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Spain’s Bad Bank Profit Pledge Seen Hindered by Housing

By Sharon Smyth - Dec 10, 2012

Spain’s pledge to generate profit from its bad bank will be undermined by two more years of property-price declines and the cost of maintaining the repossessed homes it will own, according to real estate and finance professor Jose Luis Suarez.

The bank, known as Sareb, was created to purge toxic assets from the books of troubled Spanish lenders. Most of it will be linked to residential property and development land in Spain that will continue a price decline that started when the country’s housing bubble burst in 2007, said Suarez of the IESE business school in Madrid.

Sareb’s profit prospects matter to Spain because the country is trying get outside investors to take a stake of at least 51 percent in the institution. The 60 billion-euro ($78 billion) fund will generate an annual return on equity of 14 percent to 15 percent, Fernando Restoy, head of the state rescue fund that will own the rest of Sareb, said on Oct. 29. He called his estimate “conservative.”

“Sareb is going to be very different to every other bad bank in terms of assets, which are going to be mostly high risk residential,” Suarez said. That will saddle the bank with maintenance expenses for the properties it owns along with the costs of debt backing the properties, he said.

A spokesman for Sareb, when asked about the bank’s earnings prospects, cited Restoy’s comments on Oct. 29. He declined to make any further comments.

Discounted Assets

The bad bank, created as a condition of a European bailout of as much as 100 billion euros for Spain’s banking industry, will have 90,000 homes within about two years, Sareb General Director Antonio Carrascosa said on Nov. 27. The Bankia group alone will transfer 38 billion euros in real estate loans and 12 billion euros of foreclosed assets by gross value to the bad bank, he said.

Sareb will buy foreclosed assets at an average discount of 63 percent to book value. That includes reductions of as much as 80 percent for foreclosed land, 63 percent for foreclosed unfinished housing developments and 32 percent for loans to finance finished apartments, according to the state rescue fund known as FROB.

“They are discounts to book values, but that doesn’t tell us much as we don’t know what the book values are to start with,” said Vanesa Gelado, director of Drago Capital, a Madrid-based real estate fund.

Irish Loans

Ireland’s National Asset Management Agency, which has a similar mandate to Sareb’s, took on 31.8 billion euros of loans backing real estate after they were discounted by an average of 57 percent.

While most of Sareb's assets will be in Spain and linked to residential property, about a third of the real estate backing NAMA's loans is in Britain. In addition, 44 percent of NAMA's assets relate to office, retail and other types of properties, according to its website.

"We can't see Sareb making a profit in any shape or form," said Fernando Rodriguez de Acuna Martinez, a partner at Madrid-based real estate consulting firm Acuna & Asociados. "If you look at the foreclosed assets it's going to take on, you'll see around 40 percent of that is land which is unsellable."

Worthless Land

Spain has enough land approved for development to build 4 million homes and an existing supply of residences that would take about 10 years to sell, Acuna said. That makes some of the development land worthless, he said.

The country needs outside investors to hold a majority of Sareb to keep the bank's debt from being recorded as part of the government's deficit, tied for the second-highest in Europe. The bank will have initial equity of about 3.9 billion euros.

Banco Santander SA (SAN), Spain's biggest lender, plans to put up 650 million euros, El Pais reported Dec. 6. Other Spanish banks taking part include La Caixa and Banco de Sabadell SA (SAB), the newspaper said. Banco Bilbao Vizcaya Argentaria SA (BBVA), the No. 2 lender, won't invest in Sareb, Expansion reported this month.

"I'm not surprised Sareb hasn't been able to attract foreign investors, and Spanish banks will only invest with a gun pointed at their heads," Suarez said.

Axa SA (CS), Europe's biggest insurer, is in talks with the Spanish government about investing in the bank, Expansion reported on Dec. 7, citing an interview with Chief Executive Officer Henri de Castries.

'Fragile' Structure

The bank's structure is "fragile," with only about 8 percent equity and rest state-guaranteed debt, he said. Suarez's IESE was rated sixth out of 80 peers in the Financial Times European Business Schools 2012 ranking.

Spain has 700,000 unsold homes, according to the Ministry of Public Works. Acuna & Asociados puts the overhang, which includes incomplete units, foreclosures and unsold homes, at 2 million units.

"Even 700,000 unsold is an enormous amount," Suarez said."It depends where the stock is, but there are very few areas where in the coming years you are going to need to build homes."

Residential prices fell 14.4 percent in the three months to June from a year earlier, the most since the measurement began in 2008, according to Spain's National Statistics Institute.

Prices more than doubled in the decade through 2007 before starting to slide in the second quarter of 2008, data from the Public Works ministry show. Tasaciones Inmobiliarias, Spain's largest home appraiser, estimates that prices dropped 33.2 percent since a December 2007 peak.

Fewer Mortgages

Home sales by volume for the second quarter were 68 percent below their 2006 peak, according to data from the Ministry of Public Works. Spanish banks granted 21,195 new mortgages in September, an 83 percent drop from the high reached in 2007, Bank of Spain data show.

Even after the slump, home values are equal to six years of a family's gross income compared with four years in the U.K. and U.S., Suarez said. Barring a severe shock to the market, prices will decline to the long-term average for affordability by 2016, Deutsche Bank analysts including Thomas Mayer said in a July report. Prices need to fall another 25 percent to reach their fair value, the bank estimated.

A declining population will put further pressure on values. The number of people in Spain will fall in 2013 for the first time since 1981 as unemployed immigrants return home and Spaniards search for work abroad, according to a study published by the statistics institute in November. The total will drop to 41.5 million in 2052 from 46.5 million now, it concluded.

Foreigners with residency status in Spain purchased 9,502 housing units in the second quarter, down from a 30,000 at the 2006 peak, according to the Public Works Ministry.

Sareb itself could weigh on prices in the future as its property sales affect housing supply and benchmark values, theInternational Monetary Fund said in a November report.

"It will be the biggest real estate company in the history of Spain, possibly the world, so whatever it does is going to have a large impact on the market," Suarez said.

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