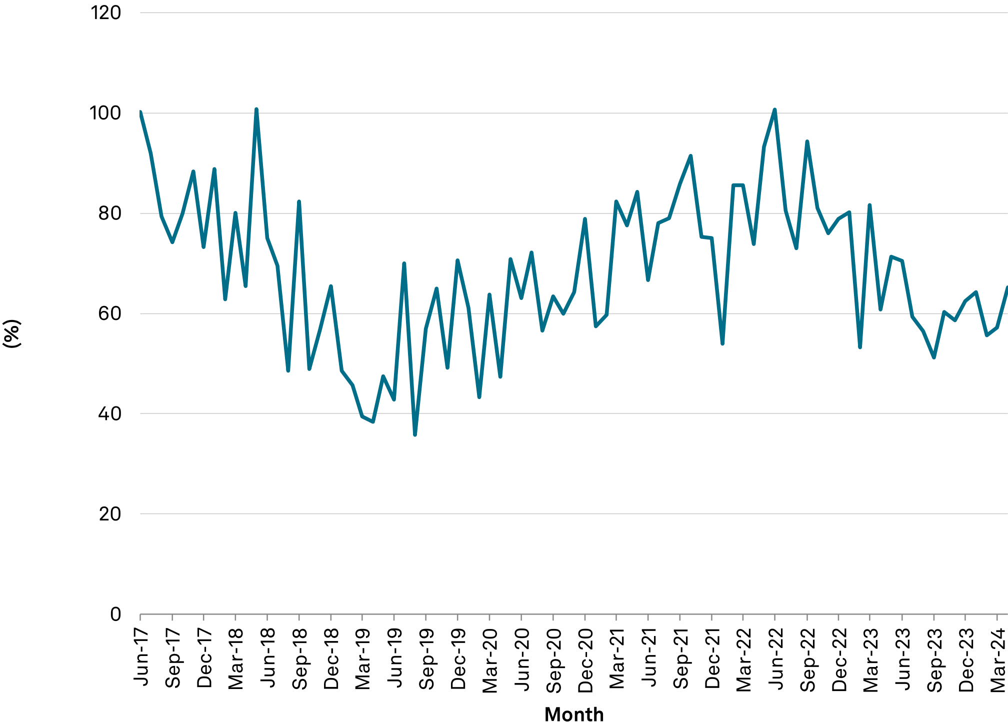
Chart 3

Historical payment rate for loans 90-180+ days in arrears



Source: S&P Global Ratings.

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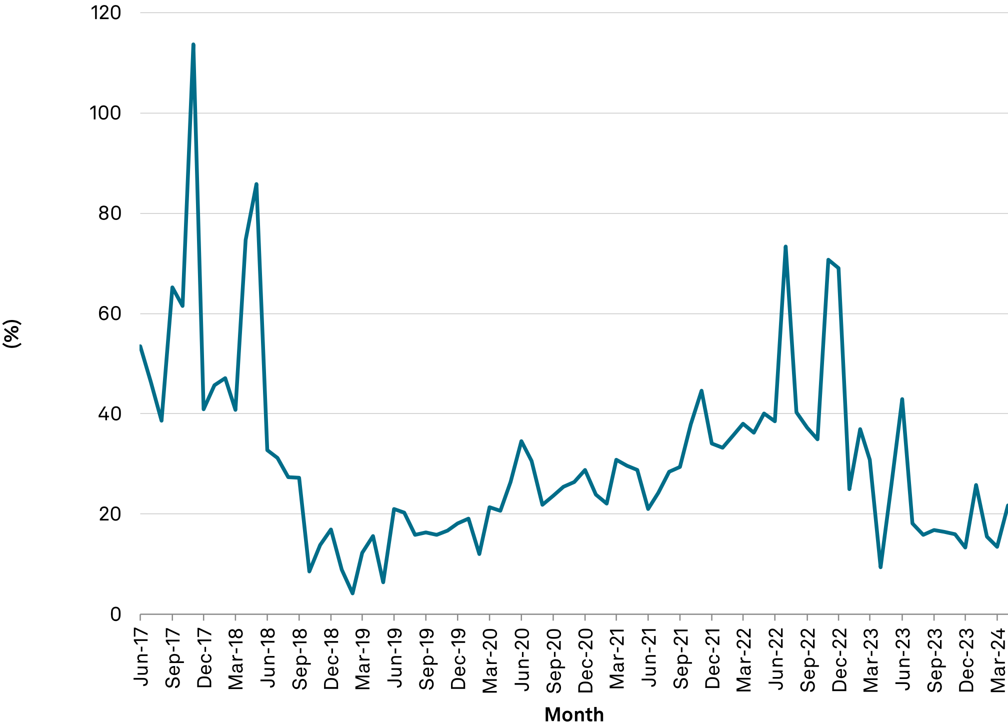
Chart 4

Historical payment rate for loans 180-360+ days in arrears



Source: S&P Global Ratings.

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The average portfolio pay rate has been nearly 99% since June 2017. The average pay rate over the last two years is 97%.

