Prosil Acquisition S.A.

Spanish Non-Performing Loan ABS / New Issue Report

Ratings

Tranche	Rating	Size (EUR m)	% of assets (OB[1])	Coupon	Final maturity
Class A	BBB-$_{SF}$	170.0	34.4	3m-Euribor + 2.0%	31 Oct. 2039
Class B	B-$_{SF}$	30.0	6.1	3m-Euribor + 6.0%	31 Oct. 2039
Class J	NR	15.0	3.0	3m-Euribor + 12.0%	31 Oct. 2039
Class Z	NR	16.0	3.2	Variable return	

Scope's Structured Finance Ratings constitute an opinion about the relative credit risks and reflect the expected loss associated with the payments contractually promised by an instrument on a particular payment date or by its legal maturity. See Scope's website for the SF Rating Definitions.

[1] Outstanding balance (OB) of the securitised portfolio at closing (EUR 494.7m)

Transaction details

Purpose	Funding
Issuer	Prosil Acquisition S.A., acting in respect of its compartment 'Cell Number 5'
Originators	Abanca Corporación Bancaria, S.A. and Abanca Corporación División Immobilaria S.L.
Transferors	Prosil Acquisition S.A., acting in respect of its compartments Cell Number 1, Cell Number 2, and Cell Number 3.
Servicer	Hipoges Iberia S.L. (Hipoges)
Portfolio cut-off date	31 March 2019
Issuance date	[*]
Payment frequency	Quarterly
Arranger	J.P. Morgan Securities plc

The transaction is a static cash securitisation of a portfolio of Spanish non-performing-loan (NPL) actively serviced by Hipoges, with around EUR 494m by outstanding balance (OB) and around EUR 40m by third-party appraisal value of real-estate-owned properties (REO). The NPL pool mainly comprises senior secured loans (94%), with the remainder composed of junior secured loans (1%), and unsecured loans and secured residual exposures (5%). The loans were originated by different entities in Abanca Group and extended to individuals (66%) and small and medium-sized companies (34%). The secured loans are backed by residential and non-residential properties including land (68% and 32% of the total third-party appraisal value, respectively).

There are four classes of notes with fully sequential principal amortisation: senior class A, mezzanine class B, and junior class J and equity Z. The class B interest payments rank senior to class A principal. However, they will be subordinated if i) the cumulative realised collections are 10% below the projected cash flows indicated in the servicer's business plan; ii) the net present value cumulative profitability ratio falls below 90%; or iii) the interest paid on class A notes is lower than interest due. Class J interest is paid junior to both the interest and principal of classes A and B.

A cash reserve equal to 4.5% of the class A notes will be fully funded at issuance with EUR 4.1m of collections received since 1st April 2019; the remaining amount will be funded by proceeds from the notes. The cash reserve will amortise to 4.5% of the outstanding amount of class A notes and will be available to cover senior items in the waterfall and interest on class A notes. All amount released from the cash reserve will be exclusively used to repay class A principal.

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Related Research

Non-Performing Loan ABS Rating Methodology

Methodology for Counterparty Risk in Structured Finance

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Rating rationale (summary)

The ratings are primarily driven by the expected recovery amounts and timing of collections from the portfolio. The recovery amounts and timing assumptions consider the portfolio's characteristics as well as our economic outlook for Spain and assessment of the special servicer's capabilities. The ratings are supported by the structural protection provided to the notes, the absence of equity leakage provisions, the liquidity protection, and an interest rate hedging agreement.

Interest rate risk is mitigated by a hedging structure under which the SPV receives the difference between three-month Euribor rate and a flat cap of 0.5%, over a pre-defined notional balance.

The ratings also address exposures to the key transaction counterparties. In our view, none of these exposures limits the maximum ratings achievable by the transaction. In order to assess the issuer's exposure to credit counterparty risks, we considered counterparty substitution provisions in the transaction, and the public ratings when available.

Rating drivers and mitigants

Positive rating drivers

Granular and secured portfolio. The NPL portfolio mostly comprises senior (first-lien) exposures (94% of OB), with relatively high granularity compared to other transactions. The top 10 exposures represent around 5% of total collateral value – excluding one large property securing a loan, which is in any case capped by OB.

Updated valuations. The servicer updated most of the properties' appraisals in H2 2018. Updated third-party appraisals are generally more accurate than bank valuations. Around 53% of the appraisals rely on a desktop procedure and the remainder are either drive-by or full valuations, which are generally the most accurate valuation methods.

Liquidity protection. A cash reserve equal to 4.5% of the class A outstanding balance provides liquidity protection to senior noteholders, covering senior expenses and interest on the class A notes for around four payment dates. All amounts released from the cash reserve will be used to amortise the class A notes.

Interest rate cap. The transaction benefits from an interest rate cap, which mitigates the interest rate risk arising from the floating-rate nature of the notes. The interest rate cap notional adequately covers the expected class A and B outstanding balance under the stressed scenarios considered by Scope.

Geographically diversified pool. The portfolio is well distributed between the different regions of Spain, with some concentration in Galicia and Madrid.

Negative rating drivers and mitigants

No back-up servicer. No back-up servicer has been appointed at closing, increasing the potential length of disruption in the case the servicer is removed. A committee formed by mezzanine and junior noteholders will assist the issuer in identifying a suitable successor.

Challenging legal environment. Legal uncertainty in Spain is higher than in other EU countries. For instance, the average length of foreclosure proceedings in Spain almost doubled in recent years due to increased litigation on the abusive nature of certain early-termination mortgage clauses. The Spanish Supreme Court also recently ruled that secured creditors can no longer demand default interest after insolvency proceedings have been opened.

Relatively weak representations and warranties. Representations provided by the sponsor are weak compared to market standards in the European Union.

Real estate collateral not insured. Only part of the REO portfolio is insured at closing and the committee of mezzanine and junior noteholders will decide, case by case, to either insure a repossessed asset or not. As a result, noteholders might suffer losses linked to accidental property damage. This risk is partially mitigated by the portfolio granularity.

Upside rating-change drivers

Legal and other costs. We factored in legal expenses and other costs for collections as detailed in the servicer's business plan. A decrease in legal expenses and other costs could positively affect the ratings.

Servicer outperformance regarding recovery timing. Consistent servicer outperformance in terms of recovery timing could positively impact the ratings. Portfolio collections will be completed over a weighted average period of 2.8 years according to the servicer's business plan. This is about 2.4 years faster than the recovery timing vector applied in our analysis.

Downside rating-change drivers

Collateral appraisal values. NPL collateral appraisals have a high degree of variability due to the nature of the assets, which are likely to deteriorate in value due to a lack of maintenance, or obsolescence risk. The latter mainly affects non-residential properties. If realised asset values are systematically below appraisal values assumed by Scope after liquidity stresses, the rating could be downgraded. According to historical data provided by the servicer, asset sale values are generally in line with the updated appraisal values. In addition, many assets are residential properties, which are generally less volatile than non-residential assets.

Increased political intervention in Catalonia. As per a recent law, the local government in Catalonia can force owners to rent residential properties that have been empty for more than two years to vulnerable families. Given the relatively low exposure to Catalonia, the current state and characteristics of the law should not represent a major risk for this transaction, but we will monitor any legal developments.

