FitchRatings

UCI S.A. and Union de Creditos Inmobiliarios S.A. E.F.C.

Key Rating Drivers

Support Drives Ratings: The ratings of UCI S.A. (UCI) and its fully owned subsidiary Union de Creditos Inmobiliarios S.A. E.F.C. (UCI EFC) are based on Fitch Ratings' assumption that there is a high probability of support from Banco Santander, S.A. (A-/Stable/F2/a-) if required. Santander directly owns 50% of UCI's share capital, BNP Paribas S.A. (BNPP: A+/Stable/F1/a+) holds 10% of the share capital directly and 40% through its fully owned consumer finance subsidiary, BNP Paribas Personal Finance SA (BNPPF).

UCI Important to Santander: Fitch believes that extraordinary capital or funding support from Santander if needed is highly probable. Support is less certain than that for fully owned core subsidiaries of Santander due to UCI's joint-venture (JV) ownership structure and Fitch's view that UCI is strategically important but not core to Santander's domestic franchise. This is reflected in Fitch notching UCI's and UCI EFC's Long-Term Issuer Default Rating (IDR) down twice from Santander's Viability Rating (VR) of 'a-'.

UCI Less Important to BNPP: In Fitch's opinion, UCI is of less strategic importance to BNPP because there is limited overlap in geographical and product coverage. BNPP is a material funding provider for UCI, indicating that extraordinary support is possible, but is insufficient to underpin UCI's ratings.

Long Record of Support: Both shareholders have an extensive record of providing support in the form of capital (most recently EUR82 million additional Tier 1 (AT1) and 10-year EUR80 million subordinated bonds in June 2019 and December 2019, respectively) and funding lines when needed. Santander and BNPP have maintained sizeable open credit lines for UCI since its establishment (EUR4 billion each at end-2019).

Weaker Standalone Profile: UCI high leverage and the legacy portfolio's drag on profitability and asset-quality indicators weigh on its standalone creditworthiness. The reliance on non-equity funding from shareholders makes UCI's standalone funding profile assessment challenging.

Complementary Sales Channel: UCI extends residential mortgage loans (a core product for Santander) in Santander's core markets through a large network of real estate agents and online platforms. This complements Santander's branch network channel. UCI has weathered numerous crises since its establishment in 1989.

Rating Sensitivities

Changes in Santander's Rating: A change in Santander's VR would likely lead to a change in UCI's and UCI EFC's ratings. A change in BNPP's ratings would not directly affect the ratings, assuming BNPP's stake in UCI and level of non-equity funding remain broadly unchanged.

Ownership Changes: The acquisition by Santander of a majority stake in UCI, although not expected by Fitch, would likely lead to narrower notching and an upgrade of UCI and UCI EFC. Conversely, a material reduction in Santander's stake in UCI, also not expected by Fitch, could lead to a downgrade.

Changes in Importance: Indications of increasing strategic importance of UCI and the Spanish market in general to BNPP could be positive for UCI's and UCI EFC's ratings. Indications that UCI's residential mortgage sales channel has become less strategically important for Santander could lead to wider notching.

Ratings

UCI S.A. and Union de Creditos Inmobiliarios S.A. E.F.C.	
Long-Term IDR	BBB
Short-Term IDR	F2
Support Rating	2
Sovereign Risk	
Long-Term Foreign-Currency IDR	A-
Country Ceiling	AAA
Outlooks	
Long-Term Foreign-Currency IDR	Stable
Sovereign Long-Term Foreign-Currency IDR	Stable

Applicable Criteria

Non-Bank Financial Institutions Rating Criteria (October 2018)

Related Research

Fitch Affirms Union de Creditos Inmobiliarios 'BBB'; Outlook Stable (December 2019)

Global Housing and Mortgage Outlook - 2020 (December 2019)

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Company Summary

UCI EFCis the regulated entity and the principal operating subsidiary. Most financial data are provided on a consolidated basis at UCI holding level. Fitch has therefore assigned ratings to both UCI and UCI EFC. This is because UCI EFC accounts for almost all of UCI's consolidated activities, assets and revenue.