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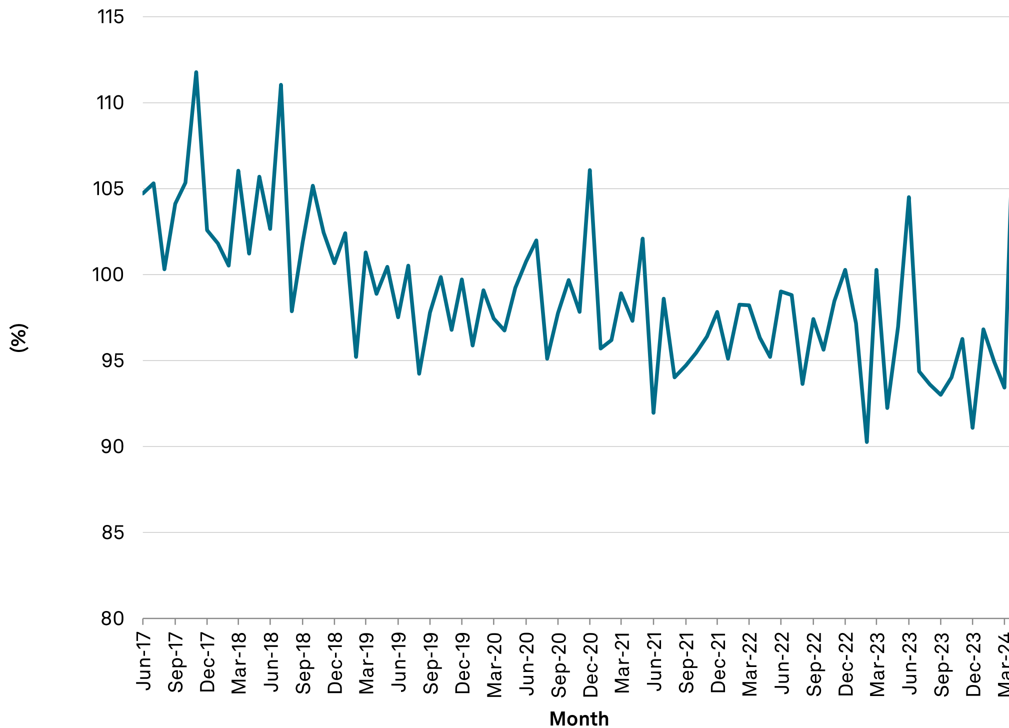
Chart 5

Historical payment rate



Source: S&P Global Ratings.

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Asset description

The portfolio's weighted-average S&P Global Ratings current indexed LTV ratio is 46.10%, and the weighted-average effective LTV ratio is 71.53% (see charts 6 and 7).

The weighted-average current LTV ratio and the weighted-average effective LTV ratios are based on our methodology.

We consider that borrowers with minimal equity in their property are more likely to default on their obligations than borrowers with lower original loans. At the same time, loans with high current LTV ratios are likely to incur greater loss severities if the borrower defaults.

