Spain's experience in settlement of distressed assets

Sareb's Activities

FUND OF PROBLEM LOANS
ACQUISITION. MANAGEMENT. SALE.

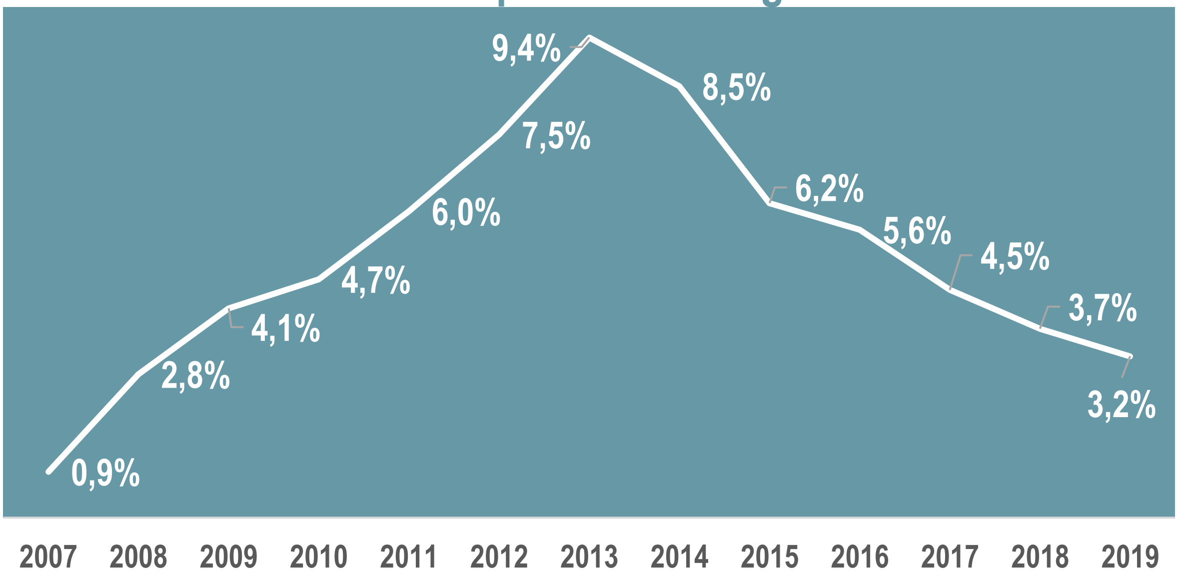
Prerequisites for the creation of Sareb

The Spanish real estate bubble has burst after a decade of excessive lending. Loans for construction and real estate increased from 10% of GDP in 1992 to 43% in 2009. Spanish banks were overly bulky in relation to the economy: in 2009, banks' assets and liabilities accounted for 227% and 172% of GDP, respectively. The outbreak of the euro-zone debt crisis pushed the economy into a sharp recession by the end of 2008. In 2009, the economic downturn was 3.5 percent.

In response, the Government has taken measures to ensure liquidity support – the amount of the deposit insurance limit has been increased to EUR 100,000 and bank bond guarantee programs have been adopted.

The continued deterioration of the economy has led to increased risks associated with real estate transactions and a potential shortage of capital in banks. In 2010-2011, the volume of non-performing loans issued to developers increased from 14% to 21%. Despite the adoption of initiatives to increase the transparency of loans in financial statements and the recognition of losses, this was not enough to restore investor confidence in the banking system.