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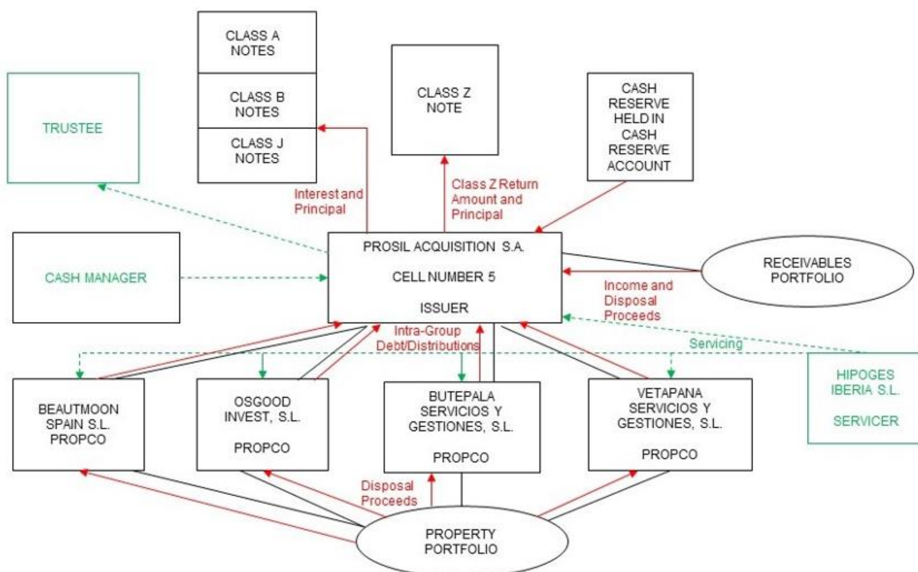
1. Transaction summary

Figure 1 summarises the transaction structure. Notes are repaid sequentially. An amortising cash reserve equal to 4.5% of the outstanding class A provides liquidity protection to class A notes.

Figure 1: Transaction diagram



Sources: Transaction documents.

We have analysed the pool as per the cut-off date on 31 March 2019. Figure 2 shows the main characteristics of the portfolio:

Figure 2: Key portfolio stratifications[1]

Data summary as of pool cut-off date 31 March 2019

Scope-adjusted pool values	All	Secured	Unsecured
Number of loans	2,924	2,688	236
Number of borrowers	2,612		
Outstanding balance (EUR m)	494,709,153	466,691,561	28,017,592
% of outstanding balance (OB)		94.3%	5.7%
Weighted average adjusted seasoning (years)	5.8	5.8	5.9
Sum of collateral appraisal values (EUR m)		355,605,315	
Borrower type (% of OB)			
Corporate	34.1%		
Individual	65.9%		
Primary procedure legal procedure (% of OB)			
Bankrupt borrower	24.0%	19.4%	100.0%
Non-bankrupt borrower	76.0%	80.6%	0.0%
Stage of procedure (% of collateral value)			
Not started		22.0%	
Initial		41.3%	
Intermediate		5.9%	
Auction		30.9%	
Geography (% of collateral value)			
Galicia		24.7%	
Madrid		15.2%	
Catalonia		11.3%	
Others		48.8%	
Borrower concentration (% of OB)			
Top 10	6.6%		
Top 100	22.5%		
Property type (% of collateral value)			
Residential		67.9%	
Non-residential		32.1%	

Source: Transaction data tape dated 19/06/2019; lien defined as economical lien; calculations and/or assumptions by Scope Ratings

2. Macroeconomic environment

Balanced economic expansion with moderated growth

Following the 2008 financial crisis and the euro area crisis, Spain requested financial assistance to recapitalise financial institutions in July 2012. The Spanish economy has also undergone a significant structural adjustment. Since exiting the European Stability Mechanism (ESM) programme in January 2014, Spain's economy has grown on average by around 2.7%, well above the euro area average of 1.8%. This has been driven by the government's structural reforms, mostly during 2010-2015, wage moderation and the resulting cost-competitiveness gains, low oil prices, the ECB's accommodative monetary policy, and favourable external conditions, particularly in the euro area. We expect this benign combination of factors to continue, albeit to a lesser degree, sustaining Spain's balanced and employment-intensive economic expansion over the next few years, albeit with less dynamism, moderating economic growth to 2% over the medium term.

Spain has undergone significant structural adjustments

The structural adjustment has resulted in a shift in resources towards the dynamic, export-oriented services sector, which has replaced the outsized construction sector as

[1] Secured also includes REOs, for which the real estate value is EUR 40.3m, namely 11.2% of the total collateral value.

the engine of growth and job creation. In addition, wage moderation – as evidenced by real unit-labour costs falling by 7.7% since 2009 (based on AMECO data) compared to a broadly stable development in the euro area – have led to greater cost-competitiveness and significant job creation, with 2.5m of the 3.8m jobs lost during the crisis now recovered. Banking sector reforms have also contributed to tougher lending standards, steering the allocation of credit towards more productive and financially sound firms, supporting the investment recovery.

Continued household deleveraging is expected

Looking ahead, we expect continued household deleveraging to dampen consumption, in light of the low overall net wealth and savings rates, and investment growth to remain robust over the medium term. Fiscal policy support is also likely to remain mildly positive, even though political uncertainties will remain until the next Spanish government is formed. Finally, taking into account the lower trade balance, we project a moderation in the current account, to below 1% in the medium term, driven by weaker foreign demand, and a slowdown in tourism.

Figure 3: Real GDP growth, %

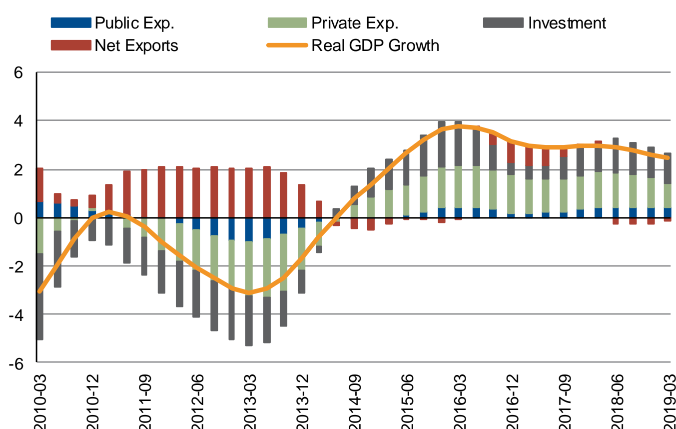
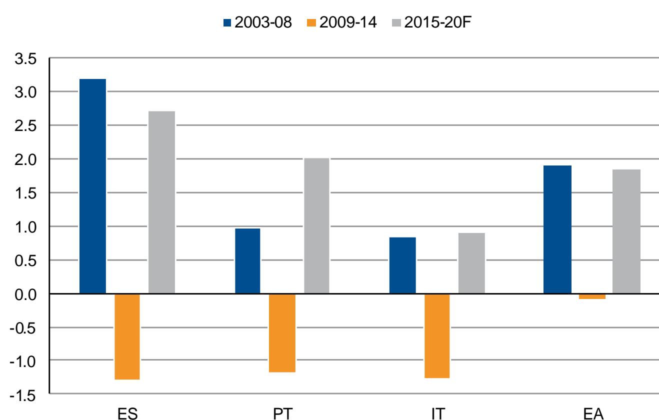