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Chart 6

S&P Global Ratings effective loan-to-value ratio distribution

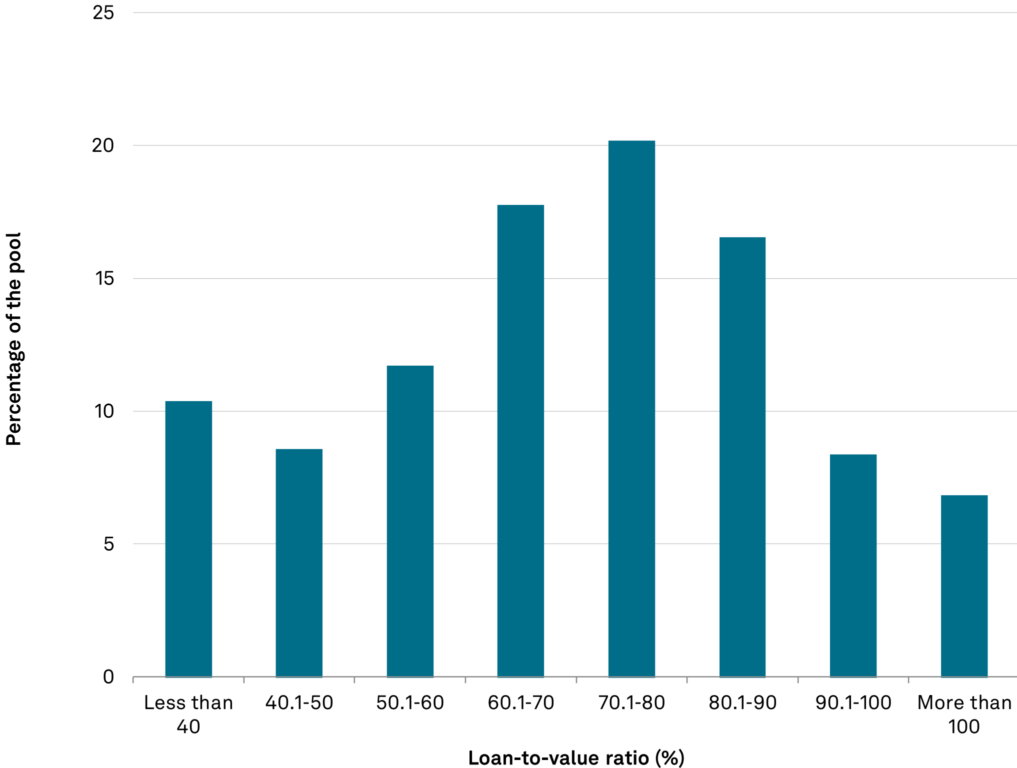

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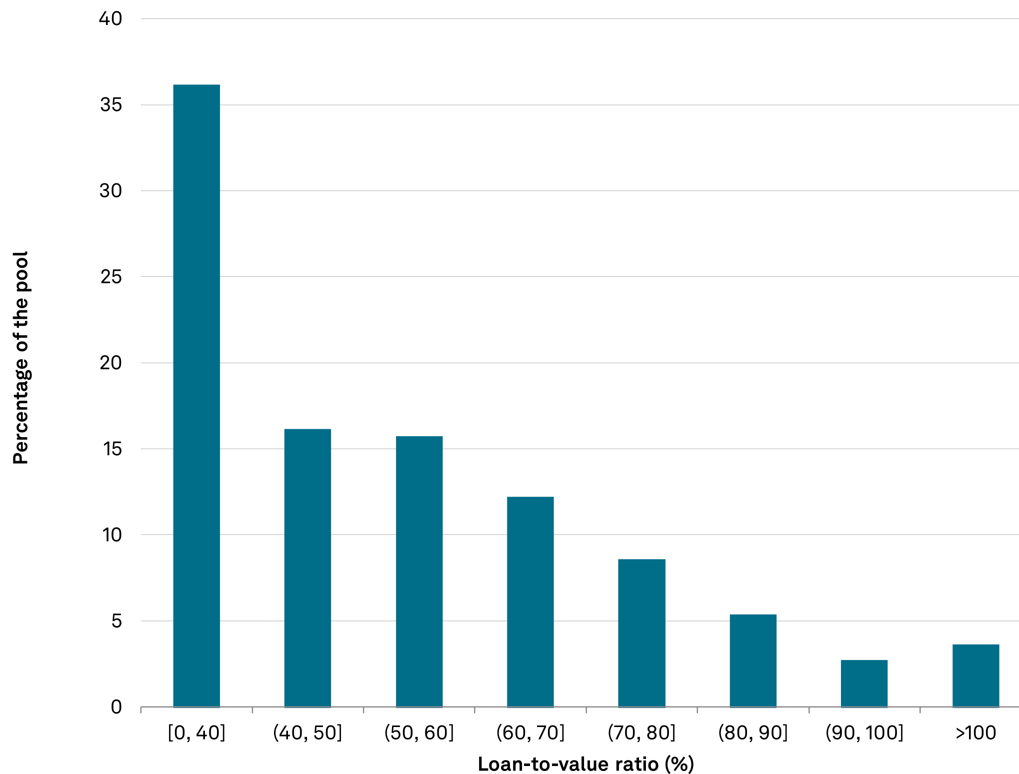
Chart 7

S&P Global Ratings current loan-to-value ratio distribution



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Of the pool, 8.51% of the loans follow a geometric amortization profile. In our view, geometric loans have increasing installments, which introduces potential payment shock risk in the transaction. As installments are known in advance and given the slow growth rate, we have stressed a 1.2x penalty, within the low range of our criteria.

The portfolio's weighted-average seasoning is 176 months, but this is offset by not giving benefit to the seasoning of loans that have been classified as reperforming in the past five years or are currently in arrears (see above).

The assets are concentrated in Catalonia, which represents 71.29% of the portfolio based on the outstanding balance, with the remaining relatively well-distributed across Spain.

Table 2

Geographic distribution

Region (concentration limit)	Percentage of the pool (%)
Andalucia (30%)	3.64
Aragon (5%)	0.59
Asturias (5%)	0.02
Balearic Islands (5%)	0.77
Canary Islands (10%)	0.89

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Table 2

Geographic distribution (cont.)	
Region (concentration limit)	**Percentage of the pool (%)**
Cantabria (3%)	0.06
Catalonia (30%)	71.29
Extremadura (5%)	0.27
Galicia (10%)	0.19
La Rioja (2%)	0.05
Murcia (7.5%)	1.63
Navarra (3%)	0.40
Valencia (20%)	7.55
Madrid (30%)	10.11
Basque Country (10%)	0.49
Castilla-Leon (10%)	0.93
Castilla-La Mancha (10%)	1.12
Ceuta (1%)	0.00
Melilla (1%)	0.00

While the warranty provider provides certain representations and warranties on the assets, its responsibility to indemnify the issuer is limited. We consider the warranty provider's responsibility in case of a breach to be weaker than what we normally see in European RMBS transactions, and we have increased the originator adjustment to incorporate this risk. We have also considered the pool's high seasoning as a mitigating factor in this regard.

