

NPL Management Inside ReoCo

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ReoCo is an instrument used by banks for credit recovery. The financial crisis of 2008 has increased the number of non-performing loans (NPLs) and the need to collect debt.

Debt collecting or credit recovery is fundamental because it allows banks to increase their liquidity and to use it for their core activities. The financial crisis triggered write-downs and losses on NPLs due to real estate collaterals. For this reason, the necessity of credit recovery increased in order to stop losses.

The study describes the use of ReoCos for credit recovery, with a focus on Italy.

Keywords: NPL, ReoCo, bank, real estate

INTRODUCTION

ReoCo Company (Real Estate Owned Company) was founded with the aim to improve the recovery of receivables secured by real estate mortgages through the participation in the auctions, to sustain price and, when awarded, to acquire the possession, while ensuring real estate management and rapid resale to market value. Given this operational vocation, ReoCo's specific mission is focused on constant monitoring and analysis of collateral portfolio.

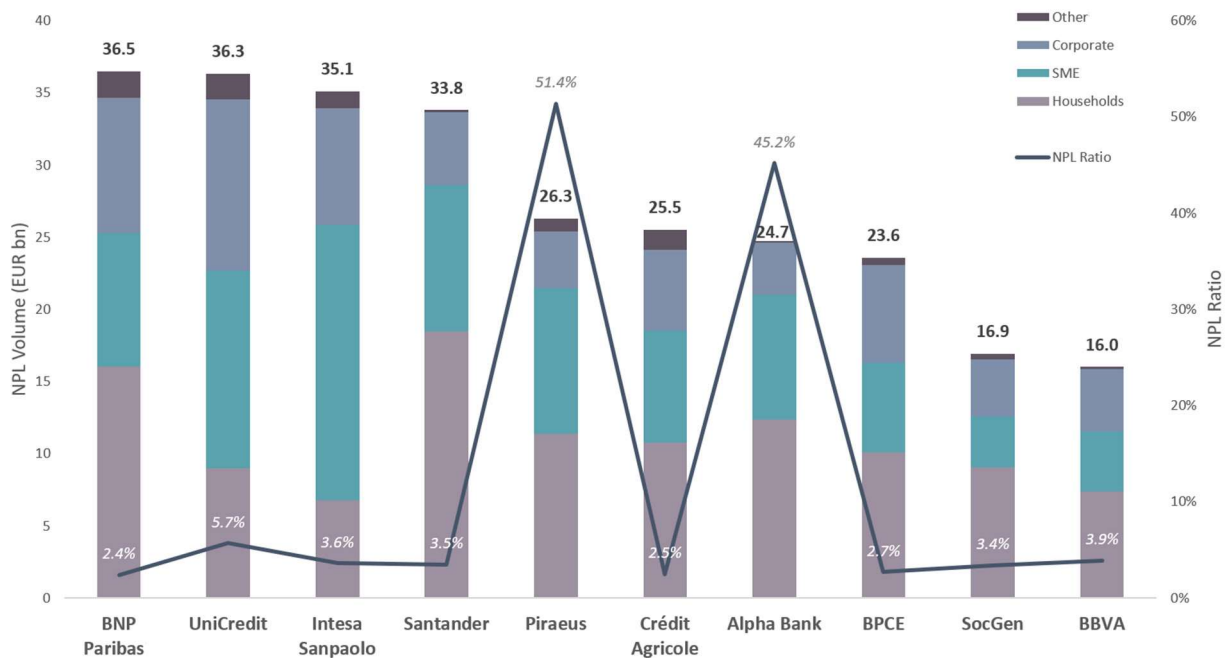
In Italy, ReoCos were born with the objective of credit recovery. This is why, after the financial crisis, the credit increased, and following European Central Bank's directives, reducing the number of NPLs became a fundamental goal for banks. Inside ReoCo, all typical real estate activities are performed, asset/advisory and facility/properties activities. Furthermore, acquisition of new assets is totally different from other real estate companies. Assets are bought by ReoCo through auction or *datio in solutum*, instead of a classic purchase agreement. The auction arises on credits owned by the bank itself. Auctions on these assets are unsolved credits on which the bank is losing money. For this reason, the bank itself can offer the asset to ReoCo in order to let it recovers the bank's money in the auction. ReoCos are within the consolidated financial statements of the respective banks. Therefore, they are a tool closely connected with their banks. The credit owned by the bank is turned over an asset for ReoCo. Analysis and due diligences are fundamental inside ReoCo because hidden costs are to be prevented, and the nearest possible market value has to be reached. ReoCo cannot generate other losses, since NPLs are losses for banks, ReoCo cannot increase these costs. For this reason, valuation inside ReoCo is fundamental. Auction decision is based on Max Bid as explained later on. It is the crucial value for ReoCo's participation in the auction or for a *datio in solutum* contract. In any case, the first step in decision-making is always GBV and NBV (see paragraph "Repossess Valuation").