Dynamics of the level of non-performing loans in the Spanish banking sector



Data source: statista.com
Infographic: FPL JSC

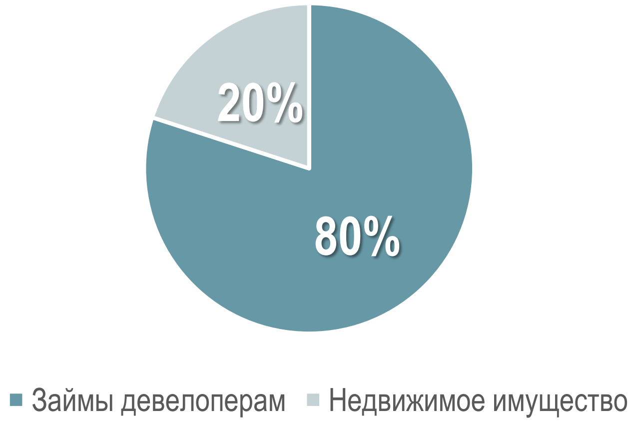
In this regard, in 2012, the authorities began implementing a comprehensive bank restructuring strategy, including asset diagnostics and segmentation, as well as bank restructuring and recapitalization. One of the key elements of this strategy **was the creation of the SAREB Asset Management** Company.

Creation of Sareb

SAREB was established in 2012 to purchase, manage and dispose of stressed assets as part of the implementation of the Memorandum of Understanding concluded between the European Commission and the Government of Spain. The memorandum provided for the allocation of funds for Spain in the amount of 100 billion euros, of which only 41.4 billion euros were used – 38.9 billion euros for the recapitalization of banks and 2.5 billion euros for the capitalization of SAREB.

SAREB was established as a private commercial company with a government mandate with a limited operational life of 15 years. SAREB has repurchased about 200,000 stress assets from 9 banks with a total nominal value of 107 billion euros for 51 billion euros. SAREB has issued government-guaranteed bonds to finance the transactions.

The structure of the repurchased assets



200.000
number of assets repurchased

51 billion euros
purchase price of assets

55%
average discount

SAREB uses five instruments to resolve acquired problem loans: (i) debt collection, (ii) debt restructuring, (iii) transfer of collateral by the debtor to repay the debt, (iv) compulsory debt collection through the initiation of legal procedures, and (v) assignment of loans to third parties.

In order to increase the value of the real estate portfolio and generate additional cash flows, SAREB also leased out property.

In addition, SAREB has been attracting specialized asset management service companies since 2014.

Asset buyback

SAREB applied the following approach to the repurchase and valuation of distressed assets.

Commercial banks in Spain were divided into 4 groups based on the results of the relevant diagnostics:

Group 0 – banks without capital deficit;

Group 1 – banks owned by the Bank Restructuring Fund (FROB);

Group 2 – banks with capital deficits and unable to meet them without resorting to government assistance;

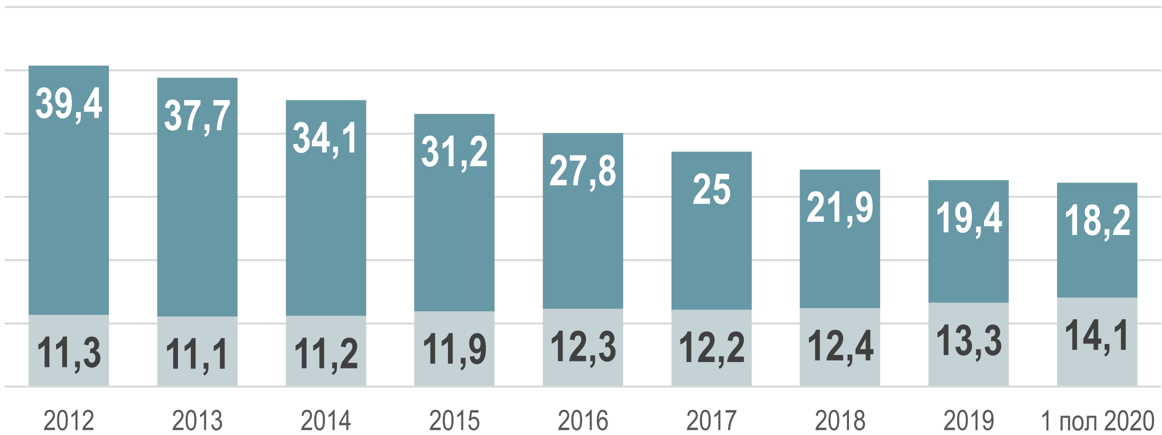
Group 3 – banks with capital deficits that can adopt recapitalization plans without resorting to government assistance.

