EIB SME initiative for Spain - performance report

Macroeconomic background

Scope expects severely adverse performance of Spanish SME loans in 2020.

Spanish SMEs, in particular in the hospitality and tourism sector will see a deep cut into their business in 2020, from the COVID-19 pandemic; however, Spanish SMEs in general may benefit from their continuous deleveraging since 2012; moreover, the effectiveness of governmental support measures coupled with a banking sector cooperation may partially mitigate the impact; while support measures generally target liquidity issues, in particular small and micro-SMEs are more facing solvency issues:

- **economic drop** – severe GDP reduction expected for 2020, that may be followed by a recovery in 2021;
- **unemployment rise** – significant increase expected towards year-end 2020, up from 14.0% in 2019, fuelled by temporary contracts;
- **limited demand for credit continuous** - Q1 2020 still showed a reduction in private sector credit demand, on the back of continuous tightening of credit standards from the banks.

COVID-19 challenges the Spanish economy in 2020, given the significant exposure to the tourism, hospitality and entertainment sector (25+% of Spain’s gross value added; 38.4% of all employment). Low interest rates and the drop in oil prices, provide marginal mitigation through positive reflection on input costs. Also the support from the central government may reduce the adverse effect and provide a bridge to avoid some corporate defaults. Apart from this, the general challenges for the Spanish economy still reside in the high structural unemployment, especially among young people, and the significant **political uncertainty around an unstable central government.** In particular weaker SMEs may suffer first in the current crisis, if compromises lead to less efficient or delayed support measures.

Until the COVID-19 outbreak, Spanish corporates showed improving credit profiles and credit service capacity. This is a result of corporate deleveraging (41.6ppt reduction in outstanding debt levels since the peak in Q2 2008) and the availability of low-margin and low instalment credit, driven by high competition in SME lending sector.[1] The impact of the crisis and the mitigation from governmental support and bank incentives to support remains to be seen.

Scope considers obligors in the reference portfolio of the EIB SME initiative for Spain to be of weaker credit quality. The initiative supports lending to SMEs with limited access to credit, resulting from banks' prudent lending approach towards weaker obligors. These generally smaller SMEs to date benefited significantly from the positive macroeconomic environment up to Q3 2019, but are now likely to be impacted first. The general maintenance of a weak credit profile, i.e. the deleveraging and access to cheap credit might have only been partially applicable to the SMEs in this transaction, makes them more vulnerable to the current adverse impact on the business models showing as a drop in consumption demand.

[1] *Statements incorporate the results of the ECB bank lending survey up to the Q1 2020 issuance, published in April 2020.*

Related research

Scope Ratings: Spain’s credit vulnerabilities to Covid-19: growth, labour market and public finances, April 2020 - LINK

Scope Ratings: Kingdom of Spain Rating Report, 18 May 2018 - LINK

EIB SME initiative for Spain - performance report

Liability structure

Risk covers[1] (notional amounts reflect the 50% guarantee rate)	Actual current balance (EUR)[2]	Maximum[3] current balance (EUR)	%[4]	Current rating (17/05/2020)	Maximum[3] balance at closing (EUR)	%[5]	Initial rating (08/05/17)
Senior Risk Cover	**292,392,743.11**	**608,260,984.55**	**41.5%**	**AAASF**	**1,905,239,428.81**	**69.0%**	**AASF**
Upper Mezzanine Risk Cover	**103,654,642.66**	**124,254,745.36**	**8.5%**	**AAASF**	**124,254,745.36**	**4.5%**	**BBB+SF**
Middle Mezzanine Risk Cover	11,517,182,52	13,806,082.82	0.9%	NR	13,806,082.82	0.5%	NR
Lower Mezzanine Risk Cover	69,103,095,11	82,836,496.91	5.7%	NR	82,836,496.91	3.0%	NR
First Loss Piece	529,790,395.79	635,079,809.60	43.4%	NR	635,079,809.60	23.0%	NR
Total	1,006,458,059.19	1,464,238,119.24			**2,761,216,563.50**		

