PRESS RELEASE

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

NON-BANK FINANCIAL INSTITUTIONS

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 of 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 a 50:50 Joint Venture (JV) between Banco Santander S.A (Santander) and BNP Paribas Group (BNPP).

KEY RATING CONSIDERATIONS

DBRS Morningstar maintained the SA1 support assessment for UCI, which implies the expectation of predictable support from its shareholders. DBRS Morningstar has an A (high) Long-Term Issuer Rating with a Stable Trend on Santander and a Long-Term Issuer Rating of AA (low) with a Stable Trend on BNPP. The Issuer Rating for UCI is two notches below the Issuer Rating of Santander (the lower rated shareholder), reflecting both the expectation 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 due to its ownership and the expectation of support, UCI's ratings are positioned multiple notches above the entity's intrinsic creditworthiness.

As a monoline mortgage lender DBRS Morningstar notes that UCI's profitability is highly concentrated on net interest income. UCI has in the past targeted clients with a riskier credit profile than traditional commercial banks and this translated into higher non-performing loan (NPL) ratios and higher margins than retail banks, however more recent lending has, to date, shown better performance. DBRS Morningstar notes that UCI's funding profile has a high reliance on short term funding from the shareholders, and that its capital profile experiences some pressure due to tight capital buffers over its regulatory requirements. DBRS Morningstar will continue to monitor the developing situation and potential impact of the coronavirus (COVID-19) outbreak on revenues, profits and asset quality, whilst taking into account the significant relief measures being taken by governments and regulators, however DBRS Morningstar notes the demonstrated willingness and ability of the shareholders to provide liquidity and capital support, if needed.

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 would 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 deviate from those of the shareholders if, in DBRS Morningstar's opinion, the likelihood of support was to reduce or if the ownership structure were to change.

RATING RATIONALE

UCI is a JV between Santander and BNPP with both groups holding a 50% stake. UCI S.A. 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 loans under management of around EUR 10.7 billion and a mortgage market share in Spain and Portugal of around 2% at end-September 2020. UCI operates mainly in Iberia with 87% of loans to Spanish borrowers and 11% to Portuguese borrowers at end-September 2020.

DBRS Morningstar views UCI´s earnings power as constrained due to the lack of revenue diversification as its income is concentrated mainly on net interest income from its mortgage book, and this is further impacted by the low level of activity in the Spanish mortgage market since the global financial crisis. This is also reflected in a low return on equity (RoE) of 3.2%. DBRS Morningstar considers the COVID-19 crisis will generate pressure on revenues as the net interest margin will be negatively impacted due to the longer horizon of low interest rates and potentially higher funding costs. In addition, Spain has also approved mortgage holidays and forbearance on loan repayments, for households classified as vulnerable. The extent of the impact is uncertain but it will affect UCI´s revenues.

UCI's risk profile is mainly driven by its loan book which has an elevated NPA ratio of 14.8%. UCI's NPL ratio (NPLs, +90 days and unlikely to pay) improved to 12% at end-2019 down from 12.3% at end-2018, which is still very high compared to the aggregate mortgage NPL ratio of the Spanish banking system of 3.2% at end-June 2020. DBRS Morningstar sees UCI's asset quality as improving less than we had anticipated, given the positive economic conditions in Spain during 2019. NPLs decreased by only 4% YoY during 2019 compared to a reduction of 19% of the entire Spanish Financial System. For 2020 we expect the economic conditions in Spain will be much more challenging in the context of the COVID-19 crisis and it is likely asset quality will further. We will continue to monitor the developing situation and in particular the asset quality evolution of its loan book under moratoria, which DBRS Morningstar understands is in line with the current proportions reported by the overall Spanish Banking System.

DBRS Morningstar also considers in its analysis the potential litigation risks related to the transparency of the sale of consumer mortgages linked to the IRPH index (Índice de Referencia de Préstamos Hipotecarios). As of end-September 2020, 46% of UCI´s loan book was referenced to the IRPH index. DBRS Morningstar considers that the March 2020 European Court of Justice (ECJ) ruling IRPH mortgages removes uncertainty and understands the potential impact of the ruling for UCI should be limited (for more details see DBRS Morningstar's commentary "ECJ Decision on Spanish Mortgages Positive for Banks").

DBRS Morningstar notes that UCI has, with crucial liquidity support from its shareholders, managed a very challenging economic and financial environment since 2008. At end-September 2020, funding from credit institutions (mainly from is shareholders) accounted for around 60% of total funding with the rest of the entity's funding coming from Residential Mortgage Backed Securities (RMBS). During 2020, UCI has issued EUR 392 million of RMBS in Portugal [Green Belém No.1]. UCI committed to using an amount equal to the issuance proceeds of the Class A notes to originate mortgage loans for residential properties in Spain and Portugal that satisfy the Green Bond Initiative's sector-specific criteria for low carbon buildings. Lastly, DBRS Morningstar considers that if the economic and financial shut-down related to the COVID-19 crisis continues, we would expect UCI, if required, to rebuild their usage of liquidity support from its shareholders.

As a non-bank institution, UCI's capitalisation requirements were lower than for banks, however, new legislation effective since July 2020 results in UCI needing to comply with the Credit Institutions Directive 2013 and the Capital Requirements Regulation 2013 (the so-called CRD IV package). This increases UCI's Total Capital requirement to 10.5%. As of 1 January 2020 UCI was also required to use the new IFRS9 accounting framework, and DBRS Morningstar notes that UCI has opted to apply IFRS9 transitional arrangements in order to phase-in the full impact of IFRS9 (around 100 bps) on its regulatory capital ratios. DBRS Morningstar expects that UCI will be able to meet the new requirements helped by the phasing-in period. Including the impact of the new regulations (IFRS9 and CRD IV package), and the issuance in 2019 of EUR 82 million of new capital in the form of Additional Tier 1 Instrument (AT1), and EUR 80 million in the form of Tier 2 Instrument (both entirely subscribed by its shareholders), UCI's Total Capital ratio at end-2019 was 11.0%, above the requirement of 10.5%.

ESG CONSIDERATIONS

A description of how DBRS Morningstar considers ESG factors within the DBRS Morningstar analytical framework and its methodologies can be found at: https://www.dbrsmorningstar.com/research/357792.

Notes:
All figures are in Euros unless otherwise noted.

The principal methodology is the Global Methodology for Rating Banks and Banking Organisations (8 June 2020) - https://www.dbrsmorningstar.com/research/346375/global-methodology-for-rating-banks-and-banking-organisations

For more information regarding rating methodologies and Coronavirus Disease (COVID-19), please see the following DBRS Morningstar press release: https://www.dbrsmorningstar.com/research/357883

The sources of information used for this rating include Santander 2019 & H1 2020 Presentations, Santander 2019 & H1 2020 Press Releases, Santander 4Q 2019 & 2Q 2020 Report, Santander 2019 Annual Accounts, European Banking Authority Risk Dashboard, Bank of Spain, 2019 UCI Annual Report, Confidential Company Documents and S&P Global Market Intelligence. 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.

Generally, the conditions that lead to the assignment of a Negative or Positive trend are 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: http://cerep.esma.europa.eu/cerep-web/statistics/defaults.xhtml

The sensitivity analysis of the relevant key rating assumptions can be found at: https://www.dbrsmorningstar.com/research/367885

Ratings assigned by DBRS Ratings GmbH are subject to EU and U.S. regulations only.

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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	Issued
06-Oct-20	Long-Term Issuer Rating	Confirmed	A (low)	Stb	EU
06-Oct-20	Short-Term Issuer Rating	Confirmed	R-1 (low)	Stb	EU

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