Cerberus buys major share in BBVA's real estate assets riding the wave of the Spanish roaring housing market

Banco Bilbao Vizcaya Argentaria S.A. (BBVA:MCE) – market cap as of 1/12/2017: €47.17bn

Introduction

On November 29, 2017, it was announced that BBVA had sold to the American fund Cerberus the bulk of its real estate business in Spain. Through this operation, the Spanish bank will reduce by 70% its gross property exposure, which currently stands at €17.8bn, thereby making it the bank with the lowest real estate exposure with respect to its size, since real estate will come to make up only 1.5% of BBVA's total assets in Spain.

About Banca Bilbao Vizcaya Argentaria, S.A.

BBVA is a global financial services group founded in 1857. The Group is the largest financial institution in Spain (by business volume) and Mexico, and it has leading franchises in South America and the Sunbelt Region of the United States. It is also the major shareholder of Garanti Bank. Its diversified business is focused on high-growth markets and relies on technology as a key sustainable competitive advantage.

As of the end of September 2016, the total assets of the Group amounted to €724.6bn and BBVA, with its presence in 35 countries, could count on 68m customers, 8,761 offices, 30,890 ATMs and 136,244 employees.

About Cerberus Capital Management, L.P.

Established in 1992, Cerberus Capital Management, L.P. is one of the world's leading private investment firms. Cerberus has more than $30bn in AUM, invested in three complementary strategies: global credit opportunities, private equity, and real estate. From its headquarters in New York City and network of affiliates and advisory offices in the U.S., Europe, and Asia, Cerberus has the on-the-ground presence to invest in multiple asset classes globally.

Industry overview

The Spanish economy and housing sector experienced severe fluctuations in recent years. The collapse of the real estate market in 2008 triggered five consecutive years of negative growth between 2009 and 2013, which created mass unemployment and required governments to allocate €40bn to bank bailouts. Nevertheless, market recovery has started to take place, especially in Madrid and in the Southern coast of the country. Sale transactions have increased in volume in the first three quarters of 2017 by 70% and property prices have grown by 13% to an average of €802,000 in the same period. Several US private equity firms such as Blackstone have also increasingly purchased Spanish housing facilities. The economy and domestic housing prices are forecasted to expand overall by 3.1% and 3.0% respectively this year.

Most impressively, higher demand and supply shortages have caused the average price for rentals and leases to grow by 20.9% in 2017. Temporary leases to tourists have significantly contributed to this upsurge, as their profitability has majorly increased in contrast to long-term tenancies. An investigation conducted by the city of Barcelona illustrates that these assets embody 7.7% of the town's overall rental home supply. Furthermore, a similar study predicts that rental rates will resume to climb by 8% in Barcelona and approximately 14% in Madrid.

Despite the aforementioned positive developments, Spain's housing sector is nowadays still suffering from numerous difficulties, including 500,000 of unsold new homes. In particular, BBVA owns $25bn in nonperforming assets in Spain and $33bn in its entire portfolio. Additionally, BBVA's real estate segment generated losses of $1.37bn since 2015.

Deal structure

The sale will happen through the creation of a joint venture and, at the closing, BBVA will sell 80% of its stake in the venture to Cerberus for €4bn. The real estate business envisaged in the agreement consists of about 78,000 real estate assets (predominately located in Catalonia, Madrid and Valencia) with a gross book value of about €13bn. This means that the transaction will happen with a 61,5% discount on the book value of the assets, in line with the provisions set aside by BBVA, so the impact of the operation on earnings will be limited.

The acquisition comprises the commitment of Haya Real Estate (owned by Cerberus) to manage the remaining 20% of the real estate portfolio held by BBVA after the deal is concluded. According to a BBVA's press release, "the transaction is not expected to have a significant impact on the Group's attributable profit, but should have a slightly positive impact on the fully loaded CET1 ratio".

Regulatory authorities still need to express their approval, but experts are optimistic that the deal will be completed in the second half of 2018, allowing BBVA to maintain the smallest real estate exposure among Spanish banks.

Deal rationale

Unlike other competitors, BBVA had kept full ownership of its real estate business. In order to cut it from the balance sheet, the plan was to sell minority stakes to multiple real estate funds. However, bowing to the pressure of watchdogs, the sale was carried out in bulk and this lowered the final sale price. As the Spanish economy is set to be the best performer among the large Eurozone economies, with a growth of 3.1%, housing prices in big cities and on the Southern coast have risen. This has given Spanish banks the opportunity to offload significant stakes in real estate assets. Indeed, this deal is the second biggest property deal in Spain's history, after the recent sale from Banco Santander of 51% of its portfolio of €30bn in real estate properties and loans to Blackstone in July.

BBVA will cut its gross property exposure by 70% with this transaction - it currently stands at €17.8bn. The sale of the real estate assets will allow the bank to reduce its capital consumption and improve the quality of its balance sheet. Furthermore, the disposal will lessen the negative contribution from BBVA's property business (negative €281m in the nine months before September 2017). In this type of operation, it is usual for the seller to maintain a minority stake in the capital of the transferred company, and so avoids having to consolidate on its balance sheet. Chief Executive Carlos Torres Vila said that the transaction is extremely important because it significantly reduces BBVA's exposure to a non-core business, allowing the bank to strengthen its transformation process.

Cerberus, on the other hand, leverages this opportunity to bet on the fast-growing Spanish economy as the country returned to growth in 2013 and has outperformed the rest of Europe since then, helping to revive residential construction as house prices pick up, which has started to attract foreign investors back into the market. Moreover, we should expect synergies within Cerberus's portfolios, as BBVA has also signed an agreement with Haya Real Estate - a real-estate service company owned by Cerberus - for Haya to provide services to the real estate portfolio held by BBVA once the transaction has been executed.

Market reaction

On November 28, the price of a stock of BBVA closed at €7.13 and at €7.29 on the 29th, showing a 2.2% appreciation.

Advisors

The financial advisors to the transaction have not been publicly disclosed.