Established Mortgage Specialist

UCI occupies a well-established niche in the Spanish and Portuguese mortgage markets (87% and 11% respectively of the portfolio). The group had 672 full-time employees at end-1H19.

The company offers only residential mortgages, mainly through external real estate agents who receive origination fees. It also issues about 20% of its mortgages in Spain through its own website. This share should increase in the medium term, especially among younger buyers, as digitalisation leads to disintermediation in real estate transactions.

Product differentiation is minimal and mortgages are mainly at floating interest rates (92% at 3Q19). However, more than 65% of new originations are priced at mixed or fixed rates.

International operations are limited to Brazil, through a small real estate broker with no balance-sheet or foreign-currency exposure. UCI's operations in Greece have been in wind-down since 2016, but still account for 2% of the total portfolio.

Institutional Support Assessment

Support from Santander Highly Probable

The ratings are based on Fitch's assumption that there is a high probability of support from Santander if required. Fitch believes that a UCI default would lead to reputational risk for Santander given the shared home market of UCI and Santander, and given UCI's considerable wholesale market presence.

Support from BNPP Less Likely

In Fitch's opinion, UCI is of less strategic importance to BNPP than it is to Santander. This is due to limited overlaps in geographical and product coverage.

Conflict Resolution Mechanism Limits Notching

In the case of JVs, Fitch typically notches at least twice from the supporting entity (or entities) since competition or confrontation between the JV partners could make support less likely. However, UCI's shareholder agreement contains a conflict resolution mechanism to mitigate this risk, which supports Fitch's decision to notch twice from Santander's VR of 'a-'.

Key Qualitative Assessment Factors

Operating Environment

New Lending Growth to Stabilise

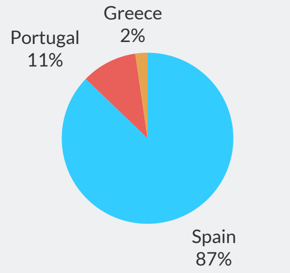
Fitch expects new mortgage lending growth of about 5% per year in Spain in 2020-2021. Loan growth remained flat in 2019, following the mid-year enactment of a new mortgage law, which required longer processes between the binding mortgage offer and the property sale. Notaries use the longer period to ensure borrowers are fully aware of the risks.

Limited Housing Supply

We forecast nominal home prices in Spain to continue to grow by about 5% in both 2020 and 2021 driven by property scarcity in large cities and improving labour dynamics, supported by a recently approved 22% rise in minimum wage and falling unemployment. Housing developments continue to be rare, with construction permits at 16% of 2000-2002 levels.

Mortgage Portfolio by Country

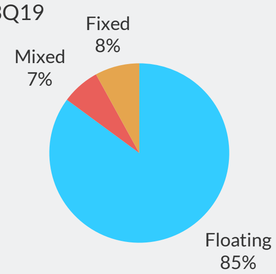
End-3Q19



Source: Fitch Ratings, UCI S.A.

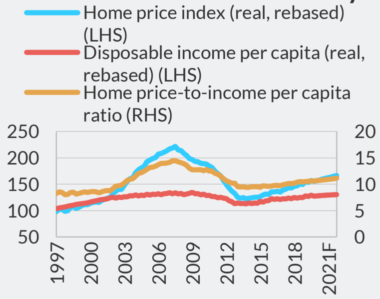
Mortgage Portfolio by Product

End-3Q19



Source: Fitch Ratings, UCI S.A.