Figure 4: Average real GDP growth, %



Sources: Haver, INE, EC and Scope Ratings

Challenges for growth prospects

While the short-to-medium-term growth outlook is robust, Spain's long-term economic growth prospects face considerable challenges. The IMF and the EC estimate potential growth at around 1.7%-2.0% over the medium term, constrained by weak productivity growth, unfavourable labour force demographics, and high structural unemployment. According to the IMF, productivity levels in Spanish manufacturing, trade, and market services sectors are considerably lower than for EU peers due to Spain's corporate structure, which is composed of low-productivity small and micro-firms. The IMF further indicates the need to fully implement the Market Unity Law, liberalise professional services, enhance access to equity financing for start-ups, reduce size-related requirements, and improve public R&D spending to raise potential growth and competitiveness. These constraints are shown in the fact that, based on OECD data, about half of real GDP growth over 2015-17 was driven by total hours worked, whereas contributions from capital and total-factor productivity were approximately equal. While this is slightly better compared to peers such as Portugal or Italy, it indicates a need to improve Spain's productivity, which is the main growth driver among higher-rated peers. In this context, we hold a positive view of the economy's improved fundamentals, including a turnaround in productivity growth from its pre-crisis negative trend, which suggests longer-term payoffs from past structural reforms.

Inflation in line with European peers

In our view, the national structural reforms, combined with euro area governance reforms and ECB actions, have led to a significant decline in financing rates for all sectors of the economy. This includes non-financial corporations, whose borrowing rates have dropped

between 200bp and 300bp depending on loan size and maturity. At the same time, the sustained accommodative monetary policy stance in the case of Spain is also adequate in light of still-subdued price levels. Headline and core inflation are around 1% as of May 2019, in line with euro area core inflation but still markedly below the ECB's target of close to but below 2%.

Figure 5: NFC borrowing rates (%) and Eurosystem assets (% of GDP, rhs)

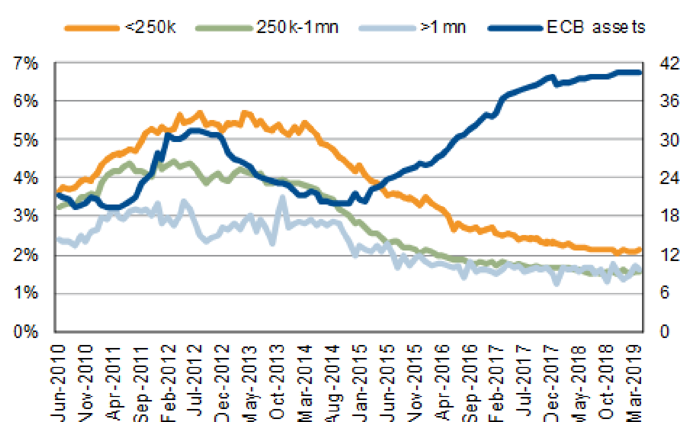
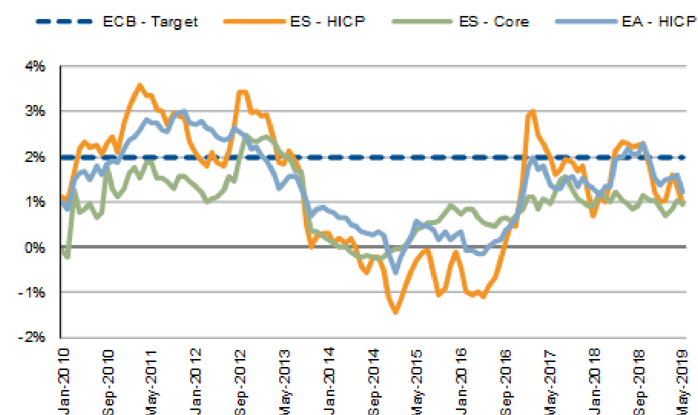


Figure 6: Harmonised index of consumer prices (%)



Sources: Haver, Banco de Espana, ECB, Scope Ratings

3. Portfolio analysis

Rating-conditional recovery assumptions

Figure 7 compares our lifetime gross collections and recovery timing assumptions for the entire portfolio against those from the servicer's business plan. We have applied rating-conditional recovery rates (i.e. assume expected collections decrease as the instrument's target rating increases). The assumptions result from the blending of secured (NPL secured and REOs) and unsecured recovery expectations. We have applied different analytical frameworks to the secured and unsecured segments to derive recoveries.

For the NPL portfolio analysis under a BBB- rating scenario, using our adjusted pool figures, we have assumed an expected collection rate (gross recovery rate) of 41.8% of OB over a weighted average life of 5.2 years (excluding collections already received). By portfolio segment, we have assumed gross recovery rates of 44.3% and 3.0% for the NPL secured and unsecured segments, respectively. For REOs, which account for 12% of total property value, we assumed an expected collection rate of 74.6% on the property values. We applied the same combined security value haircut of 27.1% to both secured NPLs and REOs. This haircut considers i) an average fire-sale discount (including valuation type haircuts) of 18.8% to security valuations, reflecting liquidity or marketability risks; and ii) moderate property price decline stresses (10.2% on average), reflecting our view of downside market volatility risk.

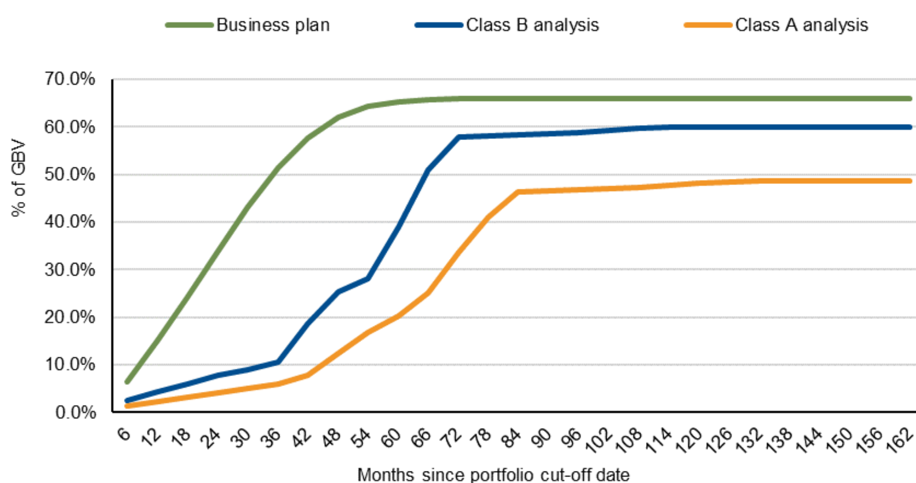
For the NPL portfolio analysis under a B rating scenario, using our adjusted pool figures, we have assumed a gross recovery rate of 51.7% over a weighted average life of 4.3 years. By portfolio segment, we have assumed gross recovery rates of 54.8% and 3.6% for the secured and unsecured segments, respectively. For REOs, we assumed an expected collection rate of 96.0% on the property values. We applied the same combined security value haircut of 4.0% to both secured NPLs and REOs. This haircut considers i) an average fire-sale discount (including valuation type haircuts) of 7.1% to security valuations, reflecting liquidity or marketability risks; and ii) property price appreciation (2.9% on average).

