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Spanish Banks Cut Developers as Zombies Dying: Mortgages

By Sharon Smyth and Rob Urban - Mar 20, 2013

Spain's zombie developers are finally about to die.

Spanish banks are pulling the plug on thousands of builders kept alive during the past five years even as they built almost nothing, said Mikel Echavarren, chief executive officer of Irea, a Madrid-based consulting firm that has advised on 22 billion euros ($28.5 billion) of refinancing. The banks, forced by the government last year to set aside provisions for the developers, have no incentive to keep funding them.

"Banks have taken the hit, so extend and pretend is over," said Echavarren. "There's no motivation to refinance companies that aren't viable, have no liquidity or possibility of future earnings so we'll see a tsunami of developer bankruptcies in the next two years."

The final collapse of an industry that accounted for as much as 18 percent of Spain's growth amid the country's decade- long real estate boom will add to unemployment, already at a record 26 percent, depress consumer spending needed to turn around the economy and push down the value of residential real estate that's already dropped more than 30 percent since 2007, said Raj Badiani, an economist at IHS Global Insight in London.

While job losses in the construction industry continued in recent quarters, "they've been less severe than expected, given the scale of the real estate slump," said Badiani. "With banks cutting financial life support to many developers living on borrowed time, we can expect an accelerated downward adjustment in employment levels." Badiani estimates the jobless rate could climb to more than 27 percent this year and house prices will fall at least 50 percent from the peak by 2015.

Zombie Developers

More than half of the country's 67,000 developers can be categorized as "zombies," with liabilities that exceed their assets and only enough income to repay the interest on their loans, according to R.R. de Acuna & Asociados, a real-estate consulting firm.

Reyal Urbis sought protection from creditors last month in the second-largest filing of its type ever in Spain after accumulating 3.6 billion euros of debt. Banks including Banco Santander SA and Banco Bilbao Vizcaya Argentaria SA (BBVA) lost interest in refinancing the company, which employs 420 people and had losses of 910 million euros, in 2012.

Renta Corporacion SA sought creditor protection yesterday and will work with Sareb, the Spanish bad bank, following the decision. The Barcelona-based developer had net debt of about 160 million euros at the end of last year.

No Incentive

Spanish lenders, ordered last year to set aside provisions of 84 billion euros to cover anticipated real estate losses, have no incentive to keep unviable builders afloat after they've accounted for losses from 280 billion euros of their loans, according to Irea.

Only developers with sufficient rental income from commercial property to repay debt or those still building homes in areas where they can be sold at a profit will survive, said Echavarren, who estimates that between 5 percent and 10 percent of Spanish developers fall into those categories.

Since 2008, more than 19,000 real estate and construction companies, or 14 percent of the total, have gone out of business, according to Iberinform, a unit of credit insurer Credito y Caucion.

Inmobiliaria Colonial SA (COL), Spain's second-largest publicly traded developer, is about to start talks to review the terms of 3 billion euros of loans maturing next year, Spanish newspaper Expansion reported. Realia Business SA (RLIA), the third-largest, has until March 27 to complete restructuring negotiations for 847 million euros of debt related to its residential real estate business.

Most Solid

Realia, which had rental income of 173 million euros in 2012 from its commercial real-estate assets in France and Spain, is the most "solid" of all the publicly traded real estate companies in Spain, according to Juan Jose Fernandez Figares, chief analyst at Link Securities in Madrid.

The company fell 0.6 percent to 81 cents at 3:06 p.m. in Madrid, down from 5.31 euros about five years ago.

Spokespeople for Colonial and Realia declined to comment on the debt talks when contacted by Bloomberg News.

Spain built 675,000 homes a year from 1997 to 2006, according to a report by a unit of Spanish savings bank Cajamar. That's more than France, Germany and the U.K. combined. The frenzy resulted in a surplus of about 2 million empty homes that will take between seven and 13 years to absorb, according to Madrid-based property research firm R.R. de Acuna & Asociados.

The Development Ministry estimates there are around 700,000 new unsold homes in Spain and more than half of those are in coastal areas. The total number of empty homes in Spain is 3 million, according to a spokeswoman for the government who asked not to be identified by name.

Land Demand

At the peak of the real estate boom, Spain started work on 800,000 homes, and developers bought up enough land to develop five to 10 years of stock, according to Echavarren.