Home Prices and Affordability



Source: Fitch Ratings, OECD, Ameco, INE, Haver Analytics

Fixed-rate Loans Cushion Medium-Term Risks

Spanish mortgages in arrears of three months or more will remain close to 3.5% into 2021, supported by GDP growth of about 2% and lower unemployment. The larger proportion of fixed-rate loans originated after 2015 should be more resilient amid rate rises. Economic deterioration beyond our expectations could lead to job losses and higher delinquency and default rates for employees on temporary contracts, who make up about a quarter of the workforce.

Management and Strategy

Limited Complexity, Sound Planning

Most senior management, including the chief executive and chief operating officers, have been with UCI for an extended period and with frequent secondments to and from the two shareholders. The management has an adequate level of depth and experience considering the streamlined business model. Since its inception, UCI has recorded only two loss-making years despite the many challenges faced by Spanish mortgage lenders.

Operationally Independent Joint Venture

Neither shareholder directly influences UCI's operations, due to the limited integration and synergies. Shareholder oversight is exercised by the board of directors, which includes two representatives from each JV partner.

Risk Appetite

Adequate Underwriting at Origination

UCI's underwriting standards are well-established and stable. After 2008 the underwriting function was centralised at the head office and automated through electronic loan-scoring. UCI consults positive and negative credit bureaux.

Average loan-to-value ratios (LTVs) of newly-originated loans since 2009 have consistently been below 80%. Average LTV ratio of outstanding loans was 68% at end-1H19. Real estate valuations are performed externally, but about 30% of the portfolio has LTVs above 100%, largely due to the sharp drop in Spanish house prices in 2008-2014.

Proactive Collection Procedures

UCI has tightened its recovery processes in recent years and employs a large collection team (almost half the workforce). UCI actively disposes of repossessed properties, using external consultants and largely financing their sale. However, the company also increasingly rents out repossessed properties.

Key Financial Metrics – Latest Developments

Legacy NPLs Weigh on Asset Quality

UCI remains burdened by its legacy non-performing loans (NPLs) following the 2008-2014 crisis. About 98% of UCI's total NPLs were originated before 2010, while the impaired loans ratio for post-2010 annual vintages has been below 1%.

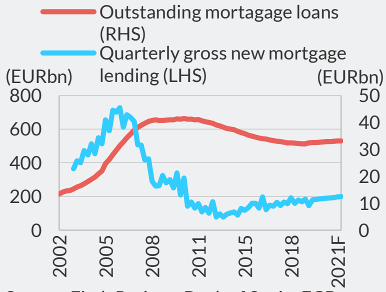
Fitch sees the coverage ratio of NPLs with loan loss allowances at 23% as low, given that impaired mortgages with LTV above 80% account for 84% of NPLs (62% of NPLs have LTVs at above 100%). However, this is partly mitigated by tangible and externally-appraised collateral.

Low-rate Environment Challenges Profitability

UCI's profitability remains challenged by legacy exposures, the low interest rate environment and competition. Newer mortgage originations, the lower cost of subordinated debt, and gains from buy-backs of its own bonds, have positively contributed to overall profitability.

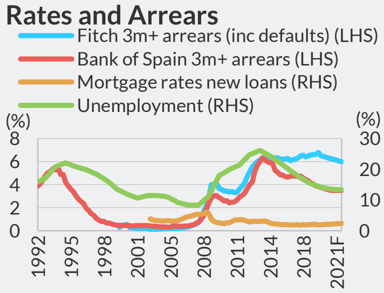
Pre-tax income-to-average equity has improved to 2.3% in 2018 from 1.2% in 2017. However, Fitch's core finance NBFI profitability indicator of pre-tax income to average assets remained low at 0.1% in 2018.

