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Sareb, Europe's largest property fund manager starts liquidation process

BARCELONA – Since a group of nine Spanish nationalised and semi-nationalised savings banks transferred €50 billion worth of real estate assets to Sareb, the Spanish bad bank is now the largest private fund manager in Europe. The assets are mainly residential properties and development loans which during a 15-year lifespan will be liquidated. An improvement in the macroeconomic conditions is essential to obtain the expected annual 13 percent return for Sareb's shareholders. Eurostate reports in this article on structure and the potential impact of Sareb on the Spanish real estate market.

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€50 billion of assets equates to nearly the total combined value of Nama and Unibail-Rodamco, Europe's second and third largest real estate investors. Sareb was created as a condition of the €100 billion bailout plan agreed with EU lenders in June 2012. The Spanish Government is a minority shareholder with 45%. The remaining capital is contributed by 28 different private institutions, such as Spanish 'good banks', insurance companies and international companies like Axa, Deutsche Bank and Barclays. "As Sareb has been structured as a private company, the debt structure doesn't affect the Spanish bond market", argues Minister for Economic Affairs, Luis de Guindos.

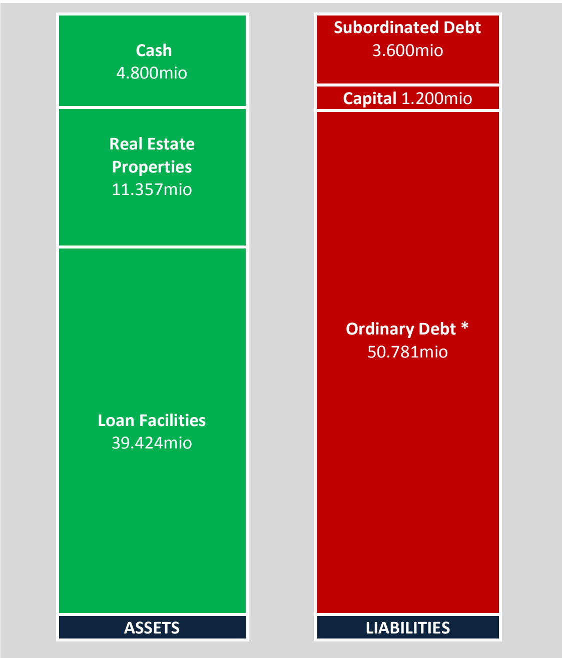

***Figure 1** – Sareb's capital structure (source: Sareb, 21/03/13)*
** Guaranteed by the Spanish State*

Transfer

At the end of 2012 the Spanish Ministry for Economic Affairs published the final criteria for the transfer of real estate assets and development loans from nine nationalised banks to Sareb. Banks from group 1 and group 2 (see figure below) were obliged to transfer all direct assets above 100.000€ and development loans above 250.000€.

Group 1 (nationalised banks)	Book value Assets (€ mln)	Number of Assets
1. BANKIA	22.153	89.814
2. CAIXA CATALUNYA	6.617	29.425
3. NOVA CAIXA GALICIA	5.064	17.887
4. BANCO DE VALENCIA	1.923	6.723
5. BANCO GALLEGO	606	1.276
Group 2 (semi-nationalised banks)		
6. BMN	5.817	16.138
7. CEISS	3.140	18.115
8. LIBERBANK	2.917	14.120
9. CAJA3	2.212	3.976
TOTAL	**50.449**	**197.474**

***Figure 2** – Assets transferred to Sareb (source: Sareb, 21/03/13)*

In total 200.000 assets were transferred at an average discount of 80% on land, 63% on unfinished properties, 54% on finished projects and 46% on real estate development loans. All juridical documents and appraisal reports are currently being prepared by 14 different consultants, coordinated by Clifford Chance and CB Richard Ellis. As the Spanish economy continues unstable and residential prices seem not to have reached their bottom yet, a realistic price settlement is one of the difficulties and outstanding risks for Sareb. Also Fitch remains sceptic and argues that it will be an enormous challenge for Sareb to prove its success.