The proportion of the pool with jumbo valuations is 12.36%. Due to the illiquid nature of larger valued properties, these loans may suffer an additional market value decline, in our view. A property is classified as jumbo under our criteria if its value exceeds €500,000.

Servicer

BBVA provides the day-to-day operational servicing capabilities for this transaction and is the master servicer, while Pepper assumes servicing responsibility for loans in arrears.

While the servicing strategy is to find a long-term solution, a large portion of the portfolio has already undergone a permanent restructure considering borrowers' circumstances. Should these restructure agreements fail, and a sustainable solution not be available, the servicing strategy aims to realize the real estate value in the most efficient manner.

Both BBVA and Pepper are experienced servicers in the Spanish market with well-established and fully integrated servicing systems and policies. We have considered their ability to service the portfolio under our operational risk criteria, and we are satisfied that they can perform their functions. Operational risk does not constrain the ratings.

Credit Analysis And Assumptions

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WAFF and WALS

We have applied our global RMBS criteria to the pool to derive the WAFF and the weighted-average loss severity (WALS) at each rating level.

The WAFF and the WALS assumptions increase at each rating level because notes with a higher rating should be able to withstand a higher level of mortgage defaults and loss severity. We base our credit analysis on the loans, the properties, and the associated borrowers' characteristics.

Table 3

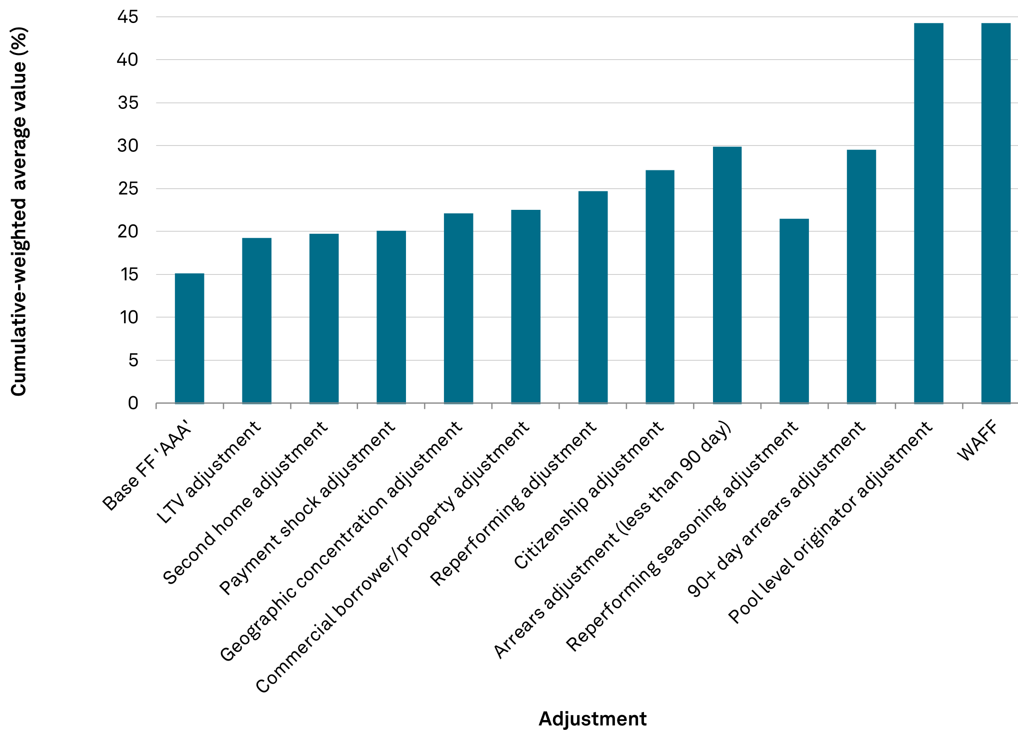
Portfolio WAFF and WALS

Rating level	WAFF (%)	WALS (%)	Credit coverage (%)
AAA	44.46	21.16	9.41
AA	37.63	17.48	6.58
A	32.68	12.04	3.93
BBB	27.42	9.48	2.60
BB	22.35	7.90	1.77
B	21.08	6.59	1.39

WAFF--Weighted-average foreclosure frequency. WALS--Weighted-average loss severity.

Chart 8

Cumulative 'AAA' WAFF migration



WAFF--Weighted-average foreclosure frequency. FF--Foreclosure frequency. LTV--Loan to value.

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Macroeconomic and sector outlook

In our analysis, we considered the following economic data and their effect on collateral credit quality in determining our credit assumptions (see "Related Research").

For Spain, our current expectations are described in the table below.

Table 4

Spain market statistics

	2023	2024f	2025f	2026f
Nominal house prices, % change year on year	4.4	4.0	3.0	2.4
Real GDP (% change)	2.5	2.7	2.1	2.0
Unemployment rate	12.2	11.6	11.4	11.3
CPI inflation (average, y/y%)	3.4	3.0	2.1	2.0
Policy rate (end of year)	4.0	3.25	2.5	2.5

Sources: National Statistics offices, Eurostat, S&P Global Ratings. Y/Y--Year on year. f--Forecast. CPI--Consumer price index.

