

DBRS Morningstar Confirms Unión de Créditos Inmobiliarios, E.F.C (UCI) at A (low), Trend Stable

BANKING ORGANIZATIONS

DBRS Ratings GmbH (DBRS Morningstar) confirmed the ratings of Unión de Créditos Inmobiliarios, E.F.C (UCI or the entity), including the 'A' (Low) Long-Term Issuer Rating and the R-1 (low) Short-Term Issuer Rating. The trend on all ratings is Stable. The rating action follows the confirmation of the ratings of Banco Santander SA (Santander). UCI is a specialised mortgage lender in Spain and Portugal, and is a 50:50 Joint Venture (JV) between Banco Santander S.A (Santander; rated A (high) with Stable trend by DBRS Morningstar) and BNP Paribas Group (BNPP; rated AA (low) with Stable trend by DBRS Morningstar).

KEY RATING CONSIDERATIONS

DBRS Morningstar maintained the SA1 support assessment for UCI, which implies the expectation of predictable support from its shareholders. The Issuer Rating for UCI is two notches below the Issuer Rating of Santander (the lower rated shareholder), reflecting the expectation of predictable and timely parental support in case of need, as well as that UCI is a non-bank subsidiary in which neither shareholder has a majority stake. DBRS Morningstar notes that the recent shareholder capital increase demonstrates the willingness and ability of the shareholders to provide capital support. DBRS Morningstar also notes that due to its ownership and the expectation of support, UCI's ratings are positioned multiple notches above the entity's intrinsic creditworthiness.

DBRS Morningstar expects that UCI will continue to book losses in 2023 and possibly in 2024 given the UCI's Net Interest Income (NII) negative sensitivity to increases in interest rates as well as the high cost of risk (CoR) expected in the coming years.

RATING DRIVERS

Given the SA1 designation, which implies the expectation of predictable support from the shareholders, UCI's ratings will generally move in tandem with the ratings of its lower rated shareholder. An upgrade or a positive rating action on Santander SA could be reflected in UCI's ratings.

Similarly, a downgrade or a negative rating action on Santander SA would be reflected in UCI's ratings. However, the ratings of UCI may decouple from those of the shareholders and likely decline, if, in DBRS Morningstar's opinion, the likelihood and/or predictability of support were to reduce or if the ownership structure were to change.

For more information on the rating drivers of Santander, see the separate press release: <https://www.dbrsmorningstar.com/research/421185/dbrs-morningstar-confirms-banco-santander-sas-long-term-issuer-rating-at-a-high-stable-trend>.

RATING RATIONALE

Franchise:

UCI is a specialised mortgage lender established as a Joint Venture (JV) between Santander and BNPP with each group holding a 50% stake. UCI S.A. (or the Group) is a holding company which in turn owns 100% of UCI E.F.C., the rated entity. UCI's franchise focuses on the mortgage market, with total gross loans of around EUR 9.9 billion and a mortgage market share in Spain and Portugal of around 2% at end-June 2023. UCI operates mainly in Iberia with 86% of its loan book related to Spanish borrowers and 12% to Portuguese borrowers at end-June 2023.

Earnings:

DBRS Morningstar views UCI's earnings power as constrained due to the lack of revenue diversification as its income is concentrated mainly in net interest income from its mortgage book. UCI's commercial activity has been significantly affected by the interest rate normalisation, and weak mortgage demand dynamics in the Iberian mortgage sector during 2023. As a result, as of end-June 2023 UCI's new lending volumes were down by around 60% YoY, compared with a 17% reduction for the Spanish Banking System. The Group posted a EUR 55 million net attributable loss in 2022 reaching a negative Return on Equity (RoE) of 5.1% driven by a higher cost of risk (CoR) and a lower NII. The results were affected by the sale of a EUR 200 million Non-Performing Loan (NPL) portfolio that resulted in a net loss of around EUR 55 million. NII declined by 20% YoY as all UCI's liabilities quickly repriced to the current interest rate environment, given that its funding mix consists of RMBS securities (with a variable coupon) and short-term interbank lending. However, its loan book is composed of approximately equal proportions of: i) fixed term mortgages, ii) mortgages linked to Euribor 12 month and iii) mortgages linked to IRPH (Índice de Referencia de Préstamos Hipotecarios, a Spanish Mortgage Loan Benchmark Index). Yet, since interest rates starting to rise in 2022, the IRPH index evolution has been lower than other market rates, increasing by 250 bps whereas the Euribor 12 month rose by 450 bps, negatively affecting UCI's NII.

Risk:

UCI's risk profile is mainly driven by its loan book and foreclosed assets. It has a highly elevated Non-Performing Loan ratio of around 15% at end-June 2023 as compared to the aggregate mortgage NPL ratio of the Spanish banking system of 2.3% at end-March 2023. UCI's NPL ratio worsened in previous years due to the introduction of IFRS9 and the supervisory reclassification of loans. However, DBRS notes that the majority of the NPLs are related to loans originated prior 2008. In contrast, UCI's portfolio originated from 2012 going forward has, to date, reflected better performance. DBRS Morningstar considers that the entity will book a high CoR in coming years given that UCI still needs to significantly reduce its portfolio of problematic assets. In addition, the impact of higher interest rates is also expected to negatively impact UCI's asset quality profile. In this regard, DBRS Morningstar considers that the evolution of Stage 2 loans (exposures whose credit risk has significantly increased) as a key indicator. At end-June 2023, these exposures represent around 7.6% of its portfolio.