Average transfer discounts
Development land: -80%
Unfinished projects: -63%
Finished properties: -54%
Development loans: -46%

Sale strategy

Contrary to the name bad bank would suggest, Sareb doesn't dispose of any licenses to operate on the financial markets and therefore won't provide home mortgages to potential buyers. Instead, Sareb will instruct the nationalised banks with sales mandates that include a 3.5% fee commission over sales and additionally 30% of the overvalue if a property is sold above its book value. If a bank provides a property mortgage it will get a fee commission of 0.75 to 2.25%. Besides these variable fees, the participating banks will receive an annual asset management fee of 0.15%. Through these commercial agreements, the real estate divisions owned by the nationalised banks will generate an additional cash flow of nearly €400 to €500 million annual. Several of these real estate divisions are currently being sold to take advantage of the strong potential of these lucrative mandates.

Liquidation

By ensuring that the sale of the assets is spread over a 15-year period, it should mean that the remaining property market in Spain will be unaffected. According to Sareb's President, Belén Romana, the total portfolio that will be put on the market represents only 4% of the market share and won't affect the overall Spanish real estate market. Chairman at Banc Sabadell, Josep Oliu, confirms that there is absolutely no reason to think that Sareb will distract the property market. "Sareb took over the assets from the nationalised banks based on pre-settled discounts. This is the minimum value. All the future transactions will be higher, achieving the necessary profit for Sareb", according to Oliu. However, between 60% and 65% of the foreclosed properties and development loans actually relates to undeveloped land and half-built projects that have already proven near impossible to sell. Proactive management and additional capital will be necessary in order to create a liquidation strategy.

Land portfolio

Sareb's land portfolio is equal to a book value of €15.8 billion, which represents 30% of the total portfolio. The main part of the land portfolio will be sold towards the end of Sareb's 15-year lifespan. Investing in development projects means spending money without any guarantee of selling or finding tenants. Due to the ongoing recession and the already excessive surplus of new built properties during the boom years, very few investors are willing to finance new construction projects. In addition, in order to stimulate the sale of land and properties there are a couple of issues that should change, such as the oversupply of new built houses, structural high unemployment rates and the sharp decline of purchasing power of Spanish families. Moreover, population growth is essential for land development and the creation of more new built houses. According to the National Institute for Statistics, the Spanish population is forecast to shrink 5% by 2027, the end of Sareb's 15-year lifespan.

Land portfolio represents 30% of total transfer

Geographical area

All foreclosed properties and the underlying securities of the development loans are situated across Spain, meanwhile international properties were excluded from the transfer. More than 50% of the portfolio is situated in coastal regions of the Mediterranean (see figure below). The current oversupply of permanent and second homes in these regions is the largest in Spain and will convert the sale process into an enormous challenge for Sareb. "As soon as quality disappears, large discounts are the only solution. In these circumstances, prices are often situated far below the average sale prices that Sareb applies", according to a local agent.