Mortgage Lending



Source: Fitch Ratings, Bank of Spain, ECB, Haver Analytics

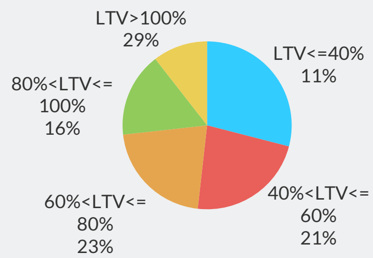
Unemployment, Mortgage Rates and Arrears



Source: Fitch Ratings, Bank of Spain, Haver Analytics

Mortgage Portfolio by LTV

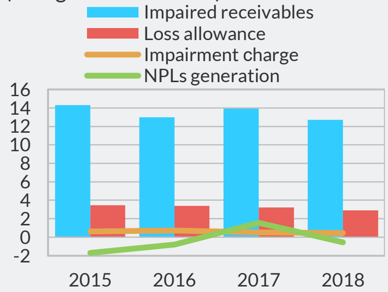
End-2018



Source: Fitch Ratings, UCI S.A.

Credit Quality

(% of gross receivables)



Source: Fitch Ratings, UCI S.A.

Net interest income marginally covers operating expenses and UCI's generally high impairment charges. The latter have consumed on average 64% of pre-impairment operating profits during the period of 2015-2018. Operating expenses are low (compared with UCI's asset base or revenue), supported by sales through external agents.

Shareholder Support Enables High Leverage

UCI's regulatory total capital ratio was around 11.5% at end-2019. The ratio has improved from 9.3% at end-2017 in anticipation of an increase of the regulatory minimum to 10.5% during 2020-2021. The improvement was driven by EUR82 million of AT1 bonds issued in June 2019 and by a 10-year extension of EUR80 million of Tier 2 subordinated debt in December 2019. AT1 bonds and renewed Tier 2 debt were equally subscribed by both shareholders.

UCI's regulatory capital ratio offers a modest cushion above the minimum owing to the 35% risk weights assigned by the Bank of Spain to mortgages with LTVs not exceeding 85%.

Improving Access to Markets

Funding and Liquidity Ratios

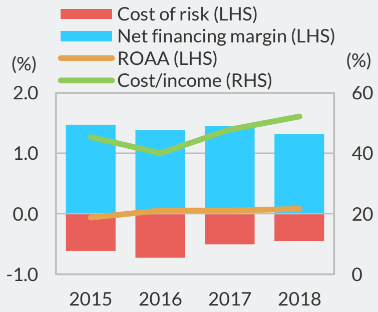
(%)	2015	2016	2017	2018
Short-term debt/total funding	60.1	58.6	57.5	66.0
Unsecured debt/total debt	71.1	67.9	64.9	66.0
Parental funding/total funding	70.3	67.2	64.1	65.3

Source: Fitch Ratings, UCI

Santander and BNPP have extensive records of providing funding support to UCI, when needed, by maintaining large open credit lines for UCI since the latter's establishment. The maturities of the lines were extended during periods of RMBS market stress.

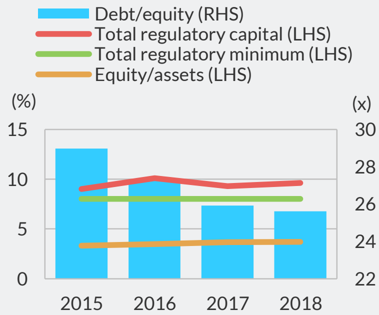
In 2015, UCI began to reissue RMBS (Prado I to Prado VI), through which it funds most of its new mortgage origination. UCI's funding profile improved in 2019 with a new EUR300 million REPO line with a third-party bank.

Profitability & Efficiency



Source: Fitch Ratings, UCI S.A.

Capitalisation & Leverage



Source: Fitch Ratings, UCI S.A.

Consolidated Income Statement

(EURm)	2015	2016	2017	2018
Revenue				
Interest income	265	233	232	219
Other income	18	66	22	30
Total revenue	**284**	**299**	**253**	**248**
Expenses				
Interest expense	101	83	76	78
SG&A expenses	83	86	85	89
Impairment charges	71	82	56	50
Other expenses	38	41	32	22
Total expenses	**293**	**292**	**248**	**238**
Pre-tax income	**-9**	**7**	**5**	**10**
Income tax	-2	0	-1	1
Net income	**-8**	**6**	**6**	**9**
Memo: Common dividends relating to the period	0	0	0	0

Source: Fitch Ratings, UCI S.A.