Banks in Groups 1 and 2 were required to sell assets in SAREB.

At the same time, criteria were also set for assets to be sold – loans with a net book value of over 250,000 euros, foreclosed collateral with a net book value of over 100,000 euros and other assets of organizations controlled by the eligible bank.

The asset valuation and the repurchase price were based on valuation reports performed by independent experts. The assets were repurchased by SAREB after applying a discount rate that varied depending on the type of asset.

Dynamics of the portfolio structure, million euros

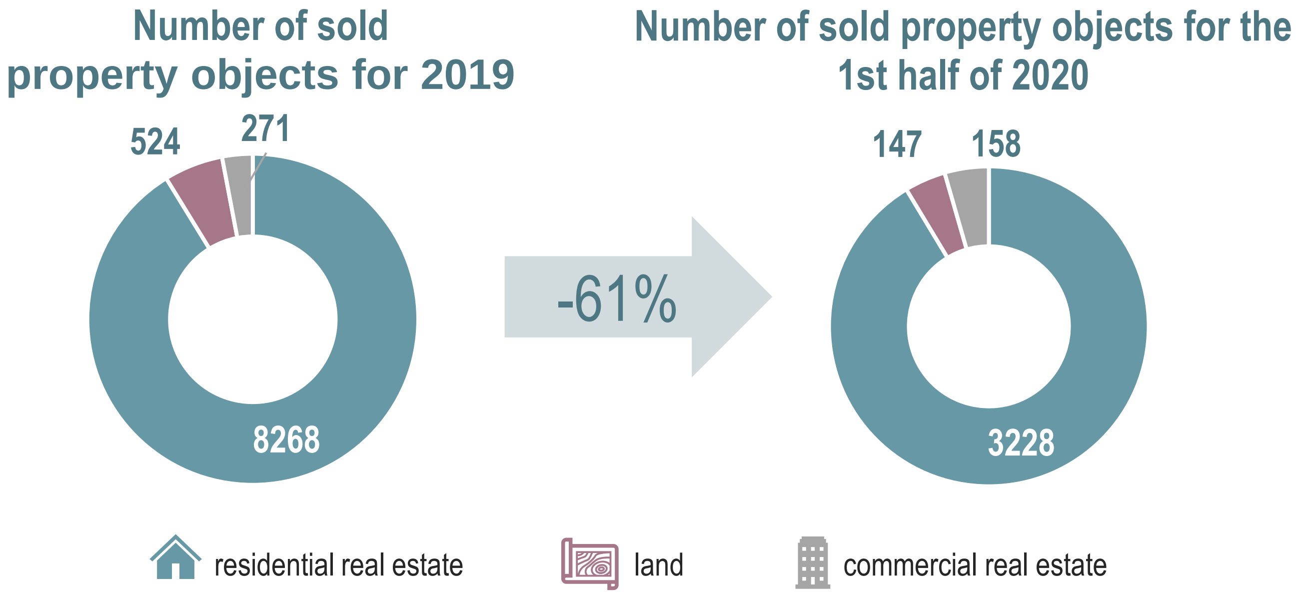


Data source: Sareb Annual Report for the 1st half of 2020
Infographic: FPL JSC

Asset sales

SAREB used a multi-channel strategy to sell assets:

- **retail channel** – for the sale of residential real estate
- **direct channel** – for the sale of larger assets
- **institutional channel** for the sale of large assets (commercial real estate) to professional international investors



Data source: Sareb Annual Report for the 1st half of 2020
Infographic: FPL JSC

The sales were carried out both by organizing auctions and directly to target investors.

In 2017, SAREB launched an online asset sales platform aimed at international investors. The purpose of launching the platform was to inform potential buyers about the planned sale, which was part of the European Initiative to launch the European non-performing loans market.

SAREB engages third-party organizations to conduct marketing events.

The content was prepared by the Corporate Development Department
The Fund of Problem Loans JSC The World Bank's research reports and SAREB materials were used in the preparation.