The borrowers in this transaction are particularly vulnerable to a deterioration in the macroeconomic conditions as a large portion had at least one restructuring in the past or is currently in arrears. Our credit assumptions reflect the quality of this portfolio. In addition, our assigned ratings incorporate some buffer to account for the risk of higher defaults and longer recovery timing.

Transaction Summary

We assigned our ratings to Lugo Funding's class A notes and to the interest deferrable class B-Dfrd to F-Dfrd notes. Our ratings address the timely payment of interest and the ultimate payment of principal on the class A notes. Our ratings on the class B-Dfrd to F-Dfrd notes address the ultimate payment of interest and principal on these notes, until they become the most senior notes outstanding. Unpaid interest will not accrue additional interest and will be due on the notes' legal final maturity. At closing, Lugo Funding also issued unrated class Z and Y notes.

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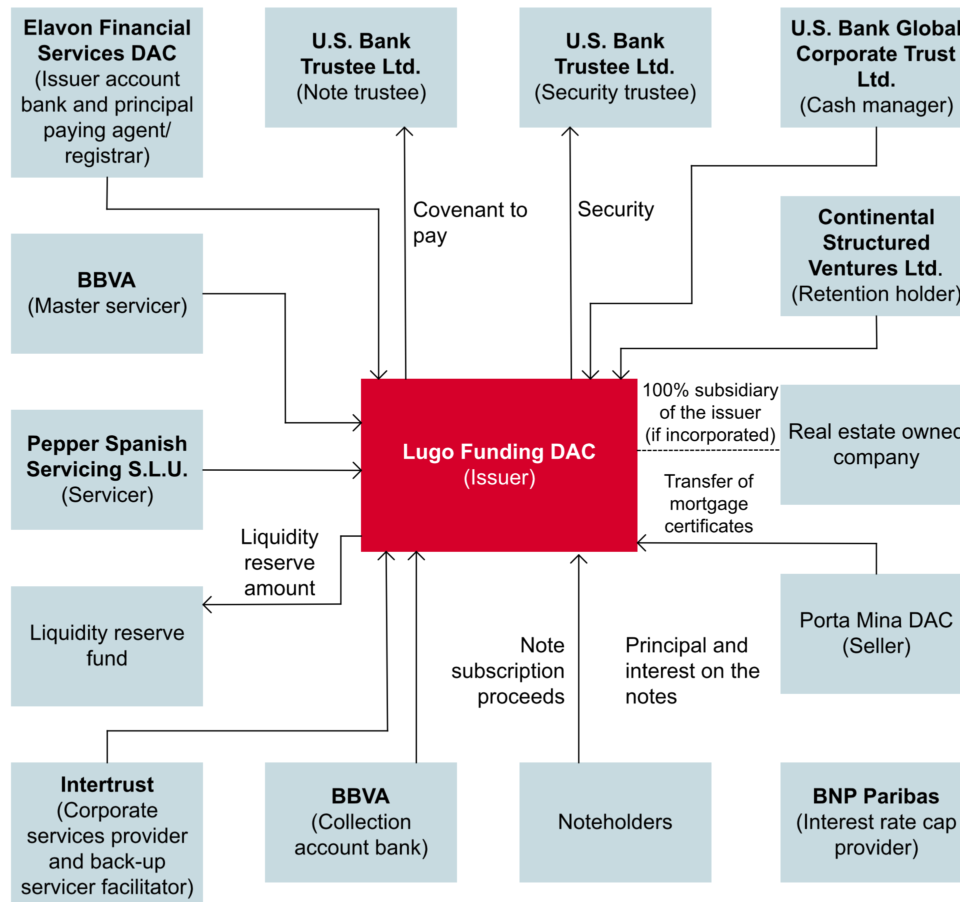
Chart 9

Transaction structure



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The issuer is an Irish special-purpose entity (SPE), which we assume to be bankruptcy remote for our credit analysis. We analyzed its corporate structure in line with our legal criteria (see "Asset Isolation And Special-Purpose Entity Methodology," published on March 29, 2017). We have received and reviewed versions of the legal opinions.

We analyzed its corporate structure in line with our legal criteria and reviewed the transaction's legal opinion, which provides assurance as to whether the structure achieves a valid and effective sale of assets. We believe that the sale of the assets would survive the seller's insolvency. Legal documents are in accordance with our legal criteria.

Note payments

Interest is paid quarterly on the interest payment dates, beginning in February 2025. The rated notes pay interest equal to three-month EURIBOR plus a margin with a further step-up in margin in February 2030.

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The amortization of the notes is fully sequential. All the notes will reach legal final maturity in May 2066. The transaction also features an optional call date in February 2030.

Available funds

Available amounts include:

- Principal collections;
- Interest collections;
- Interest on the bank account;
- Reserve fund; and
- Recoveries.

Liquidity reserve fund

The transaction has a liquidity reserve fund that is available to cover shortfalls on the senior fees, and interest on the class A notes.