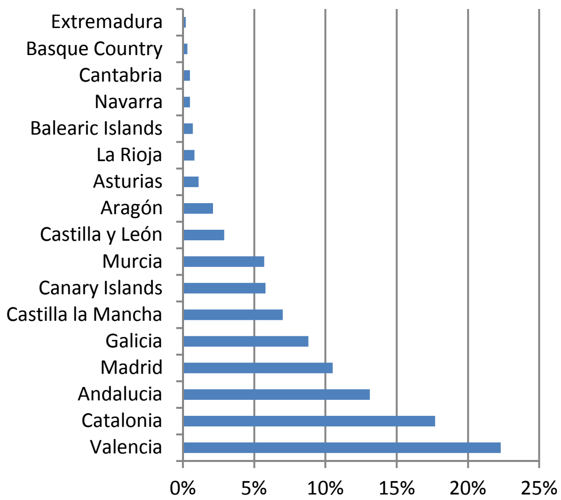

***Figure 3** – Sareb's Geographic area (source: AFI, FROB, MFOM, from Idealista, 21/01/13)*

Conclusions

There are still many doubts about Sareb's sale strategy and whether the transfer-discounts are sufficient to carry the additional costs and sale risks to protect the downside. Before its creation, it was suggested that some of the properties could be transferred into social rents to absorb property owners being evicted from their homes. Trapped in expected shareholders returns, there is little margin to move in this direction. For now, the likes of Bankia are instructed to sell the assets they just transferred to Sareb themselves. Seen as being one of the main contributing parties, responsible for the dramatic situation in the Spanish property market, these banks are now being served with lucrative sale mandates and fixed management fees. Also a high degree of conflict of interests has not led to positive reactions from IMF. Simultaneously, Sareb is a lender, a profit making organisation and a competitor on the property market. Sareb's strategic plan to provide access to Spanish banks, just when these banks are Sareb's most prominent competitors, has raised a lot of suspicion. In fact, the decision could be more tactical than appears to protect the 'good bank' real estate assets and control the bad bank price regulation. Despite taking huge provisions during 2012 on the property market, the Spanish economy has still shrunk and is expected to contract even further during the forthcoming quarters. This may cause Sareb to force a revalue of its entire portfolio as soon as its current assessment process is finished. Sareb's current business plan foresees price growth with 3% to 6% from 2017 to 2027 and expects to make €5.6 billion profit: €1.4 billion in the first ten years and €4.2 billion between 2023 and 2027. This means that 75% of Sareb's profit depends on macroeconomic circumstances. Meanwhile, after its first half year, Sareb has had to modify its previous expectations on investment returns from 15% to 13% in a market that still shows no sign of recovery. The IMF believes that the main course of bank restructuring may have been served, but a sour dessert may still be on the menu. It's clear that the proof of the pudding is in the eating, especially for Sareb.

75% of Sareb's profit expected during last five years (2023-2027)

The content of this publication is based on sources from Sareb, Frob, Fitch, Economist, Reuters, Idealista, Expansión and El País.

Portfolio assessment

At the end of 2012 200.000 assets were transferred to Sareb at a gross discount to book value of 52%. Assets include 76.000 empty homes, 6.300 rented homes, 14.900 land plots and 84.300 development loans, so called *Préstamos Promotor*. Each asset will be analysed thoroughly for which 600 employees of 14 different service companies are currently being coordinated by Clifford Chance for legal issues, CB Richard Ellis for valuation issues and IBM for information technology. This process has been started last month and could take several months. The last business plan revised by KPMG last month foresees to liquidate approximately 98.000 residential properties worth €13.6 euro during the 15-year lifespan. 50% will be sold during the first five years from which 7.528 properties during 2013 worth €933 million that would initially mean an average of €124.000 per property.

Private equity funds

Earlier this year, three US private equity funds, Cerberus, Fortress and Centerbridge, were interested to participate with €150 to €200 million in Sareb's shareholders capital. However their overture was rejected by Sareb as they wanted first choice on buying portfolios at additional discounts. "Sareb has a legal obligation to treat all the shareholders the same", a spokesman stated afterwards. At the beginning of April 2013 Goldman Sachs, private equity firm N+1 and Banco Santander were appointed to identify international investors for Sareb's shareholders capital structure. On the selling side there are not many examples of development loans being liquidated. Last year Banco Santander sold a portfolio called *Operación Silverstone* worth €500 million to Cerberus and Lone Star. BBVA tried the same by selling a €1.5 billion portfolio called *Operación Camelia*. However, the sale process was finally cancelled as the two buyers, Lone Star and Värde Partners didn't agree on price and guarantees. Stimulated by recent law modifications, fiscal benefits and potential growth, the creation of a Spanish REIT, so called *SOCIMI* makes more sense to consider the property rental market as an investment alternative. However, for the time being and in order to protect the downside, international funds anticipate on portfolio sales with higher discount rates than the discounts applied by Sareb.

An average 63% transfer-discount for unfinished projects - *probably not sufficient to carry the additional cost for remaining building works and sale risk, especially in areas with a large oversupply of unsold houses and regions with strong demographic decline.*