Scope's assumptions reflect recovery timing and amount stresses

The assumptions applied to the class A notes analysis reflect a stress on cash flow levels, driven, among other factors, by the rating-conditional assumption for fire-sale discounts.

In addition, the assumptions applied to analyse the rated notes consider a stress on cash-flow timing, driven, among other factors, by the rating-conditional assumption for completing the judicial process and the expected time that property companies (Propcos) will need to sell the properties in the open market.

Figure 7: Business plan's gross expected recoveries vs Scope's assumptions



Sources: Special servicer's business plans and Scope Ratings

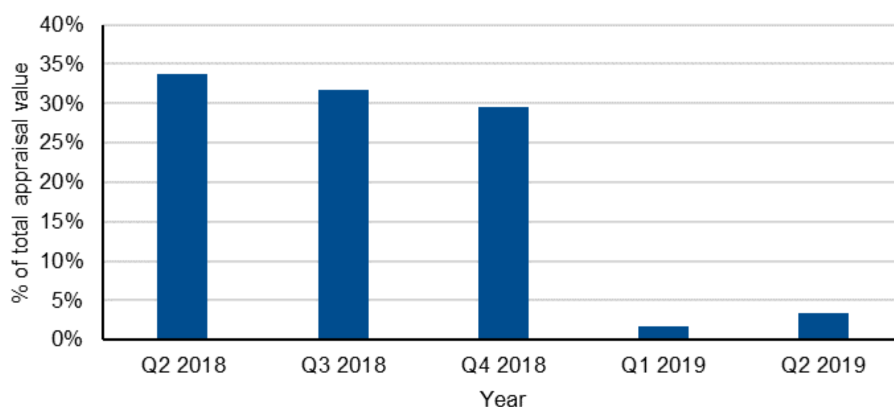
3.1. Analysis of secured portfolio segment and REOs

3.1.1. Property appraisal analysis

Updated property appraisals

We have relied on line-by-line third-party appraisals of the properties' market value. Most valuations were performed in 2018.

Figure 9: Collateral valuation dates (% appraisal value)



Source: Transaction data tape

High NPL collateral liquidity and obsolescence risk

Asset liquidity risk is captured through fire-sale haircuts applied to collateral valuations. Figure 10 below shows the rating-conditional haircuts applied to property valuations for the analysis of the class A and B notes. These assumptions are based on historical distressed-sales data provided by the servicer and reflect our view that non-residential properties are generally less liquid, resulting in higher distressed-sale discounts.

The fact that properties not sold in auction are awarded to the Propcos, which will manage, through the servicer, the repossessed assets and sell them in the open market, has also been considered when sizing the haircuts. Liquidity in the open market is higher than for sales occurring within the auction process.

The haircuts applied also consider the type of valuation used by the appraiser. Desktop valuations represent 53.3% of total appraisals, to which we have applied a higher haircut than to drive-by valuations.

Figure 10: Transaction-specific fire-sale discounts and valuation haircut assumptions

Valuation type	% of appraisal value	% class A haircut (residential)	% class A haircut (non-residential)	% class B haircut (residential)	% class B haircut (non-residential)
Drive-by	46.8	13.0	18.0	2.2	7.2
Desktop	53.3	20.5	25.5	8.1	13.1

Sources: Transaction data tape; calculations and/or assumptions by Scope Ratings

3.1.2. Property market value evolution assumptions

Moderate market downturn risk

Figure 11 details our base case assumptions on property price changes over the transaction's lifetime, and the rating-conditional stresses applied for the analysis of the rated notes. These assumptions are i) specific to the transaction and region; ii) based on an analysis of historical property price volatility; and iii) based on fundamental metrics relating to property affordability, property profitability, private-sector indebtedness, the credit cycle, population dynamics and long-term macroeconomic performance.

Figure 11: Collateral location and Scope's transaction-specific price change assumptions

Region	Galicia	Madrid	Catalonia	Canary Islands	Andalucía
Class A analysis	10.7	7.5	6.0	5.0	10.4
Class B analysis	2.5	-10.0	-10.0	-10.0	-3.9
Collateral distribution (% apprailsal value)	25%	15%	11%	14%	13%

3.1.3. Concentration haircuts

Relatively granular portfolio

In the analysis of the class A notes, we have addressed borrower concentration risk by applying a 10% rating-conditional recovery haircut to the 10 largest borrowers by OB. The portfolio is relatively granular; therefore, idiosyncratic risk is limited in this transaction. One position, a hotel in Tenerife, accounts for 8.3% of total collateral value, but the concentration risk is mitigated by the exposure being capped at EUR 1.1m (loan OB).

3.1.4. Residual claims after security enforcement

Scope addresses potential residual claims after security enforcement

A secured creditor may initiate legal actions against a debtor if debt remains outstanding after an enforcement action is closed on a mortgaged property. Secured creditors generally rank pari-passu with unsecured creditors for amounts that have not been satisfied with the security's enforcement.

No credit to residual claims from corporate borrowers

For corporate loans, we have not given credit to potential further recoveries on residual claims after security enforcement. This is mainly because i) special servicers are generally less incentivised to pursue alternative enforcement actions as foreclosures are more cost-effective; and ii) receivers may decide to close bankruptcy proceedings after a certain period of time, setting a time limit for obtaining further recoveries.

Partial credit to residual claims from individuals

We have assumed that some recoveries are received from 80% of the residual loan balance to individuals. If the borrower is an individual, he might find new sources of income over time and become solvent again, allowing the servicer to realise some recoveries even after years since default.

3.1.5. Tribunal efficiency

For the NPL pool, we have applied line-by-line time-to-recovery assumptions that consider the type of legal proceeding (i.e., bankruptcy, non-bankruptcy), and the current stage of the proceeding.

Duration of judicial process and REO add-on

The recovery process consists of two stages: i) the judicial process; and ii) in the case of asset repossession, the Propco selling the awarded property in the open market (REO add-on).

The assumption for judicial process timing is based on public data regarding the average time for a legal procedure together with estimates received from the servicer for different types of procedures. The data we analysed show similar duration for bankruptcy and non-bankruptcy procedures. We have not differentiated between courts regarding the estimated time for the judicial process as the data shows only a limited variability.

As generally observed in Spain, we have assumed that the properties will fail to sell in auction and will be awarded to the Propcos. We have assumed that Propcos will need around 24 months to sell the property in the open market (REO add-on).

For the secured NPL portfolio, the total length between the start of the recovery process and sale of the property is therefore estimated at around 76 months for bankruptcies and non-bankruptcies in the BBB- scenario; 65 months in the B scenario. For the REO portfolio, we have just considered the REO add-on as the total time to sell a property.

