2014 was a record year for loan portfolio sales in Europe and 2015 is on track to be another very strong year.

With stiff competition for European loan assets (particularly in the UK, Ireland and Spain) driving up pricing, achieving target returns has become more challenging and investors are now increasingly looking to their advisers for innovative deal and financing structures, as well as efficient and early stage analysis of target assets, to maximise their price competitiveness and to give them increased confidence in their deal-specific strategies and pricing assumptions.

As investors expand their search for more profitable deals into less familiar jurisdictions and asset classes, we expect that it will become even more important to have access to advisers with experience in structuring these types of transactions and navigating the acquisition process, who are aware of common pitfalls and can co-ordinate efficient analysis of the jurisdiction-specific complexities.

In this briefing, we highlight some of the recent market trends in loan portfolio sales and touch on some of the ways in which we can help buyers gain the edge in this active market.

MARKET TRENDS

Loan portfolios with a face value of €91 billion were disposed of across Europe in 2014, an increase of over 40% on 2013 figures. Notable sales included those made by Lloyds Banking Group, Nationwide and Royal Bank of Scotland in the UK, the National Asset Management Agency (NAMA) and Irish Bank Resolution Corporation (IBRC) in Ireland, and SAREB (the Management Company for Assets Arising from the Banking Sector Reorganisation) in Spain. Buyers were, for the most part, private equity houses and hedge funds. In terms of asset classes, commercial real estate loan portfolios continued to represent a very significant part of the European loan portfolio market in 2014; consumer loan assets, both secured and unsecured, also remained a popular asset class, in particular in Spain, Italy and the UK, and disposal of corporate loans continued to increase, most notably in Spain and Ireland.

By all accounts 2015 is on track to be another very strong year. Although the results of the asset quality review (AQR) and stress tests conducted by the European Central Bank (ECB), which identified that there were 13 banks that would be required by the ECB to take remedial action to address their capital shortfall, have not been as big a driver for increased loan portfolio sales as initially expected, deal volumes are expected to continue to increase in 2015 and remain buoyant over the next few years.

"Clients do not hesitate to praise this high-end, full-service firm as being 'a cut above everyone else' and the 'best in town'"
The expectation of continued strong portfolio sales is driven in part by the pressures (both domestic and political and resulting from EU state aid requirements) on state-supported institutions and "bad banks" to continue to make major asset disposals and wind-down their operations. It is also driven in part by the continuing and ever increasing pressures on financial institutions to reassess their strategies in light of the changing economic and regulatory landscape and to reshape their balance sheets to meet new regulatory capital requirements, reduce their operational costs and free up capital and funding for other activities.

As well as the sell-side pressures, the expectation of continued strong portfolio sales is of course also driven in equal part by buy-side demand, with a wide range of investors reported as having large amounts of committed funding and mandates to invest. PwC’s market update in March estimated that investors in this market have more than €70 billion of equity available to invest in European loan portfolios and that with the power of leverage these investors could close deals with a face value of around €90-100 billion in 2015. The figures are currently on track for these predictions to be met.

Non-performing loans remain the most popular asset class with investors because of the potential returns they offer although the average discounts to face value have decreased as a result of stiff competition for deals driving up pricing. Our experience is that the content of portfolios are also expanding to include more structured products, with the proposed sale by UKAR of "Granite" (a £13 billion securitisation vehicle originally established by Northern Rock in 2001) announced earlier this year being a good example of this growing trend.

In terms of key jurisdictions, the expectation is that the UK, Ireland and Spain will remain important centres of market activity in the next couple of years – a good example of this continuing trend being NAMA’s announcement in February that it had appointed advisers to sell a €8.4 billion portfolio of non-performing loans called Project Arrow.

Italy is also expected to continue to be a growth market for investors and possible Italian insolvency law and tax reforms intended to remove the difficulties for lenders in seizing secured assets and loosen the bureaucracy surrounding the sale of non-performing assets, as well as proposals to introduce a state-sponsored bank to acquire a number of non-performing portfolios, can only help in this regard.

In terms of future trends, the expectation is that the market will broaden to less familiar jurisdictions, in particular Greece and Central and Eastern Europe e.g. Romania, as investors seek new avenues for enhanced returns and the range of financial institutions under regulatory scrutiny increases.

BUY-SIDE DRIVERS AND CHALLENGES

Although investor appetite for distressed and non-core assets in Europe continues to be strong and the market continues to grow, the volume of disposals to date is less than some had predicted. This has kept competitive tension strong in most asset auctions. As prices remain high, investors continue to face pressure on their returns. Even as the market expands into new jurisdictions and asset classes, we expect investors to continue to seek opportunities for profit, so that auctions will continue to attract significant interest. It goes without saying therefore that bidders need to exploit every chance to improve their bids’ competitiveness.

