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Goldman Seeing Bullish Signs in Spain RMBS: Mortgages

By Esteban Duarte - Jan 25, 2013

[Goldman Sachs Group Inc. \(GS\)](#) traders are telling investors [Spain](#)'s housing market is improving, even as [unemployment](#) is at a record 26 percent and 2 million homes linger unsold after a decade-long building boom crashed.

A Goldman Sachs trading desk is recommending Spanish residential mortgage securities that are priced cheaper than other assets linked to the country and may be attractive to comparable European bonds, according to a presentation seen by [Bloomberg News](#). While official statistics are lagging behind, homes are selling in regions with the most inventory and housing starts are dropping, the bank said.

Spain is mired in its second recession in three years and Prime Minister [Mariano Rajoy](#) is imposing the deepest budget cuts in the country's democratic history to avoid an international bailout. While that's restored some investor [confidence](#), the number of jobless is near 6 million and home prices that more than doubled in the decade through 2007 before turning negative in the first quarter of 2008 have fallen by about 26 percent.

"We have significant concerns over the increasing unemployment levels in Spain, particularly in a falling housing market," said Dipesh Mehta, a London-based securitization analyst at Barclays Plc, without referring to the Goldman Sachs report. "On both counts we do not expect the situation to improve anytime soon."

About 40,000 homes have been foreclosed on in Spain since the collapse of the market five years ago. Overbuilding created ghost towns of unoccupied homes around the country, and the Ministry of Public Works estimated last year there were 700,000 unsold homes. With unfinished units and foreclosures, the total stands at 2 million, according to Madrid-based real estate consulting firm Acuna & Asociados.

No Credit

"On the asset side there will be further depreciation," said Angel Mas, president of European [mortgage insurance](#) at [Genworth Financial Inc. \(GNW\)](#) "We are nowhere near the end of this, because there's no credit in the market. Until there is some credit available, we won't see the true value of the assets, because there aren't enough transactions."

The Goldman Sachs presentation was created by a European sales and trading desk to be distributed to clients and may differ from the bank's research. Sophie Bullock, a spokeswoman for the New York-based bank, which turned bullish last year on U.S. housing amid the nascent recovery, declined to comment.

Potential Upside

Investors should buy in the 159 billion euros (\$213 billion) Spanish RMBS market as the debt offers potential upside should the economy recover, according to the Goldman Sachs presentation.

The debt has been left behind in a rally that has narrowed spreads on everything from Irish mortgage bonds to U.K. subprime home-loan securities, Goldman Sachs said.

Investor confidence has jumped since European Central Bank President [Mario Draghi](#) pledged in July to do “whatever it takes” to protect the euro and the prospect of a Greek exit from the 17-nation common currency has faded. Spain sold 7 billion euros of 10-year bonds this week, data compiled by Bloomberg show. Yields on the country’s January 2023 securities fell 10 basis points today as of 8:03 a.m. in [New York](#) to 5.13 percent, after the ECB said banks will next week repay more of its emergency three-year loans than economists forecast in another sign the region’s debt crisis is abating.

RMBS securities are attractive compared to pools of covered bonds secured by Spanish home loans, known as multi-cedulas, which have drawn buyers including Pacific Investment Management Co. and BlackRock Inc.

Covered bonds differ from asset-backed securities because the originator guarantees the bonds, on top of the real-estate collateral. That backing means some of them have returned more than 40 percent since June when Spain requested a 100 billion-euro rescue for its financial sector from the European Union.

Comparable Spreads

A pool of home loans originated by [Banco Santander SA \(SAN\)](#), the nation’s largest lender, trades at about a 3.5 percentage point spread, compared with 2.1 percentage points for covered bonds issued by the country’s largest banks, the presentation said.

Still, that’s not enough for some investors.

“There is too much inventory on bank balance sheets to come out yet,” said Henry Cooke, the London-based head of Europe ABS at [Threadneedle Asset Management Ltd.](#) “The RMBS are better than covered bonds, but the lack of information makes me cautious.”

Goldman Sachs highlighted seven Spanish real-estate indexes that show real-estate prices have dropped between 11 percent to as much as 35 percent since the peak.

The average price of houses and apartments declined 15.2 percent from a year earlier, the most since the measure began in 2008, the National Statistics Institute in [Madrid](#) said last month.

Reposessed Homes

Prices of reposessed Spanish homes sold by lenders last year tumbled 65 percent compared with the value of the property when the loans were made, Fitch Rating analysts said in a Dec. 12 report. That compares with an average 50 percent decline since 2007, the Fitch report said.

“Fitch believes that the factors weighing on the Spanish residential [property market](#) will continue to deteriorate,” Madrid-based analysts Carlos Masip and Juan David Garcia wrote in the report. “The gap

between original valuation and the sale price is a reflection of a distressed mortgage market, characterized by high borrower indebtedness, constrained affordability” and “falling property prices,” they wrote.

The Spanish government is setting up a so-called bad bank called Sareb to take toxic assets off the books of Spanish lenders. That’s “in fact provided some avenues for the right [home prices](#) to be recognized in the books,” said Genworth’s Mas.

Housing Moving

The government, wary of the easy credit that fueled the [country’s boom](#), has done little to encourage the lending that’s needed to get the housing market moving again, said Mas.

“I still believe the biggest mistake the Spanish government is making is trying to drive looking at the rear-view mirror,” he said. “The only way to get out is to somehow reactivate the credit market.”

Investors demand 360 basis points, or 3.6 percentage points, above the interbank borrowing rates to buy senior Spanish mortgage-backed securities, according to [JPMorgan Chase & Co. \(JPM\)](#) data. That’s the lowest extra yield above benchmark rates since June 2011, and compares with 400 basis points for a bond backed by Irish home loans, 450 basis points on a Portuguese comparable security and 1,400 basis points on senior bonds backed by Greek residential mortgages.

Spreads Tightening

Spreads on Spanish mortgage-backed bonds are tightening even with residential mortgages arrears at 3.5 percent at the end of September 2012, the highest since at least 2006 when delinquencies were close to zero, according to Spanish Mortgage Association data.

Investors could add Spanish real estate bonds ranging from those backed by prime borrowers to subprime such as class A notes issued by UCI 14, a transaction set up by Union de Creditos Inmobiliarios SA, a lender jointly controlled by BNP Paribas SA and [Banco Santander](#), the Goldman Sachs presentation said.

With RMBS, it depends on the price of the assets,” Mas said. “If you are just talking about how the RMBS is trading, there may be some at a big enough discount to recover.”

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