Figure 13: Duration of different processes and steps in the recovery process in months (Scope's assumptions)

Scenario	Bankruptcy proceedings	Non-bankruptcy proceedings	REO add-on
BBB-	52	52	24
B	48	48	17

3.2. Analysis of unsecured portfolio segment

Unsecured portfolio analysis is based on statistical data

For the analysis of the class A and B notes, we have applied rating-conditional recovery rate haircuts of 14% and 0%, respectively. These stresses are consistent with the granular approach described in Scope's Consumer ABS Rating Methodology.

According to historical data, the longer the time elapsed since a loan is classified as defaulted, the lower the recoveries for unsecured loans. The assumptions are calibrated to reflect that unsecured borrowers in the portfolio are classified as defaulted for an average of 5.9 years as of the cut-off date.

4. Portfolio characteristics

Further detail on key portfolio characteristics as of 18 June 2019 is provided below.

4.1. Eligible loans

Limited representations and warranties

The representations and warranties on the receivables are provided by Cortland Investors II S.À R.L. (Cortland), a Luxembourg-based limited partnership. Cortland is the sponsor and will retain the regulatory net economic interest until the notes are repaid. Indemnity obligations will be general, not senior, and the issuer will have no recourse to Cortland's assets.

Representations reflect those provided by the original lender to the seller upon the portfolio's sale and are slightly weaker than for other NPL transactions we have rated. An extract of the representations is reported below:

- All receivables are governed by Spanish law and are denominated in euros; all properties are located in Spain
- Each mortgage over the properties enumerated in the transaction documents validly secures the principal component of the relevant receivable
- All loans have been entirely issued without any right to further advances or additional disbursements.
- All receivables are validly transferable without limitations
- To the transferor's best knowledge, no loan is subject to any set-off.

The following standard representations and warranties have not been included:

- All information provided in the transaction's dataset is true, complete and accurate (only some fields have been covered by the representation). As a mitigant, the relatively strong results of the agreed-upon-procedure provide comfort on data accuracy.
- Any representation limiting the domicile of individual borrowers to Spain.

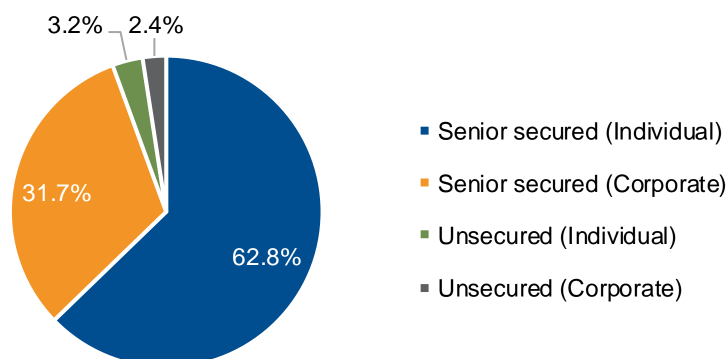
4.2. Detailed stratifications

4.2.1. Borrower type

Secured portfolio with a high share of individual borrowers

Small and medium enterprises (SMEs) and individuals represent 34% and 66% of the pool, respectively. The relatively high amount of first-lien secured loans (94%) is credit positive.

Figure 15: Borrower and loan type (% OB)



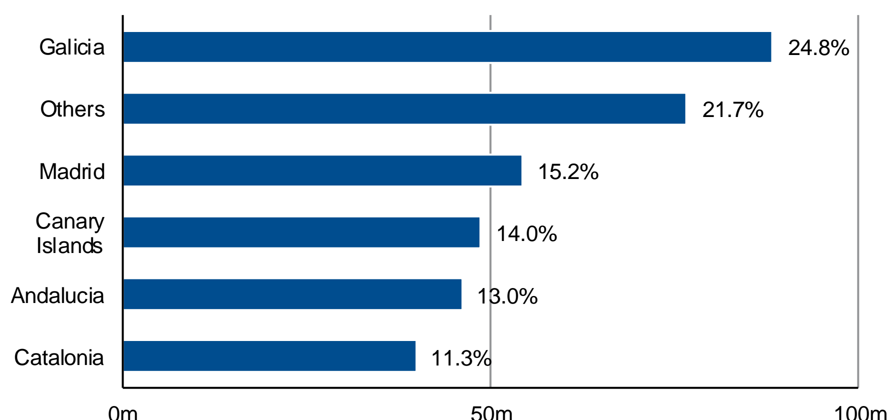
Sources: Transaction data tape; calculations by Scope Ratings

4.2.2. Geographical distribution

Geographic diversification is credit-positive

The borrowers and the properties (loan collateral and REOs) are relatively well distributed geographically. Our analysis sizes for geographic concentration risks based on the market-value-decline assumptions described above.

Figure 16: Property location (% of appraisal values)



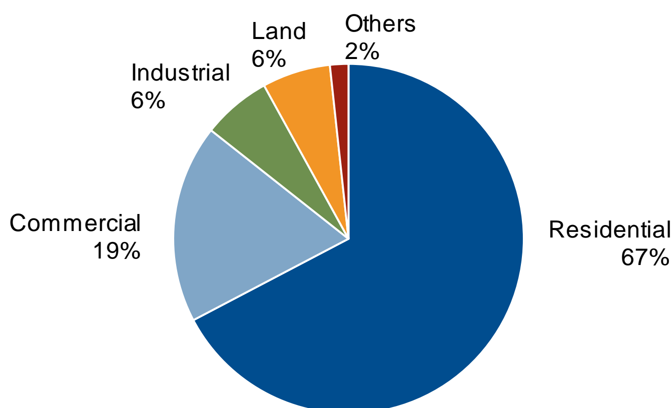
Sources: Transaction data tape; calculations by Scope Ratings

4.2.3. Property type

Lower liquidity stresses applied to residential properties

The properties (loan collateral and REOs) consist of residential (67.3%), commercial (18.4%), industrial (6.4%), land (6.3%), and other non-residential (1.7%) assets[2]. The relatively large share of residential properties is positive as these assets are more liquid, and less price-volatile. This is reflected in the lower fire-sale discount assumptions in our analysis.

Figure 17: Distribution by type of collateral (% of appraisal value)



Sources: Transaction data tape; calculations by Scope Ratings

4.2.4. Collateral valuations and Scope's specific collection rate assumptions

Recovery rate assumptions reflect portfolio's LTV distribution

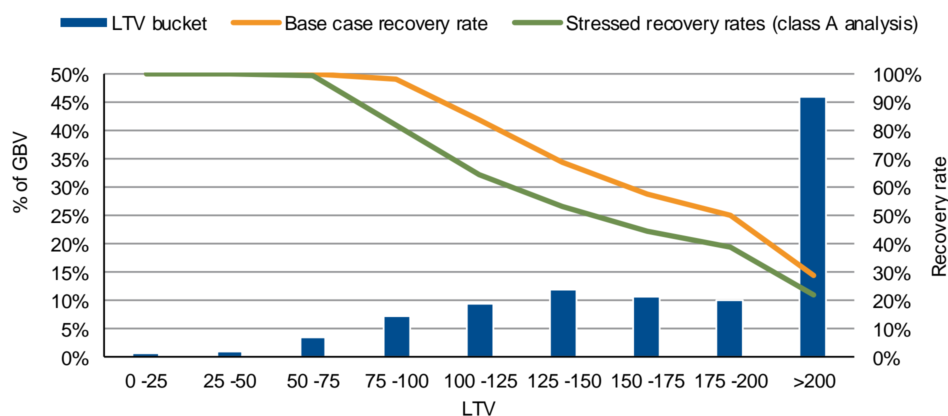
For secured loans, our rating conditional stresses lead to a weighted average gross recovery rate of i) 41.8% of OB for the NPL portfolio and 74.6% of appraisal values for the REO portfolio, under the rating-conditional stress for class A; and ii) 51.7% of OB and 96% of appraisal values for the REO portfolio, under the rating-conditional stress for class B.