Consolidated Balance Sheet

(EURm)	2015	2016	2017	2018
Assets				
Cash & equivalents	0	0	0	0
Residential mortgage loans	11,319	10,978	10,887	10,783
Other mortgage loans	106	126	149	127
Gross loans	**11,425**	**11,104**	**11,036**	**10,910**
Memo: Impaired loans included above	1,634	1,443	1,539	1,388
Less: Loan-loss allowances	396	376	356	316
Net loans	**11,029**	**10,728**	**10,681**	**10,595**
Foreclosed assets	426	398	367	336
Fixed assets	72	97	105	120
Deferred tax assets	69	72	69	74
Intangibles	1	1	1	1
Other assets	455	455	468	388
Total assets	**12,051**	**11,751**	**11,690**	**11,514**
Liabilities				
Short-term debt	6,971	6,614	6,450	6,557
Long-term debt	4,554	4,597	4,684	4,386
Subordinated debt	80	80	80	80
Total borrowings	**11,605**	**11,291**	**11,215**	**11,024**
Other liabilities	48	50	45	63
Total liabilities	**11,653**	**11,341**	**11,260**	**11,087**
Total equity	**398**	**410**	**430**	**427**
Total liabilities and equity	**12,051**	**11,751**	**11,690**	**11,514**

Source: Fitch Ratings, UCI S.A.

Summary Analytics

	2015	2016	2017	2018
Asset-quality metrics (%)				
Impaired loans/gross loans (%)	14.3	13.0	13.9	12.7
Impaired loans generation (%)	-1.7	-0.8	1.6	-0.6
Loan-loss allowances/impaired loans (%)	24.2	26.0	23.1	22.7
Impaired loans less loss allowances/tangible equity (%)	376.7	316.4	328.6	304.3
Loan impairment charges/average gross loans (%)	0.6	0.7	0.5	0.5
Growth of gross receivables (%)	-2.8	-2.8	-0.6	-1.1
Earnings and profitability metrics (%)				
Pre-tax income/average assets (%)	-0.1	0.1	0.0	0.1
Pre-tax income/average equity (%)	-2.3	1.6	1.2	2.3
Net income/average assets (%)	-0.1	0.1	0.1	0.1
Net income/average equity (%)	-1.9	1.6	1.5	2.1
Operating expenses/operating revenues (%)	45.3	40.0	47.9	52.1
Impairment charges/pre-impairment op. profit (%)	71.3	63.1	60.3	61.2
Interest income/average net loans (%)	2.4	2.1	2.2	2.1
Interest expense/average debt (%)	0.9	0.7	0.7	0.7
Net interest income/average net loans (NIM) (%)	1.5	1.4	1.5	1.3
Risk adjusted NIM (%)	0.8	0.6	0.9	0.9
Capitalization and leverage metrics (%)				
Debt/tangible equity (x)	35.1	33.2	30.9	31.0
Debt/equity (x)	29.0	27.3	25.9	25.6
Tangible equity/tangible assets (%)	2.7	2.9	3.1	3.1
Equity/total assets (%)	3.3	3.5	3.7	3.7
Internal capital generation (%)	-0.2	3.1	4.7	-0.5
Dividend payout ratio (%)	0.0	0.0	0.0	0.0
Funding and liquidity metrics (%)				
Unsecured debt/total debt (%)	71.1	67.9	64.9	66.0
Short-term debt/total debt (%)	60.1	58.6	57.5	59.5

Source: Fitch Ratings, UCI S.A.

The ratings above were solicited and assigned or maintained at the request of the rated entity/issuer or a related third party. Any exceptions follow below.