The reserve fund was fully funded at closing by part of the issuance of the class Z notes, representing 2.25% of the class A notes' balance at inception. The reserve fund can amortize in line with the notes' balance, subject to a floor of 0.50% of the initial class A notes' balance.

Excess amounts above the required amount will be released in the payments waterfall and provide credit support.

Payment priority

The transaction has a combined interest and principal waterfall. Interest on the notes is payable quarterly in accordance with the waterfall. The amortization is fully sequential, with deferrable interest on the class B-Dfrd to F-Dfrd notes.

Upon an enforcement notice being served on the issuer, all funds from the enforced security are distributed according to the liquidation priority of payments. We have reviewed the issuer events of defaults and have concluded that they are remote in our ratings scenarios. As a result, we have not considered the post enforcement priority of payments in our analysis.

Simplified priority of payments:

- Combined interest and principal priority of payments
- Senior fees, including funding of expenses
- Servicing fees
- Class A interest amount (payable pro rata and pari passu)
- To fund the liquidity reserve fund up to the liquidity reserve fund target balance
- Class B-Dfrd interest (if not deferred)
- Class C-Dfrd interest (if not deferred)

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- Class D-Dfrd interest (if not deferred)
- Class E-Dfrd interest (if not deferred)
- Class F-Dfrd interest (if not deferred)
- If applicable, to fund drawdowns under multi-credit agreements
- Sequential repayment of the rated notes by an aggregate amount equal to the target amortization amount
- Class B-Dfrd interest (if deferred)
- Class C-Dfrd interest (if deferred)
- Class D-Dfrd interest (if deferred)
- Class E-Dfrd interest (if deferred)
- Class F-Dfrd interest (if deferred)
- Sequential repayment of the rated notes until when fully repaid
- Junior payments

The target amortization amount means the positive difference between the outstanding amounts of the class A to the balance of the principal backed portion of the class Z notes at the closing date minus the reserve fund and the outstanding balance of the non-defaulted receivables (up to 12 months past due), at such calculation date.

Hedging

The issuer benefits from an interest rate cap with a strike rate at 3.5% based on a scheduled notional. The interest rate cap acts to minimize the exposure to liquidity stresses up to nine years after closing.

The transaction does not have a basis risk swap. We have accounted for this in our cash flow analysis by applying a basis risk stress to account for the mismatch between the three-month EURIBOR paid on the notes and the 12-month EURIBOR.

Clean-up call

The issuer can exercise a clean-up call option as soon as the principal balance outstanding on the collateral is below 10% of the principal balance at closing, as long as it has enough resources to meet all payment obligations under the outstanding notes. In our analysis, we have not considered a clean-up call to occur.

Cash Flow Assumptions And Analysis

We stress the transaction's cash flows to test the credit and liquidity support that the assets, subordinated tranches, and cash reserves provide. We apply these stresses to the cash flows at all relevant rating levels.

Our standard cash flow analysis indicates that the available credit enhancement for the class B-Dfrd, C-Dfrd, D-Dfrd, E-Dfrd, and F-Dfrd notes is commensurate with the ratings assigned.

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Spread compression

The asset yield on the pool can decrease if higher-paying assets default or prepay. We have taken this into account by applying spread compression in our cash flow analysis.

Commingling risk

Our assessment of the amounts at risk of commingling considers both the amounts accumulated in the servicer collection account before the servicer's insolvency ("accumulation risk") and the amounts that may be paid to that account following the servicer's insolvency before the borrowers are notified to pay into the issuer account ("notification risk").

In this transaction, borrowers pay their due amounts into a collection account held with BBVA (resolution counterparty rating of 'A+'). These amounts are subsequently transferred on each business day into an account in the SPE's name held with the bank account provider, Elavon Financial Services DAC.

Since we see the sale of the whole business as a credible resolution strategy for BBVA, we believe this mitigates comingling risk during the potential notification period (see "Various Actions Taken On Spanish Midsize Banks Amid Progress on Resolvability," published on Nov. 25, 2022). In addition, given the daily transfer of collections to the transaction account in the SPE's name, we believe accumulation risk is also mitigated. As Pepper is not a rated entity, we have stressed one month of liquidity commingling.

Setoff risk

Deposit setoff risk is mitigated under the Spanish legal framework. The portfolio contains no employee loans and entities that are not orginators provide the insurances. Therefore, we have not applied a stress for potential setoff risk in our analysis.

Fees

The issuer must pay periodic fees to various parties providing services to the transaction, including servicers, and the management company, among others. We have accounted for these in our analysis. In particular, and in line with our global RMBS criteria, we have applied a stressed servicing fee of 0.50% to account for the potential increase in costs to attract a replacement servicer.

Interest deferral trigger

On any payment date, if the cumulative balance of any mortgage loans that have defaulted since the portfolio cutoff date is equal to or exceeds 27.0%, 24.8%, 21.0%, 19.1%, or 17.25% for classes B-Dfrd, C-Dfrd, D-Dfrd, E-Dfrd, and F-Dfrd respectively, the issuer will defer interest on such class of notes according to the priority of payments, as long as the relevant class of notes is not the most senior class outstanding.