[2] Percentages are expressed in terms of total appraisal value.

The weighted average loan-to-value of portfolio secured loans is around 165% when capping the LTVs at 200%.

Recovery proceeds are capped at the minimum of the loan's outstanding balance, the property value, and the mortgage value. This partly explains why recovery rates flatten at low loan-to-value buckets.

Figure 17: Secured loans' distribution by LTV and Scope's transaction-specific secured recovery rate assumptions



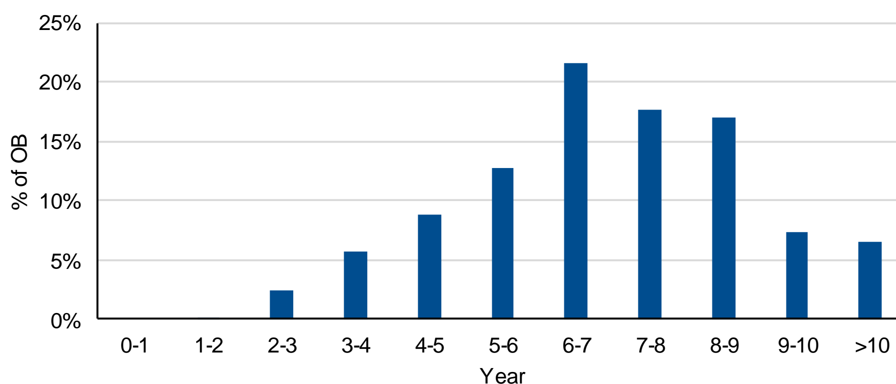
Sources: Transaction data tape, calculations by Scope Ratings

4.2.5. Loan seasoning

Ageing of unsecured portfolio reduces expected recoveries

The weighted average time since default to the 31 March 2019 cut-off is around 5.8 years for both secured and unsecured exposures (mostly residual claims from secured debt). The pool's ageing reduces the expected recoverable amount of unsecured loans significantly, since most recoveries are front-loaded in the first years after a default, according to historical data from different jurisdictions. However, the low share of unsecured exposures mitigates this effect.

Figure 18: Portfolio seasoning distribution as of cut-off date



Sources: Transaction data tape; calculations by Scope Ratings

4.2.6. Borrower status

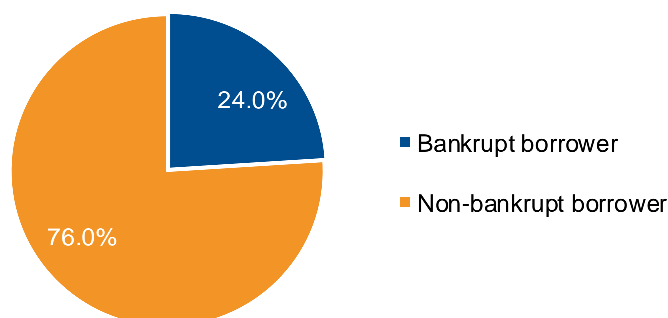
Figure 19 below shows the main legal proceedings for each borrower (one borrower can have several), as we have assumed based on the transaction's data tape.

Low proportion of non-started and bankrupt processes is credit-positive

Relative to the initiated judicial proceedings, non-started processes require more work at the start by the special servicer to classify and initiate the correct process. Generally, bankruptcy processes are generally more complex and costly, but in Spain the data

received indicates that bankruptcy processes are generally not more lengthy than non-bankruptcy process.

Figure 19: Borrower status assumptions (% of OB)



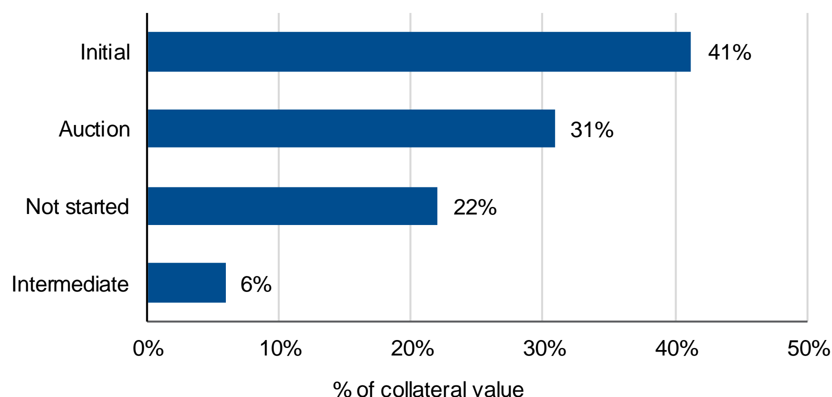
Sources: Transaction data tape; calculations by Scope Ratings

4.2.7. Recovery stage of secured exposures

Proceedings in early judicial stage lengthens recovery timing assumptions

Figure 20 below shows the stage of legal proceedings for the three types of judicial processes in relation to secured loans, as a percentage of collateral value.

Figure 20: Secured recovery stage



Sources: Transaction data tape; calculations by Scope Ratings

5. Special Servicer

Hipoges, founded in 2008, currently manages over EUR 20bn of assets on behalf of financial institutions and international investors, of which c.65% are in Spain. They cover a broad spectrum of distressed assets over Southern Europe, including residential and commercial real estate, SME loans and unsecured portfolio. Hipoges has offices in Spain, Portugal, Greece and Italy, with around 350 employees worldwide.

Scope has conducted an operational visit of Hipoges' premises in Madrid, focusing on their servicing practices, the servicer's asset valuation expertise, and the IT arrangements. Scope views the servicer's processes and capabilities as appropriate for servicing a portfolio of NPLs and REOs.

6. Key structural features

6.1. Combined priority of payments

The issuer's available funds (i.e. mainly collection amounts received from the portfolio, the cash reserve, the expense reserve, and payments received under the interest rate

cap agreement) will be used in the following simplified order of priority, and only to the extent that the more senior amounts have been paid in full:

1. Servicer fees and other issuer counterparty fees, taxes and transaction expenses
2. Interest on class A notes
3. Cash reserve replenishment to its target
4. Interest on class B notes, provided no subordination trigger is breached
5. Class A notes outstanding principal
6. Upon a breach of a subordination trigger, the interest on class B
7. Pro rata and pari passu principal on class B and the mezzanine servicing fees, if any
8. Interest on class J
9. Pro rata and pari passu principal on class J and
10. Class Z payments, Junior servicing fees, if any, and other subordinated amounts

Full class B interest deferral is likely under Scope's scenarios

Class B subordination triggers may be relatively ineffective at protecting senior noteholders as the subordination event is reversible. If at any point during the transaction's life both triggers are jointly cured, then all class B interest amounts due and unpaid at the preceding payment dates will be paid senior to class A principal. The subordination of the class B interest will be triggered if i) the cumulative collection ratio[3] falls below 90%; ii) the present value cumulative profitability ratio[4] falls below 90%; or iii) the interest amount paid to class A notes is lower than the due and payable interest amount.