"Slaughters are outstanding – they have a strength in depth that is almost unmatched."

CHAMBERS UK, 2015
TARGETED DILIGENCE AND GETTING THE PRICE RIGHT

In our experience, it is essential for bidders to test their pricing assumptions and their deal-specific strategies at an early stage. Key to this is targeted, early and efficient diligence. Often due diligence remains a buyer’s main source of comfort: in general, buyers continue to receive limited contractual comfort from sellers and vendor due diligence, if provided at all, is often narrow in scope or subject to very low liability caps.

Although legal due diligence is only one part of the diligence process, it is frequently an important one. If properly conducted and presented, it can help strengthen an investor’s confidence in its pricing assumptions, allowing it to move its bid closer to the top of its range. In particular for distressed assets, legal diligence can be vital in assessing the viability of an investor’s proposed strategy, as these strategies often rely on enforcing existing legal rights or navigating through the legal restrictions imposed by the underlying documents.

Given sellers often provide limited information, particularly at early stages, assessing the gaps in the due diligence materials is vital and requires close co-operation between the commercial, financial and legal teams, as commercial risks may be dealt with through contractual protections and vice versa. Identification of key diligence gaps can often assist a bidder to decide at an early stage whether to adjust its pricing, demand extra contractual comfort from the seller, or else cut its losses by withdrawing from the process.

We have extensive experience of these matters and, where multiple jurisdictions are involved, we often assist our clients by taking a lead co-ordinating role, even where the assets are located entirely outside the United Kingdom. In these deals, we are able to access and seamlessly integrate advice from the best legal advisers in all European jurisdictions, with whom we often have long-standing relationships.

BOOSTING RETURNS THROUGH DEBT FINANCE

Investors looking for ways of boosting returns are increasingly turning to debt financing providers at an earlier stage and seeking a higher level of leverage. This reflects the increased range of debt financing that is becoming available to bidders as well as the increasing familiarity among debt providers with this market. More innovative finance structures, including securitisations, are now also available.

As an example, we have, in particular over the last year or so, helped a number of purchasers of UK residential mortgages access the securitisation market, not only for refinancings but direct financings of the asset purchases. Our experience of working with both bidders and financiers also helps us test whether proposed sale terms and bid structures are workable from a financier’s perspective. This covers not only credit issues but also matters such as asset-level regulation and structural compliance with EU risk retention rules and (in the US) the Dodd-Frank Act.

More experienced sellers may already have anticipated these issues, and may even provide some assistance in arranging financing. With less experienced sellers, good advisers can help identify the key issues that would need to be dealt with to unlock the pricing benefits that result from a more financeable deal and we have a track record of helping our clients produce imaginative approaches to resolving these issues across a wide range of transactions.

“This magic circle firm fields a highly respected London practice and also works in close partnership with its ‘best friends’ network of firms in continental Europe.”

CHAMBERS GLOBAL, 2013 (EUROPE-WIDE) AND CHAMBERS EUROPE, 2013 (EUROPE-WIDE)
FINDING THE RIGHT STRUCTURE

In addition to financing, there are many drivers for adopting a particular bid structure. For example, where a seller’s selection of portfolio assets does not fit a bidder’s target profile, there may still be flexibility to combine or alter the scope of offered portfolios. On the other hand, in the case of some recent large disposals in Ireland and the UK, we have seen bidders find competitive advantage in forming a consortium, allowing them to combine their different appetites for parts of the offered portfolio or the capital structure.

In the right context, a co-investment structure can allow investors to bring in external parties with the expertise and regulatory permissions to service the underlying assets, addressing regulatory issues and strengthening control over the assets’ future performance.

Sellers are sometimes also concerned to see that assets are properly administered after the sale, due to the possible effects on both their own reputation and their regulatory relationships. The right structure for holding and servicing the assets is key to resolving these issues.

OUR CREDENTIALS AND TEAM

Maintaining focus on the points above will become more important for investors as sellers move on to disposals of their more challenging assets and as the market expands to include new asset classes and jurisdictions, each with their own specific issues.

We have the experience and the knowledge to make the difference for our clients in this area.

Over the last three years, we have acted on many deals in this market, for investors as well as public and private sellers, where we have been able to combine our peerless M&A capability and regulatory and tax expertise with our deep knowledge of the various classes of assets, whether they be complex leveraged and secured loans or pools of retail assets with the attendant regulatory requirements, and have a track record of helping our clients get the deal done and producing imaginative approaches to resolving any issues that arise. We also have a top-rated financing practice and have acted for bidders and financiers in relation to the financing and refinancing of the purchase of loan assets in this market, including through more innovative finance structures such as securitisations.