Funding and Liquidity:

DBRS Morningstar notes that UCI's funding and liquidity management mainly relies on interbank lending. At end-June 2023, funding from credit institutions (mainly from its shareholders) accounted for around 71% of total funding with the rest of the entity's funding coming from Residential Mortgage Backed Securities (RMBS). Since 2015, UCI has placed in the market a total of 13 securitisations, and as a result has been able to repay part of the short-term credit lines and at the same time finance its new lending activity. During 2023, UCI issued around EUR 490 million of RMBS. DBRS Morningstar also notes that as of end-June 2023 UCI complies with the new liquidity ratios that were introduced in Spain for NBFIs during 2022.

Capitalisation:

Since January 2022 UCI's capital ratios were affected by the entry into compliance with the Capital Requirements Regulation (the so-called CRD IV package) for NBFIs in Spain. The Overall Capital Requirement of UCI was set at 12.25% for both the Group and UCI E.F.C for 2023. In order to comply with these requirements, UCI Group received EUR 274 million of regulatory capital from their

shareholders from December 2021 to December 2022. As a result, UCI Group's CET1 ratio stood at 9.1% at end-June 2023, above its CET1 requirement of around 8%. DBRS Morningstar notes that UCI Group's capital ratios have a tight capital cushion over its requirements that could be eroded in case the entity continues to post losses in coming quarters. Nevertheless, DBRS Morningstar considers that shareholder support has been demonstrated in the recent additional capital subscribed by its shareholders. DBRS Morningstar also notes that UCI's EFC capital ratios were above capital requirements at end-June 2023.

ENVIRONMENTAL, SOCIAL, GOVERNANCE CONSIDERATIONS

Credit rating actions on Banco Santander SA are likely to have an impact on this credit rating. ESG factors that have a significant or relevant effect on the credit analysis of Banco Santander SA are discussed separately at <https://www.dbrsmorningstar.com/issuers/9564>.

There were no Environmental or Governance factor(s) that had a significant or relevant effect on the credit analysis.

A description of how DBRS Morningstar considers ESG factors within the DBRS Morningstar analytical framework can be found in the DBRS Morningstar Criteria: Approach to Environmental, Social, and Governance Risk Factors in Credit Ratings at <https://www.dbrsmorningstar.com/research/416784/dbrs-morningstar-criteria-approach-to-environmental-social-and-governance-risk-factors-in-credit-ratings> (4 July 2023).

Notes:

All figures are in Euros unless otherwise noted.

The principal methodology is the Global Methodology for Rating Banks and Banking Organisations (22 June 2023), <https://www.dbrsmorningstar.com/research/415978/global-methodology-for-rating-banks-and-banking-organisations>. In addition DBRS Morningstar uses the Global Methodology for Rating Non-Bank Financial Institutions (1 September 2023), <https://www.dbrsmorningstar.com/research/420144/global-methodology-for-rating-non-bank-financial-institutions>.

The following methodologies have also been applied:

-- DBRS Morningstar uses the DBRS Morningstar Criteria: Approach to Environmental, Social, and Governance Risk Factors in Credit Ratings (4 July 2023), <https://www.dbrsmorningstar.com/research/416784/dbrs-morningstar-criteria-approach-to-environmental-social-and-governance-risk-factors-in-credit-ratings>, in its consideration of ESG factors.

The sources of information used for this rating include Morningstar Inc. and Company Documents, Santander 2022 & H1 2023 Presentations, Santander 2022 & H1 2023 Press Releases, Santander 4Q 2022 & 2Q 2023 Report, Santander 2022 Annual Accounts, and UCI Annual Report. DBRS Morningstar considers the information available to it for the purposes of providing this rating to be of satisfactory quality.

DBRS Morningstar does not audit the information it receives in connection with the rating process, and it does not and cannot independently verify that information in every instance.

The conditions that lead to the assignment of a Negative or Positive trend are generally resolved within a 12-month period. DBRS Morningstar's outlooks and ratings are under regular surveillance.

For further information on DBRS Morningstar historical default rates published by the European Securities and Markets Authority (ESMA) in a central repository, see: <https://registers.esma.europa.eu/cerep-publication>. For further information on DBRS Morningstar historical default rates published by the Financial Conduct Authority (FCA) in a central repository, see <https://data.fca.org.uk/#/ceres/craStats>.

The sensitivity analysis of the relevant key rating assumptions can be found at: <https://www.dbrsmorningstar.com/research/421356/>.

These credit ratings are endorsed by DBRS Ratings Limited for use in the United Kingdom.

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For more information on this credit or on this industry, visit www.dbrsmorningstar.com.

Ratings

Unión de Créditos Inmobiliarios (UCI)

Date Issued	Debt Rated	Action	Rating	Trend	Attributes
03-Oct-23	Long-Term Issuer Rating	Confirmed	A (low)	Stb	EU U
03-Oct-23	Short-Term Issuer Rating	Confirmed	R-1 (low)	Stb	EU U

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