The shape and absolute level of the cash flow vector used for the class A analysis is significantly slower and lower than those in the business plan. Therefore, the probability that the class B subordination will be efficient in that scenario is relatively high.

Non-timely class A interest payment might trigger accelerated waterfall

Non-payment of timely interest on the senior notes among other customary events – such as issuer insolvency, a breach of other issuer obligations, and the issuer's inability to comply with obligations lawfully – would trigger a post-enforcement waterfall if requested by 25% of the most senior noteholders or following an extraordinary resolution of the most senior noteholders. This would accelerate repayment of class A through the full subordination of class B payments.

Non-payment of any principal or interest at the final legal maturity will also trigger a post-enforcement waterfall at that date.

6.2. Servicing fee structure and alignment of interests

6.2.1. Servicing fees

Strong alignment of servicer and noteholder interests

The servicing fee structure links the portfolio's performance with the level of fees received by the servicer, which mitigates potential conflicts of interest between the servicer and noteholders.

Hipoges is entitled to a performance fee equal to 5.25% in addition to a EUR 263,700 quarterly fixed fee, which will decrease over time as the portfolio amortises. Additionally, VAT is applicable to certain activities, which the servicer estimates will affect around 50% of total fees.

[3] 'Cumulative collection ratio' is defined as the ratio between i) the cumulative net collections since the cut-off date; and ii) the net expected collections. Net collections are the difference between the gross collections and the recovery expenses.

[4] 'Present value cumulative profitability ratio' is defined as the ratio between i) the sum of the present value (calculated using an annual rate of 3.5%) of the net collections of all receivables relating to closed positions; and ii) the sum of the target price (the present value of the net collections according to the servicer's business plan) of all receivables relating to closed positions. The servicer classifies a position as closed in accordance with the servicing agreements.

A haircut of 20% will be applied to performance fees in case the present value of the aggregated net collections is below the present value of aggregated expected collections in the business plan.

In addition, in case the present value of the net aggregated collections is lower than the present value of the aggregated net expected collections of the business plan, a portion of the fees will be paid in a mezzanine and a junior position in the priority of payments. The amount of fees paid in the mezzanine and junior position in the priority of payments depends on the level of underperformance compared to the business plan.

Both these measures incentivise the servicer to maximise recoveries and comply with the initial business plan. Given that the triggers are linked to the aggregated present value of net collections and not only the closed positions, the alignment of interests in this transaction is stronger than in other NPL transactions we have rated.

6.2.2. Servicer monitoring

Monitoring function protects noteholders' interests

An overview of the servicer's activities and calculations, prepared by the monitoring agent (E&Y Servicios Corporativos, S.L.), mitigates operational risks and moral hazard that could negatively impact noteholder interests. This risk is further mitigated by a discretionary servicer termination event should the servicer underperform. The additional risk lying with the servicer activities.

Under the servicing agreement, the servicer is responsible for the servicing, administration, and collection of receivables as well as the management of legal proceedings. The monitoring agent will verify the calculations of key performance ratios and amounts payable by the issuer, as well as perform controls based on a random sample of loans.

The monitoring agent will report to a committee that represents the interests of both junior and mezzanine noteholders. The committee can authorise the revocation and replacement of the servicer upon a servicer termination event, subject to the approval of the noteholders' representative. The monitoring agent can also, on behalf of the committee, authorise the sale of the receivables, the closure of debt positions, and the payment of additional costs and expenses related to recovery activities.

6.2.3. Servicer termination events

Committee of mezzanine and junior noteholders assists the issuer in finding successor servicer, if necessary

A servicer termination event includes *inter alia* i) insolvency; ii) failure to pay due and available amounts to the issuer within five business days; iii) unremedied breach of obligations; iv) unremedied breach of representation and warranties; and v) loss of legal eligibility to perform obligations under the servicing agreement. The servicer can also be substituted if it underperforms relative to the initial business plan.

In case of a servicer termination event, a committee formed by mezzanine and junior noteholders will use all reasonable efforts to identify a suitable successor servicer in consultation with the issuer, and with the approval of class A noteholders.

6.3. Liquidity protection

A cash reserve provides liquidity to senior noteholders

A cash reserve equal to 4.5% of class A notes will be fully funded at issuance with EUR 4.1m of collections received since 1st April 2019: the remaining amount will be funded by proceeds from the notes.

The cash reserve will amortise to 4.5% of the outstanding amount of class A notes and will be available to cover senior items in the waterfall and interest on class A notes.

All amounts released from the cash reserve will be used to repay class A notes principal.

Class B will not benefit from liquidity protection.

An expense reserve, equal to EUR 100,000 at closing date, will be funded by collections received since 1st April 2019 and will be available to cover recovery expenses. This will give additional liquidity protection to the structure.

6.4. Interest rate hedge

The interest rate cap mitigates interest rate risk

Due to the non-performing nature of the securitised portfolio, the issuer will not receive regular cash flows and the collections will not be linked to a defined interest rate. On the liability side, the issuer will pay a floating-rate coupon on the notes, defined as three-month Euribor plus a 2.0% fixed margin on the class A notes and six-month Euribor plus an 6.0% fixed margin on the class B notes.

An interest rate cap, with a 0.5% flat strike (cap rate) partially mitigates the risk of increased liabilities on classes A and B due to a rise in Euribor. The swap counterparty is JP Morgan AG.

The notional balance of the swap adequately matches our expected outstanding amount of the class A notes when applying the stress assumed for the class A analysis. In our view, this sufficiently mitigates interest rate risk. A delay in recoveries beyond our stressed recovery timing assumptions could result in the notional balance being below the outstanding amount of classes A and B, creating interest rate risk exposure on the unhedged portion. This is shown in Figure 21 and Figure 22. For the analysis of the class A notes, we have stressed the Euribor forward curve, as shown in Figure 21.

