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Spanish banks haven't accepted 'correct pricing'

US advisory firm says foreign buyers of distressed loans will eventually enter Spain, but they will continue to wait on the sidelines until evidence that banks and Spanish regulators are willing to accept 'market realities'.

Robin Marriott

Spanish banks and the country's financial regulators are yet to accept "correct valuation and pricing" when it come to real estate, according to a US property consultancy firm.

Los Angeles-based Crosswater Realty Advisors said in a paper on Spain that foreign capital would not be returning to the country until the financial markets believed the bottom had been reached, most particularly in the property sectors, and that would not happen until the banks and their regulators "exhibit the will to take the necessary, but very hard steps, to write-down their real estate sector assets to true current market values".

Jack Rodman and Ted Leary, veteran real estate professionals at Crosswater, said in the paper called The First Rule of Holes, that sophisticated, experienced and high-yield-seeking capital had the discipline to not plunge into chaotic markets. "It will sit on the sidelines until a price floor for assets is established, markets are poised for stabilisation and professional sales processes are in place," they predicted.

Following a fact-finding mission to Spain, the pair said it was clear banks and regulators had not yet reached the point of writing down assets to true market value. Their conclusions come on the same day as PERE reported how Morgan Stanley and Spanish bank Santander had failed to agree a price for a €700 million real estate portfolio, with talks ending in collapse without apparent hope of rekindling discussions.

According to Rodman and Leary, private capital was still waiting for some evidence that the Spanish banks and their regulators were willing to accept market realities and were able to execute their disposition programmes in a "trustworthy and professional manner".

"Until that happens these highly entrepreneurial and, yes, very high yield-seeking investors will simply sit on the sidelines as Spanish real estate values continue to deteriorate."

They argued that Spain should look at the collective experience of the US with the RTC of the early 1990s, and similar efforts in Japan, South Korea, Thailand, and China. "Each country is different, but in all of them one undeniable fact emerged: The longer it takes to accept market reality, the deeper the hole the country digs for itself."

Their paper said the "ultimate turning point and recovery" in these situations began when either the government or the banks decided to sell non-performing loans through a public auction process which drew in foreign investors and new capital.

The Crosswater professionals said a notable example was Korea, through its Korea Asset Management Corporation (KAMCO) which in the late 1990s began an "organised and systematic process" to auction portfolios of NPLs ranging from residential mortgages, foreclosed real estate, corporate loans, credit cards and consumer debts in a series of well-publicised transactions. This resulted in billions of dollars of new investor capital pouring into the country, prices being stabilised and, eventually, values rising for the remaining assets in the banks' inventories.

"The inflow of foreign capital triggers the beginning of a virtuous cycle. Local people and specialists are employed to work on all aspects of the NPL disposition process from initial due diligence to the establishment of systems and procedures to collect and resolve the NPLs acquired. The boost to local employment, along with banks' bolstered capital levels and rising value of NPL portfolios, creates a 'multiplier' effect in the economy as new money is invested and spent," the paper highlighted.

According to the firm's thesis, the second step necessary for a country's recovery was for the real estate market to become open to market clearing prices. "That does not mean that each and every under – and non-performing assets has to be sold in one fell swoop. Instead, it needs a carefully controlled process that feeds selected portfolios into the market and creates new market values which investors can be confident in."

They added how, historically, less than 2-to-3 years after the first NPL sale, a recovery was well underway. At the same time, investor confidence was restored, and foreign investors would shift emphasis from distressed assets, which have been bid-up to values that no longer yield opportunistic returns, to sustainable investment platforms and operating businesses that allowed them to remain in the market and capture the benefits of the recovery cycle.

"Private Equity and opportunity funds have historically led this charge, preferring to enter the market after the banking crisis has passed and the NPL investors have pioneered the market," said Rodman and Leary. "In the third step to recovery, not only do the foreign investors take stakes in operating businesses, but in many Asian markets the foreign investors also invested alongside government agencies in recapitalising the banking system. Again, taking a page from Korea, the TPG Capital/Newbridge investment in Korea First Bank (in 1999) was well received at the time and profitable to both TPG and the government when they exited by selling their stake to Standard Chartered Bank for a handsome profit."

The pair concluded: "Our experience has been that the value of real estate assets on the books in deteriorating economic situations such as Spain declines 10 percent to 20 percent per year, a rate that will produce a pretty deep hole. Until credible, market-clearing prices are established through a professional, transparent, market-based mechanism, provisional against these losses may require an ever larger shovel."