"Considering the range, there could be enough land for a maximum of 8 million homes and a minimum of 4 million," Echavarren said, "Real demand is about 125,000 units per annum, so there's a land bank to last for at least the next 30 years."

A study published in November by the National Statistics Institute estimates Spain's population will fall this year for the first time since 1981 as unemployed immigrants return home and Spaniards in search of work emigrate. The population will drop to 41.5 million in 2052 from 46.2 million now, according to the study.

Gross domestic product in Spain, the euro region's fourth- largest economy, fell 0.8 percent in the fourth quarter from the previous three months, more than the 0.7 percent drop estimated on Jan. 30, the Madrid-based National Statistics Institute said on Feb. 28. It had declined 0.3 percent in the third quarter.

Recession Extending

The recession is extending into the first quarter amid weak domestic demand, the Bank of Spain said Feb. 28 and the International Monetary Fund expects the economy to shrink about 1.5 percent this year, triple the contraction projected by Prime Minister Mariano Rajoy, who says the economy will return to growth in the second half.

"Mortgage lending and demand for homes will never recover to the highs we saw," said Juan Villen, head of mortgages for Idealista.com, Spain's largest property website. "A few years ago an influx of immigrants and buoyant employment among Spaniards fuelled home sales, now everyone is leaving Spain and those left are unemployed or scared that they might become so."

In the third quarter, home sales were down 71 percent from the peak in the second quarter of 2006, according to data from the Ministry of Public Works. Spanish banks granted 274,700 new mortgages in 2012, a drop of 80 percent from 2006, data from the National Statistics Institute shows.

Justify Rescue

Carles Vergara, a Barcelona-based professor of Financial Management at the IESE Business School, says banks can no longer justify rescuing real estate companies.

"If it had been done in 2008 or 2009 it would have been more aggressive, but the banks have being doing it little by little," he said in a telephone interview. "You cannot bail out developers that took on too much risk. At the end of the day they have to pay the price."

In the second quarter of 2009, lenders had 324.7 billion euros of developer loans on their books, Bank of Spain data shows. Around 150 billion euros of that has been transferred to banks, according to Echavarren who says the rest, which has been adequately provisioned for, will pass into the banking system over the next two years as lenders refuse to refinance. According to the latest available data from the regulator, banks had 280.2 billion euros of outstanding developer loans as of the end of September 2012.

Accelerate Declines

Echavarren says the result will be an acceleration of the decline in home prices. Prices posted their biggest annual decline on record in the third quarter, falling 15.2 percent, the most since the measurement began in 2008, the National Statistics Institute in Madrid said Dec. 14. Prices have declined 36 percent from their April 2007 peak, according to real estate website Fotocasa.es and the IESE business school.

"Prices will drop in some places until who knows where," Echavarren said. "When a bank manages real estate, they market homes by cutting prices and using financing agreements to sell." Developers can't compete with banks because they are limited to how far they can reduce the price of their properties, which are backed by debt and cannot offer vendor financing, he added.

Badiani says home prices will fall by at least 50 percent from peak to trough in late 2015 or early 2016. "The risks are still tilting to the downside, and banks engaging in panic property sales could push the final downward house price adjustment closer to 60 percent."

Wider Implications

Alberto Gallo, an analyst at Royal Bank of Scotland Group Plc in London, said a further decline in home prices will have wider implications as more households will slip into negative equity and feel poorer, dragging consumption down further.

Household spending fell by 1.9 percent in 2012, almost double the rate of the previous year, according to the Bank of Spain. It may drop as much as 3 percent this year, according to Madrid-based consultancy firm Analistas Financieros Internacionales.

As for banks, taking yet more real estate onto their books will be "more a management problem than a provisioning problem," Echavarren said, "Spanish banks are in good shape now when it comes to real estate write offs."

More Writedowns

The ruling PP Party, which took over in December 2011, passed a decree in February 2012 requiring banks to speed up recognition of losses on real estate by boosting provisions set aside for land to 80 percent from 31 percent and for unfinished developments to 65 percent from 27 percent. A second decree in May forced lenders to set aside more money for real estate loans classed as healthy.

Banks may still need further write downs because of ailing developers, according to Fernando Rodriguez de Acuna Martinez, a partner at Acuna & Asociados.

"Banks had been kicking the can, but now they can absorb losses in a staggered and manageable manner. But if there's no market for land, for example, and believe me there isn't, you need to provision it at 100 percent," he said. "It's true part of the losses have been provisioned for already, but lenders will have to set aside more in the future."

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