Default timing and recoveries

We used the WAFF and WALS derived in our credit analysis as inputs in our cash flow analysis (see table 5). At each rating level, the WAFF specifies the total balance of the mortgage loans we assume will default over the transaction's life. Defaults are applied on the outstanding balance of the assets as of the closing date. We simulate defaults following two paths (that is, one front-loaded and one back-loaded) over a six-year period. During the recessionary period within each scenario, we assume 25% of the expected WAFF is applied annually for three years.

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Table 5

Default timings for front-loaded and back-loaded default curves

Year after closing	Front-loaded defaults (% of WAFF per year)	Back-loaded defaults (% of WAFF per year)
1	25.0	5.0
2	25.0	10.0
3	25.0	10.0
4	10.0	25.0
5	10.0	25.0
6	5.0	25.0

WAFF--Weighted-average foreclosure frequency.

Timing of recoveries

We have assumed that the issuer regains any recoveries 44 months after a payment default. We also tested a sensitivity scenario to extend time to recovery by six months.

Delinquencies

To simulate the effect of delinquencies on liquidity, we model a proportion of scheduled collections equal to one-third of the WAFF (in addition to assumed foreclosures reflected in the WAFF) will be delayed. We apply this in each of the first 18 months of the recession, and we assume a full recovery of these delinquencies would occur 36 months after they arise.

Prepayments

To assess the impact on excess spread and the absolute level of defaults in a transaction, we model two prepayment scenarios: high and low (see table 6).

Table 6

Prepayment assumptions

	High	Low
Pre-recession	24.0	1.0
During recession	1.0	1.0
Post-recession	24.0	1.0

Given the expected prepayment rates for similar portfolios, we have tested additional low prepayment scenarios assuming low prepayment scenarios above 1.0%.

Interest rates

Our cash flows are tested under up and down interest rate paths.

Scenario analysis

We consider the transaction's resilience in case of additional stresses to some key variables, in particular defaults and loss severity and extended recovery timing to determine our forward-looking view.

In our view, the ability of the borrowers to repay their mortgage loans will be highly correlated to macroeconomic conditions, particularly the unemployment rate, consumer price inflation, and interest rates. As the loans in the transaction are floating rate, we believe material interest rate increases will have a negative effect on these borrowers'

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ability to service their loans. As of today, our forecast on policy interest rates for Spain is 3.25% in 2024 and our forecasts for unemployment for the year 2024 and 2025 are 11.6% and 11.4%, respectively.

Furthermore, a decline in house prices typically affects the level of realized recoveries. For Spain in 2024 and in 2025, we do not expect them to decrease as our forecast for 2024 and 2025 are increases of 4% and 3%, respectively.

Given our current macroeconomic forecast and our forward-looking view of Spain's housing market, our sensitivity scenarios consider, all else being equal, the hypothetical effect on our credit ratings of different combinations of:

- An increase in WAFF (foreclosure frequency/defaults) by up to 30% at each rating level; and
- An increase in WALS (loss severity) by up to 30% at each rating level.

We therefore ran eight scenarios with increased defaults and higher loss severity, as shown in table 7 below.

Sensitivity analysis

Class	WALS x 1.0	WALS x 1.1	WALS x 1.3
WAFF x 1.0	Base Case	Sensitivity 3	Sensitivity 4
WAFF x 1.1	Sensitivity 1	Sensitivity 5	Sensitivity 7
WAFF x 1.3	Sensitivity 2	Sensitivity 6	Sensitivity 8

		Sensitivity							
Class of notes	**Initial rating**	**1**	**2**	**3**	**4**	**5**	**6**	**7**	**8**
Class A	AAA	AA+	AA	AA+	AA+	AA+	AA-	AA	AA-
Class B-Dfrd	AA	AA	A+	AA	AA	AA	A+	AA-	A
Class C-Dfrd	A	A	A-	A	A	A	BBB+	A-	BBB
Class D-Dfrd	BBB+	BBB	BBB-	BBB+	BBB	BBB	BBB-	BBB-	BB+
Class E-Dfrd	BBB	BBB-	BB	BBB-	BB+	BB+	BB	BB	BB-
Class F-Dfrd	BB-	B	B	B+	B	B	'B-' or below	'B-' or below	B- or bel

Legend: No change; One-notch downgrade; Two-notch downgrade; Three-notch or more downgrade

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The results of the above sensitivity analysis indicate a deterioration of no more than one rating category on the notes, which is in line with the credit stability considerations in our rating definitions (see "Related Research").

A general downturn of the housing market may delay recoveries. We have also run extended recovery timings to understand the transaction's sensitivity to liquidity risk.

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The transaction embeds some strengths that may offset deteriorating collateral performance.

Therefore, given its sequential amortization, credit enhancement is expected to build up over time. The existence of a reserve and liquidity funds may, to a certain extent, insulate the notes against credit losses and liquidity stresses. The interest rate cap mitigates the effect on note coupon payments from rising interest rates on the index they are linked to.