Details are provided below of some of our notable recent transactions and some of our partners with experience in this area.
OUR TRACK RECORD IN LOAN PORTFOLIO TRANSACTIONS

Highlights of our experience include advising:

- **Abbey** (now Santander) on the purchase and subsequent sale of First National Finance Corporation and First National Bank, including the consumer loan portfolios within those entities

- **Ahli United Bank** on the sale of a portfolio of residential mortgages

- **an alternative asset manager** on the disposal of a portfolio of UK residential mortgage loans

- **Arrow Global Group PLC**, one of the UK’s largest providers of debt purchase and receivables management solutions, on the proposed acquisition of Capquest (a UK consumer debt purchaser and outsourced collections provider)

- **BCC Securis Srl**, as English law counsel, on the issue of EUR80 million asset backed floating rate notes secured on a portfolio of non-performing loans for 24 Italian regional banks

- **Blackstone Group International Partners** on its potential acquisition of a residential loan portfolio

- **Cambridge Place Investment Management LLP** in connection with the purchase of various commercial real estate related assets (including A/ B loans), the third party financing of the purchase and a proposed equity IPO of the acquiring group

- **Davidson Kempner** in establishing a Master Servicing Agreement with Reviva to service loan portfolios purchased from the Danish State Bad Bank (FS)

- **Deutsche Bank** in connection with the potential sale and subsequent securitisation of a portfolio of loans originally originated by Edeus

- **Deutsche Bank** on the sale of consumer mortgage portfolios and related servicing arrangements

- **a financial institution** on the purchase of loans backed by a portfolio of UK distressed consumer loans

- **First National Finance Corporation** on the acquisition of unsecured consumer loan assets

- **Fortress Investment Group** in bids for portfolios of consumer and commercial NPL portfolios and structuring related servicing arrangements

- **Fortress Investment Group** on the acquisition of mortgage portfolios in various European jurisdictions

- **GE Capital Global Consumer Finance Limited** on the sale of a debt collections business located in Wales, with transitional services to be provided by the vendor in the interim

- **HSBC Bank USA** and **HSBC Bank plc** on various roles in connection with the issue by Palazzo Finance Tre S.r.l. of EUR600 million asset backed notes due 2018 backed by a portfolio of primarily non-performing Italian mortgage loans, lead managed by Morgan Stanley

- **a leading global investment manager** on the purchase of Portuguese and Spanish consumer loan portfolios

- **a leading global investment manager**, as part of a consortium, on the proposed purchase of the Project Pittlane commercial real estate portfolios (performing and non-performing) in Ireland and the UK

- **a leading global investment manager** on its purchase of residential mortgage portfolios (both performing and non-performing) and servicing businesses in the UK, Germany and the Netherlands, and the subsequent refinancing of such portfolios
• a major European bank on its proposed funding for a joint venture to be established in order to manage certain assets of a major Spanish bank under the terms of a service level agreement

• a major US entity on the sale of a Portuguese consumer loan portfolio

• Magnetar Investments on establishing origination and servicing arrangements for corporate and structured lending activities in UK and Spain

• Morgan Stanley on the restructuring of Four Seasons Healthcare and negotiations with the special servicer

• Och-Ziff Capital on bids for consumer NPL portfolios and structuring related servicing arrangements

• Palazzo Finance/ Fortress on its repackaging of a EUR600 million portfolio of non-performing Italian mortgages

• Paratus AMC (formerly GMAC RFC) on its servicing arrangements with a major originator of performing and non-performing residential mortgages

• Perella Weinberg Real Estate Fund on the acquisition of approximately EUR500 million of French and Spanish commercial loans owned by RBS London

• a real estate client on the acquisition of a loan originally made available by Bank Austria and secured on UK real estate assets

• Santander UK on the acquisition of RBS branches in England and Wales and NatWest branches in Scotland and the associated loans and other assets

• Santander UK on the sale of a non-performing consumer loans portfolio

• Perry Capital in connection with potential distressed investments in Greece

• Santander Cards UK on the sale to Santander of a series of unsecured consumer finance businesses based in the UK, Germany, Finland, Austria and Ireland

• Santander Cards UK on the sale by GE Capital Bank Limited of “inventory” portfolios of defaulted unsecured debts to Link Financial Limited

• UBS on its purchase of a non-conforming whole loan residential mortgage portfolio, including advising on the ongoing third party servicing arrangements and financing of the purchase through the structured capital markets

• United Bank of Kuwait on the sale of two mortgage portfolios to UK building societies

• Westbrook Fund VII on the purchase of a real-estate finance loan made to a UK real estate owning SPV

• WestLB AG as arranger in a securitisation of nonperforming loans by Priamar Finance S.r.l.
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