Figure 21: Interest rate cap class A

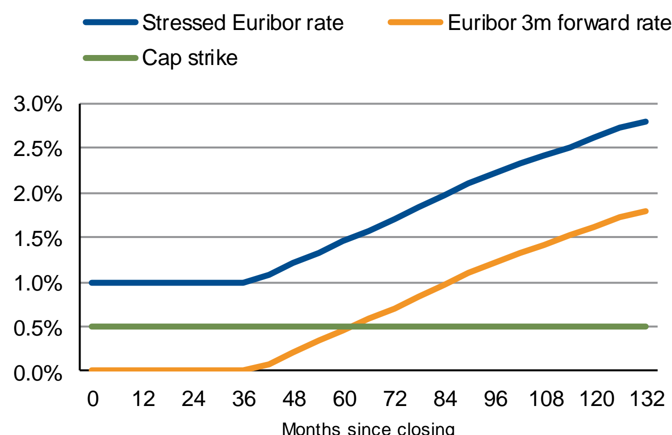
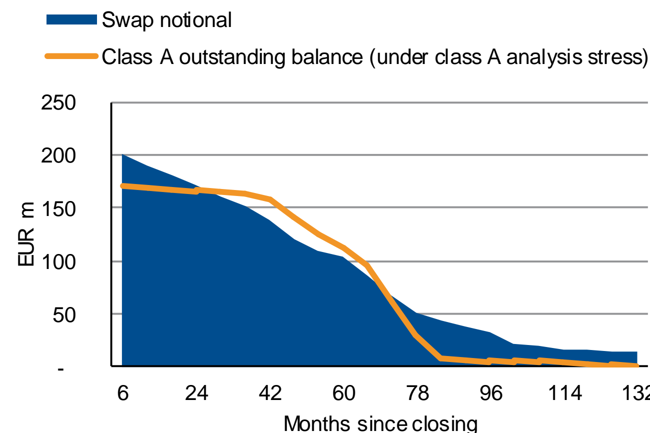


Figure 22: Cap notional vs outstanding class A notes



Sources: Transaction documents, Bloomberg and Scope Ratings

7. Cash flow analysis and rating stability

Scope's cash flow analysis considers the structural features of the transaction

We have analysed the transaction's specific cash flow characteristics. Asset assumptions are captured in our rating-conditional gross recovery vectors. The analysis captures the capital structure, an estimate of legal and other costs based on the servicer's business plan, and the contractually agreed servicing fees and other counterparty's fees. We have considered the reference rate payable on the notes based on a stressed three-month Euribor forward curve, considering the cap rate of the swap.

The ratings are a forward-looking opinion on relative credit risks

The BBB-$_{SF}$ and B-$_{SF}$ ratings assigned to the class A and class B notes, respectively, constitute a forward-looking opinion on relative credit risks. The ratings reflect the expected loss associated with payments contractually promised by an instrument on a payment date or by its legal maturity. We calculate an instrument's expected loss over an expected risk horizon, with the result benchmarked against our idealised expected loss table reported in the General Structured Finance Rating Methodology.

We tested the resilience of the ratings against deviations from expected recovery rates and recovery timing. This analysis has the sole purpose of illustrating the sensitivity of the ratings to input assumptions and is not indicative of expected or likely scenarios.

For class A, the following shows how the results change compared to the assigned credit rating in the event of:

- a decrease in secured and unsecured recovery rates by 10%, five notches.
- an increase in the recovery lag by one year, one notch.

For class B, the following shows how the results change compared to the assigned credit rating in the event of:

- a decrease in secured and unsecured recovery rates by 10%, two notches.
- an increase in the recovery lag by one year, zero notches.

8. Sovereign risk

No mechanistic cap

Sovereign risk does not limit any of the ratings. The risks of an institutional framework meltdown, legal insecurity or currency convertibility problems due to Spain's hypothetical exit from the Eurozone are not material for the notes' rating.

For more insight into Scope's fundamental analysis on the Spanish economy, refer to the rating report on Spain, dated 18 May 2018.

9. Counterparty risk

Counterparty risk does not limit the transaction's rating

The transaction is mainly exposed to counterparty risk from the following counterparties: i) the special servicer 'Hipoges'; ii) the sponsor and retention holder, providing representation and warranties, Cortland Investors II S.à r.l.; iii) the trustee, U.S Bank Trustees Limited; iv) the agent bank and principal paying agent: Elavon Financial Services D.A.C., UK Branch; v) the cash manager, US Bank Global Corporate Trust Ltd; vi) the issuer's account bank, Citibank Europe plc, Luxembourg Branch (Citibank); vii) the account bank and originator: Abanca Corporacion Bancaria, S.A. (Abanca); viii) the monitoring agent E&Y Servicios Corporativos, S.L.; and ix) the interest rate cap counterparty: J.P.Morgan AG. In our view, none of these exposures limits the maximum ratings achievable by the transaction.

Our analysis has incorporated the transaction's counterparty replacement triggers and has relied on public ratings assigned to JP Morgan AG, Elavon Financial Services D.A.C., Citibank Europe plc, and Abanca Corporacion Bancaria S.A..

All of the issuer's accounts, except for the collections account, will be held at Citibank.

Collections received from the portfolio will be deposited in an account held at Abanca under the issuer's name. These amounts will be swept daily into the transaction's payment account held at Citibank.

Rating triggers are in place for the replacement of the account banks (Citibank and Abanca). At loss of BB, banks will be replaced within 30 days.

9.1. Servicer disruption risk

A servicer disruption event may have a negative impact on the transaction's performance. The transaction incorporates servicer-monitoring, but there are no replacement arrangements at closing to mitigate operational disruption (see section 5.2.3).

In case the servicer reports are not available within 12 business days after the end of a collection period, the cash manager will base its calculations on estimates and only pay items up to interest on the class A notes, excluding servicing fees, up to an amount equal to the balance of the cash reserve as of the previous payment date.

9.2. Commingling risk

Limited commingling risk

Commingling risk is limited, as debtors will be instructed to pay directly to an account that is under the issuer's name. In limited cases where the servicer receives payments from a debtor, the servicer would transfer the amounts on the same day.

9.3. Claw-back risk

At the transfer date, the portfolio will be reallocated by the issuer within its own compartments. The issuer is bankruptcy remote by construction and will represent that it is not insolvent as of the issue date.

9.4. Enforcement of representations and warranties

Representations and warranties limited by time

The issuer will rely on the representations and warranties, limited by time and amount, provided by Cortland in the reallocation agreement. If a breach of a representation and warranty materially and adversely affects a loan's value, and it is not subject to remedy, Cortland will indemnify the issuer for damages within 30 business days of the notification.

However, the above-mentioned guarantee is enforceable by the issuer only within 12 months after the date of the reallocation agreement. The total indemnity amount will be capped at 25% of the portfolio purchase price. Furthermore, the indemnity amounts will be subject to a deductible of 3% of the purchase price on a portfolio basis, and EUR 40,000 on a single-receivable basis, and will never exceed the initial receivable purchase price.

10. Legal structure

10.1. Legal framework

Transaction governed by Spanish, English and Luxembourg law

The transaction documents are governed by English law – with the exception of the Spanish security document, the servicing agreements, the Monitoring Agent Appointment Agreement, which are governed by Spanish law, and the Luxembourg Security Documents, governed by Luxembourg law.

The transaction is fully governed by the terms in the documentation and any changes are subject to the risk-takers' consent.

10.2. Use of legal opinions

We had access to the legal opinions produced for the issuer, which provide comfort on the legally valid, binding and enforceable nature of the contracts.

11. Monitoring

Ongoing rating monitoring

We will monitor this transaction based on performance reports as well as other public information. The ratings will be monitored on an ongoing basis and will be fully reviewed at least once a year.

Scope analysts are available to discuss all the details of the rating analysis, the risks to which this transaction is exposed, and the ongoing monitoring of the transaction.

12. Applied methodology

For the analysis of the transaction we have applied our Non-Performing Loan ABS Rating Methodology, and Methodology for Counterparty Risk in Structured Finance, both available on www.scoperatings.com.

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