NPL in Brazil: the next (emerging) hot market!

PREPARED BY PRIME YIELD

The financial crisis that has hit Brazil in recent years led to a high volume of Non-Performing Loans (NPL), thus resulting in a growing transaction movement regarding this type of portfolios that mainly involve banks. And now, that Economy is just getting back on track, the pace of NPL's transaction promises to further accelerate and draw the attention of an increasing number of investors, which were already attracted by the high potential returns generated in an emerging and still relatively immature market.

Economy

After facing one of its deepest crisis, Brazilian economy seems to be recovering faster than expected, with GDP growing over 1.0% in 2017. This growth was mainly boosted by the performance in agriculture, although the industry and service' sectors were also already positively impacting GDP. Inflation now remains controlled and below expectations, interest rates record their lowest of recent times and the unemployment rate has been declining every month.

But despite these positive indicators, confidence in the country is still not ideal and awaits political outcomes, as 2018 will be an election year for both the president and governors.

Future projections are encouraging for the country, with GDP expected to grow by more than 2.0% in 2018.

GDP GROWTH 2017

1.0%

GDP GROWTH FORECASTS 2018

2.0%

Property Market

Side by side with economic performance, the Brazilian property market has lived over the last decade between peaks and valleys. Between 2008 and 2011, property value increased about 25%, triggered by low supply and high demand. Construction activity has skyrocketed in all market segments and loans for the property segment steadily increased (circa 40%) from about R$ 80 bn to R$ 113 bn .

However, from 2015 onwards, with the crisis, the property market has gradually reduced its activities both in the construction and transactions, negatively impacting prices. At the same time, there was a reduction of around 33% in property financing to about R$ 75 bn (in 2016 the decline stood at 38% and in 2017 at 7%). Forecasts for 2018 point out to a growth of around 15%.

In line with the beginning of economic recovery, the property market performance considerably enhanced over 2017. In what concerns the housing market, sales have improved, partly due to the decrease in interest rates, and developers started to clear up stock built before the crisis. Overall, the market has been progressing towards a better balance between sales, the already built stock and new launches. Forecasts for 2018 are very optimistic, based in the positive evolution expected for these structural economic fundamentals.

FORESCASTED GROWTH LOANS TO PROPERTY SEGMENT 2018

15.0%

HOUSING PRICES GROWTH 2008-2011

25.0%

REDUCTION IN PROPERTY LOANS 2015

33.0%

NPL Stock and Ratio

In Brazil, the stock of Non-Performing Loans (NPLs), generated by the combination of recession and stagnation, currently totals between R$ 400-450 bn. According to the Brazilian Central Bank (BCB), distressed assets integrated in property loan portfolios total R$ 28 bn (as for the 1st half of 2017).

As for the ratio of NPL (to total gross loans), sat at 3.2% in December 2017 (BCB), confirming the downward trend felt since June. This ratio presents a 0.4-percentage points (pp) decrease facing the 3.6% rate exhibited in November, also falling 0.5 pp y-o-y. Last May (2017) recorded the highest ever NPL ratio in Brazil (since March 2011), hitting 4.0%. And the lowest point was registered in December 2014, with a NPL ratio of 2.7%. In December (the last available data), NPL ratio was declining both in households and companies, although remaining higher in the first segment (3.5% and 2.9%, respectively). In both cases, it also decreased y-o-y (-0.4 pp and -0.6 pp) and m-o-m (-0.3 pp and -0.4 pp).

Potential NPLs Deal

After several years averaging R$ 20-25 bn, the annual transaction of NPLs portfolios in Brazil is expected to almost have doubled in 2017, ranging from R$ 30-40 bn and 2018 should reinforce this transactional upward trend at least at about 15%. Several financial institutions have already announced their intention of continuing selling NPLs portfolios, thus releasing internal resources and concentrating in the loans still not recognized as irrecoverable, but also in order to increase credit provision for households and companies (in 2017, credit granted remained well below the pre-crisis period, at around R$ 300 bn).

Given that after one year the Brazilian banks "disappear" with these "bad" credits (according to local regulations) accounting for losses related to NPLs, this type of default loans has low impact in Banks' book value, and so the discounts involved are high and the opportunities of return, too.

In the last third of 2017 alone, it was known that important national Banks such as Santander Brazil should place an R$ 50 million NPL portfolio in the market for sale, and also Votorantim confirmed the intention of disposing an R$ 300 million portfolio. Already signed in January was the acquisition of R$ 6bn NPL by Recovery from Bradesco.

These portfolios are very attractive to international companies that are looking for structured investments, as experienced global investors focused on NPLs are permanently searching for countries/regions in economic crisis to detect the potential NPL market and, at the moment, Brazil has the perfect profile for this.

Opportunities for return – precisely considering the high risk that as to be assumed – in an emerging and still immature market are excellent, and are now specially highlighted by economic recovery prospects. A more positive economic performance is expected to accelerate the pace of NPL transactions, as investors are more confident in the capacity of both households and companies to meet their loan obligations, recovering higher volumes of bad credit and achieving higher returns.

NPL STOCK

R$450-500bn

NPL RATIO TOTAL (12.2017)

3.2%

NPL RATIO HOUSEHOLDS (12.2017)

3.5%

NPL RATIO COMPANIES (12.2017)

2.9%

ESTIMATED NPL TRANSACTION VOLUMES (2017)

R$30-40bn

2018 NPL TRANSACTION Y-O-Y GROWTH

15.0%

About Prime Yield Brazil | NPL&REO Services

Established in 2010 (Brazil), Prime Yield delivers valuation, research and advisory/consultancy services and has been focusing on the NPL&REO market, specializing in Portugal and Brazil. Thinking about the players (buy and sell) who want to be actively involved in the transaction of this type of assets, the company created the new business area NPL&REO Services, also supported by Prime AVM&Analytics, an advanced technological solution that allows NPL's investors and sellers to have property valuations in a fast, simple and reliable way both for single assets or entire portfolios (RESI or CRE). Prime Yield is regulated by RICS and REV-TEGoVA, also being certified by CREA - Conselho Regional de Engenharia, Arquitetura e Agronomia under nr 0826831.

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