Counterparty Risk

The transaction is exposed to Banco Santander as the bank account provider. The documented replacement mechanisms adequately mitigate the transaction's exposure to counterparty risk in line with our current counterparty criteria, and therefore, these criteria do not constrain our ratings.

Table 8

Supporting ratings

Institution/role	Rating
Elavon FinancialServices DAC	A+/Stable/A-1
BNP Paribas, S.A.	A+/Stable/A-1

Sovereign Risk

Under our structured finance sovereign risk criteria, the maximum differential between the rating on the security and the rating on the sovereign depends on the asset sensitivity to country risk and the sovereign rating. We view the asset sensitivity to the country risk as low, and our long-term unsolicited sovereign rating on Spain is 'A'.

Considering this transaction's structural features, the notes' risk profile, and our cash flow analysis results, the notes can achieve up to six notches above the sovereign rating. Consequently, the application of our sovereign risk criteria does not cap our ratings on notes.

Surveillance

We will maintain surveillance on the transaction until the notes mature or are otherwise retired. To do this, we will analyze regular servicer reports detailing the performance of the underlying collateral, monitor supporting ratings, and make regular contact with the servicer to ensure that it maintains minimum servicing standards and that any material changes in the servicer's operations are communicated and assessed.

Appendix

Transaction participants

The full list of transaction parties (excluding those providing supporting ratings) are listed below.

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Transaction participants	
Originator and master servicer	Banco Bilbao Vizcaya Argentaria, S.A.
Servicer	Pepper Spanish Servicing, S.L.U.
Arranger and joint lead manager	Barclays Bank PLC
Seller	Porta Mina DAC
Joint lead manager	Citigroup Global Markets Ltd.
Paying agent	Elavon Financial Services DAC
Cash manager	U.S. Bank Global Corporate Trust Ltd.
Interest rate cap provider	BNP Paribas
Security trustee and note trustee	U.S. Bank Trustees Ltd.
Corporate services provider	Intertrust Management Ireland Ltd.
Collection account bank	Banco Bilbao Vizcaya Argentaria, S.A.
Cash manager	U.S. Bank Global Corporate Trust Ltd.
Registrar	Elavon Financial Services DAC

Related Criteria

- Criteria | Structured Finance | RMBS: Global Methodology And Assumptions: Assessing Pools Of Residential Loans--Europe Supplement, April 4, 2024
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- Criteria | Structured Finance | General: Global Framework For Payment Structure And Cash Flow Analysis Of Structured Finance Securities, Dec. 22, 2020
- Criteria | Structured Finance | General: Methodology To Derive Stressed Interest Rates In Structured Finance, Oct. 18, 2019
- Criteria | Structured Finance | General: Counterparty Risk Framework: Methodology And Assumptions, March 8, 2019
- Criteria | Structured Finance | General: Incorporating Sovereign Risk In Rating Structured Finance Securities: Methodology And Assumptions, Jan. 30, 2019
- Criteria | Structured Finance | RMBS: Global Methodology And Assumptions: Assessing Pools Of Residential Loans, Jan. 25, 2019
- Legal Criteria: Structured Finance: Asset Isolation And Special-Purpose Entity Methodology, March 29, 2017
- Criteria | Structured Finance | General: Global Framework For Assessing Operational Risk In Structured Finance Transactions, Oct. 9, 2014
- Criteria | Structured Finance | General: Global Derivative Agreement Criteria, June 24, 2013
- General Criteria: Global Investment Criteria For Temporary Investments In Transaction Accounts, May 31, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011
- Criteria | Structured Finance | General: Methodology For Servicer Risk Assessment, May 28, 2009

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Related Research

- S&P Global Ratings Definitions, Oct. 15, 2024
- Economic Research: Economic Outlook Eurozone Q4 2024: Consumer Spending To The Rescue, Sept. 24, 2024
- EMEA Structured Finance Chart Book: September 2024, Sept. 13, 2024
- European RMBS Index Report Q2 2024, Aug. 16, 2024
- EMEA RMBS And ABS Monitor Q2 2024, July 22, 2024
- Economic Research: European Housing Markets: Better Days Ahead, July 17, 2024
- Economic Outlook For The Eurozone Sees Growth Return And Rates Fall, June 24, 2024
- Credit FAQ: What's Next For European Nonperforming And Reperforming Loan Markets?, Jan.18, 2023
- Various Actions Taken On Spanish Midsize Banks Amid Progress on Resolvability, Nov. 25, 2022
- ESG Industry Report Card: Residential Mortgage-Backed Securities, March 31, 2021
- Residential Mortgage Market Outlooks Updated For 13 European Jurisdictions Following Revised Economic Forecasts, May 1, 2020
- 2017 EMEA RMBS Scenario And Sensitivity Analysis, July 6, 2017
- Global Structured Finance Scenario And Sensitivity Analysis 2016: The Effects Of The Top Five Macroeconomic Factors, Dec. 16, 2016
- European Structured Finance Scenario And Sensitivity Analysis 2016: The Effects Of The Top Five Macroeconomic Factors, Dec. 16, 2016

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