Risk cover loss ledgers, effective balances & credit enhancement[1]

	Maximum[3] current effective balance[6] (EUR)	Current risk cover loss ledger[7] (EUR)	Credit enhancement from effective subordination
Senior Risk Cover	**608,260,984:55**	**0.00**	**56.7%**
Upper Mezzanine Risk Cover	**124,254,745.36**	**0.00**	**47.9%**
Middle Mezzanine Risk Cover	13,806,082.82	0.00	46.9%
Lower Mezzanine Risk Cover	82,836,496.91	0.00	41.0%
First Loss Piece	576,284,602.95	58,795,206.65	-4.2%
Total	1,405,442,912.59		

[1] Amounts in this section always consider the 50% guarantee rate, i.e. the corresponding amounts in the “Reference portfolio information” section need to be considered at 50% for the risk takers.
[2] Actual current balance reflects the 50% of the cumulatively disbursed and outstanding portfolio.
[3] Maximum current balance accounts for the currently outstanding balance of reference exposures plus the reference exposures that could still be added to the reference portfolio.
[4] % of Maximum current balance.
[5] % of Maximum balance at closing.
[6] Effective balance accounts for the allocated losses from the portfolio to date.
[7] The current loss ledger may reduce or increase depending on the claim of portfolio losses and the inflow of recoveries. The sum of the current loss ledgers accounts for 50% of the total losses.

EIB SME initiative for Spain - performance report

Reference portfolio information

Portfolio ramp-up and amortisation[8] (EUR)	Total outstanding non-defaulted theoretical balance	Total outstanding non-defaulted ramped balance	Total additional ramp-up potential	Ramp-up status	Total amortisation
28/09/15	5,522,286,075.00	0.00	5,522,286,075.00	0.0%	0.00
31/12/16	4,985,798,013.91	2,484,065,352.80	2,501,732,661.11	54.7%	526,949,767.66
30/09/17	4,416,315,948.38	2,624,537,982.77	1,791,777,965.61	67.6%	1,076,143,229.28
31/03/18	3,913,614,705.62	2,519,357,348.86	1,394,257,356.76	74.8%	1,542,697,656.74
31/12/18	3,392,119,322.65	2,348,729,804.65	1,043,389,518.00	81.1%	2,012,264,889.99
30/09/19	2,810,885,825.17	1,895,325,705.07	915,560,120.10	83.4%	2,593,956,888.53

Portfolio defaults and losses (EUR)[9]	Cumulative portfolio defaults	Outstanding defaults	Principal losses	Total losses	Recoveries
28/09/15	0.00	0.00	0.00	0.00	0.00
31/12/16	5,772,199.30	5,207,985.56	5,772,199.30	5,836,466.46	0.00
30/09/17	29,944,396.52	10,685,247.85	26,799,382.24	27,115,674.38	117,499.17
31/03/18	67,796,731.28	16,998,174.40	57,521,332.90	58,167,823.76	1,675,966.64
31/12/18	124,859,028.01	6,810,113.65	118,048,914.36	118,048,914.36	1,675,966.64
30/09/19	133,737,588.68	22,259,055.04	117,590,413.30	117,590,413.30	NA

[8] Risk takers under the risk covers are exposed to 50% (guarantee rate) of the reference exposures.
[9] Risk takers under the risk covers are exposed to 50% (guarantee rate) of the losses.

