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'Unsellable' Real Estate Assets Threaten Survival of Smaller Spanish Banks

By Sharon Smyth - Nov 18, 2011

Spanish banks, under pressure to cut property-backed debt, hold about 30 billion euros ($41 billion) of real estate that's "unsellable," according to a risk adviser to Banco Santander SA (SAN) and five other lenders.

"I'm really worried about the small- and medium-sized banks whose business is 100 percent in Spain and based on real-estate growth," Pablo Cantos, managing partner of Madrid-basedMaC Group, said in an interview. "I foresee Spain will be left with just four large banks."

Spanish lenders hold 308 billion euros of real estate loans, about half of which are "troubled," according to the Bank of Spain. The central bank tightened rules last year to force lenders to aside more reserves against property taken onto their books in exchange for unpaid debts, pressing them to sell assets rather than wait for the market to recover from a four-year decline.

Land "in the middle of nowhere" and unfinished residential units will take as long as 40 years to sell, Cantos said. Only bigger banks such as Santander, Banco Bilbao Vizcaya Argentaria SA (BBVA), La Caixa and Bankia SA are strong enough to survive their real-estate losses, he said. MaC Group is an adviser on company strategy focused on financial services.

The banks will face increased pressure if Mariano Rajoybecomes prime minister as expected after national elections on Nov. 20. The People's Party leader has said the "clean-up and restructuring" of the banking system is his top priority as he seeks to fuel economic recovery by boosting the credit supply.

More Consolidation

"Naturally, there is going to be a new wave of consolidation," said Luis de Guindos, director of the PricewaterhouseCoopers and IE Business School Center for Finance and named by newspapers as a contender for finance minister in a Rajoy government. "Stricter provisioning rules for land need to be implemented. Many banks will be able to deal with it, but others won't."

Land in some parts of Spain is literally worthless, said Fernando Rodriguez de Acuna Martinez, a consultant at Madrid-based adviser R.R. de Acuna & Asociados. More than a third of Spain's land stock is in urban developments far from city centers. About 43 percent of unsold new homes are in these areas, known as ex-urbs, while 36 percent are in coastal locations built up during the real-estate boom.

"If you take into account population growth for these areas, there's no demand for them, not now or in ten years," he said. "Around 35 percent of Spain's land stock is in the ex-urbs, which means it's actually worth nothing."

Prices Fall

Spanish home prices have fallen 28 percent on average from their peak in April 2007, according to a Nov. 2 report byFotocasa.es, a real-estate website, and the IESE business school. Land prices dropped by more than 60 percent in the provinces of Lugo, A Coruna and Murcia, and 74 percent in Burgos since the peak in 2006, data from the Ministry of Development and Public Works showed. Land values fell 33 percent nationwide.

"If there were to be a proper mark to market of real estate assets, every Spanish domestic bank would need additional capital," said Daragh Quinn, an analyst at Nomura Holdings Inc. in Madrid, in a telephone interview.

Santander has 9.2 billion euros of foreclosed assets, followed by Banco Popular SA with 6.05 billion euros, BBVA with 5.87 billion euros, Bankia with 5.85 billion euros, Banco Sabadell SA with 3.6 billion euros and Banco Espanol de Credito SA (BTO) with 3.36 billion euros, according to an analysis by Exane BNP Paribas.

Disappearing Banks

Dozens of Spanish banks have failed or been absorbed since the economic crisis ended a debt-fueled property boom in 2008. Spain's bank-bailout fund took over three lenders on Sept. 30, valuing them at zero to 12 percent of book value. Bank of Spain Governor Miguel Angel Fernandez Ordonez said the overhaul of the industry was complete after 45 savings banks merged into 15 and lenders increased capital levels.

Three Banco Pastor SA shareholders with about 52 percent of the stock accepted a takeover bid from Banco Popular Espanol SA (POP)on Oct. 10 as part of the industry's consolidation. Banco Pastor's shares gained 21 percent.

The cost to the public of cleaning up the industry's books has so far been 17.7 billion euros in the form of share purchases from the government bailout funds known as the FROB.

Banks have made provisions for a potential 105 billion euros of writedowns since the market crashed. Lenders may need to make another 60 billion euros in provisions to clean up their balance sheets, including real-estate debt, according to Rafael Domenech, chief economist for developed nations at BBVA.

'Lowest-Quality Assets'

"Since the crisis began, banks have only put their lowest-quality assets on sale while they waited for a recovery, so as not to sell the better properties at a loss," said Fernando Encinar, co-founder of Idealista.com, Spain's largest property website. Idealista currently advertises 45,912 bank-owned homes in Spain, up from 29,334 in November 2010. In 2008 it didn't list any.

Spain is struggling to digest the glut of excess homes in a stalling economy where joblessness is among the highest inEurope. Unemployment has almost tripled to 22.6 percent from a low of 7.9 percent in May 2009, according to Eurostat.

Property transactions fell 28 percent in September from a year earlier, the seventh consecutive month of decline, according to the National Statistics Institute.

Financial institutions have foreclosed on 200,000 homes and that will balloon to as many as 600,000 in coming years as unemployment continues to rise, according to a report by Taurus Iberica Asset Management, a Spanish mortgage servicer which manages 35,000 foreclosed properties for 25 lenders.

1 Million Homes

"Spain has 1 million new homes that won't be completely absorbed by the market until the middle of 2017," Fernando Acuna Ruiz, managing partner of Taurus Iberica, said in an interview in Madrid. "Prices will fall a further 15 to 20 percent in the next two to three years."

About 13 percent of Spain's 25.8 million homes are vacant, according to LDC Group, an Alicante-based specialist in real-estate management. The hardest-hit areas are Madrid, with 337,212 empty properties, and Barcelona with 338,645, LDC said in a report published yesterday.

Lack of financing and concern about economic growth has choked investment in Spanish commercial real estate, currently at its lowest level in a decade, according to data compiled by U.K. property broker Savills Plc. (SVS)

A total of 1.25 billion euros of offices, shopping malls, hotels and warehouses changed hands in the first nine months, 52 percent less than a year earlier, Savills estimated.

'Enormous' Price Gap

There is an "enormous" gap between prices offered by banks and what investors are willing to pay, preventing sales of large property portfolios, MaC Group's Cantos said.

He proposes that banks create businesses, in which they can hold a maximum stake of 19 percent, that attract other investors to help dispose of their real estate assets over five to eight years. The investors would manage the businesses.

Cantos says that prime assets can be sold at a 30 percent discount, while portfolios comprised of land, residential and commercial real estate may only sell after 70 percent discounts.

"Therein lies the problem," he said. "Banks have already provisioned for a 30 percent loss, but if you are selling at 70 percent discount, you have to take another 40 percent loss. Which small and medium size banks can take such a hit?"

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