EIB SME initiative for Spain - performance report

Delinquencies (days in arrears)[10]	0-15 days[11]	0-30 days	31-60 days	61-90 days	90+ days
28/09/15	0.00%	0.00%	0.00%	0.00%	0.00%
31/12/16	0.09%	0.10%	0.01%	0.00%	0.03%
30/09/17	1.14%	1.32%	0.19%	0.07%	0.17%
31/03/18	1.00%	1.19%	0.26%	0.14%	0.21%
31/12/18	1.07%	1.35%	0.26%	0.17%	0.20%
30/09/19	1.62%	1.93%	0.30%	0.24%	0.57%

Portfolio concentrations[12]	Obligors		Industry sector	
	30/09/19	31/12/16	30/09/19	31/12/16
	Top 1 (0.60%)	Top 1 (0.48%)	Wholesale & retail trade (28.7%)	Wholesale & retail trade (29.9%)
	Top 3 (1.55%)	Top 3 (1.06%)	Food, beverage & tobacco (25.6%)	Food, beverage & tobacco (23.7%)
	Top 10 (3.55%)	Top 10 (2.59%)	Accommodation, leisure & entertainment (13.2%)	Professional services (12.1%)
	Top 20 (5.50%)	Top 20 (4.14%)	Professional services (10.1%)	Accommodation, leisure & entertainment (11.6%)
			Other (22.4%)	Other (22.8%)

[10] % of total outstanding non-defaulted theoretical balance.
[11] 0-15 days delinquencies are also part of the 0-30 days delinquencies.
[12] % of total outstanding non-defaulted ramped balance

EIB SME initiative for Spain - performance report

Scope's quantitative assumptions

	30/09/19	31/12/16
Weighted average life (years)	3.0	3.5
Point-in-time mean-default rate	18.4%	19.0%
Point-in-time coefficient of variation	41.4%	40.6%
Long-term-adjusted mean-default rate	8.2%	8.4%
Long-term coefficient of variation	76.3%	76.6%
Base case recovery rate	35.4%	38.4%
Constant prepayment rate (low)	0.0%	0.0%
Constant prepayment rate (high)	15.0%	15.0%
Credit quality of portfolio	**B-**	**B-**
Credit quality of ramped share	B	B-
Credit quality of non-ramped share	B-	B-

EIB SME initiative for Spain - performance report

Glossary

Risk cover	Cumulative portfolio loss coverage capacity with certain seniority.
Current total theoretical balance	Current respective balance of risk covers, accounting for the 50% guarantee rate and the Total outstanding non-defaulted theoretical balance of the reference portfolio.
Current risk cover loss ledger	Allocated losses from the reference portfolio, per risk cover.
Guarantee rate	The guarantee rate defines the share of the reference portfolio losses that is covered by the combined risk covers.
Total outstanding non-defaulted theoretical balance	Total outstanding non-defaulted ramped balance + Total additional ramp-up potential
Total outstanding non-defaulted ramped balance	Combined outstanding balance of non-defaulted exposures that are already assigned to the reference portfolio.
Total additional ramp-up potential	Difference between two times the combined Initial total theoretical balance of the risk covers and the combined balance of exposures assigned to the reference portfolio since closing of the transaction.
Total amortisation	Total amortisation reflects the total amortisation of the portfolio to date from principal repayments.
Conditional prepayment rate in % (CPR)	CPR reflects the unexpected repayments of principal since closing of the transaction in %.
Cumulative portfolio defaults	Combined balance of reference credit exposures flagged as defaulted in the reference portfolio. The transaction considers assets as defaulted, if they are more than 90 days in arrears, subject to subjective default, asset acceleration or restructuring.
Outstanding defaults	Reference exposures that are flagged as defaulted or 90+ days in arrears, for which the respective bank has not yet claimed the 50% loss coverage from the EIB.
Principal losses	Loss of principal from defaulted reference exposures, for which the respective bank has claimed 50% loss coverage from the EIB.
Total losses	Loss of principal and accrued interest from defaulted reference exposures, for which the respective bank has claimed 50% loss coverage from the EIB.
Recoveries	Recovery proceeds collected on defaulted reference exposures. EIB is entitled to 50% of these recoveries, which will reduce the Total loss.
Delinquencies in %	Outstanding balance of reference exposures, which are not defaulted and X days in arrears, divided by the Total outstanding non-defaulted theoretical balance.

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