In Italy, active ReoCos from different banks include:

- UniCredit
- Intesa Sanpaolo
- Banca Nazionale del Lavoro
- Banca Monte dei Paschi di Siena

These ReoCos are very different in Assets Under Management (AUM), also because some of them are very active than others. ReoCo is a new instrument with poor track record, for this reason, some banks are using it more than others.

FIGURE 1
BANKS WITH HIGHEST VOLUMES OF NPLs IN EUROPE



Source: Volumes as of end 1H19, from EBA Transparency Exercise

NPL number and NPLs Ratio are very important today for banks. These numbers are also representative of financial stability. BNP Paribas holds the largest volume of non-performing loans in Europe. The next two largest NPLs volume holders are Italian banks, UniCredit and Intesa Sanpaolo, both of them holding a significant amount of NPLs. In any case, what is more relevant is the NPL ratio because it is representative of financial stability of the bank. UniCredit holds the highest NPL ratio among these mentioned banks, but Greek banks, Piraeus Bank and Alpha Bank, ranked fifth and seventh in terms of volume and have the highest NPL ratios in Europe. Piraeus and Alpha Bank could be two risky banks now. NPLs are also a stability ratio for banks, high NPL ratio is a symptom of risky bank.

NPE AND NPL

NPLs are bad news for banks. They consume capital, they require time to be managed, diverting attention from the commercial bank's core activities (money lending); they increase running costs of the bank; they decrease profitability and they may even undermine the viability and sustainability of the bank. After the last financial crisis, banks have lost liquidity, and the world understood, for the first time, that real estate can be dangerous. New directives have been introduced for banks and credit recovery became a relevant activity, also because, NPL ratio has been introduced and banks cannot have more than a certain

percentage of NPL ratio. Some banks are unprepared to manage their NPLs effectively. They may be suffering from management inertia and a lack of a clear NPL strategy or instead they may not have established strong “workout” teams or linked with partners not able to bring the necessary resources and expertise. Further, they may not have undertaken the necessary groundwork to establish an advisory team.

Non-Performing Exposure (NPE) is a term used by regulatory authorities to denote lending contracts or other counterparty exposures which are problematic as unexpectedly deviating from contractual cash flows due to counterparty behavior. 90 days is the general threshold in which the credit become NPE.

NPL are exposures to debtors who are no longer able to meet all or part of their contractual obligations because their economic and financial circumstances have deteriorated.

NPL and NPE are also used interchangeably, but generally, it is specified (even by European Central Bank) that NPL can also be considered as a part of NPE, as a bad loan, therefore the worst part of the NPE.

**TABLE 1
NPE AND NPL**

NPE	• Past due	90 days 180 days	Risk
	• Unlikely to pay (UTP)		
	• Bad Loan (NPL)		

These are exposures to debtors that are insolvent for more than 90 days or 180 days.

These are exposures in which bank believe the debtors are unlikely to meet their contractual obligations in full.

These are exposures in which debtors are insolvent or in similar circumstances. These are the riskier debt to recover.

Banks can recover credits from NPE in different ways:

- Establishing an independent “workout” unit within the bank with the aim of closing the positions for example with agreements with the debtor
- Entering into a joint venture risk-sharing agreement with a third party
- Selling the NPLs to a third-party investor
- Selling the asset-backed securities with a SPV (special purpose vehicle) after a securitization
- Transferring credit as asset to a ReoCo

Banks are usually using a mix of the five solutions; ReoCo solution is not the most common one because:

- The bank takes the real estate risk, internally and the credit is transformed in asset for the group
- It is used generally only for bad loans

NPLs IN ITALY

Non-Performing Loans had negative repercussions on Italian economic recovery. In the last decade, Italy has been experiencing a period of deep and prolonged crisis, which led to a reduction of overall Gross Domestic Product (GDP) by 5% between 2007 and 2017. The macroeconomic context seems now to progressively improve and in the next five-year period a moderate GDP growth is expected, accompanied by reduced inflation and unemployment rate, which is however forecasted to remain higher than the pre-crisis levels.

FIGURE 2
EVOLUTION OF NPLs IN ITALY AND STOCKS OF NPLs (BILLIONS)



Source of Data: KPMG 2018, I Non-Performing Loan in Italia

Economic problems have led to a high number of NPLs in Europe, and especially in Italy (as shown in the previous Figure). In Italy, the reasons for this trend may be related to:

1. Italian real estate market and its bad performances
2. Italian bad past management
3. The performance of Italian companies
4. Recovery time

In detail:

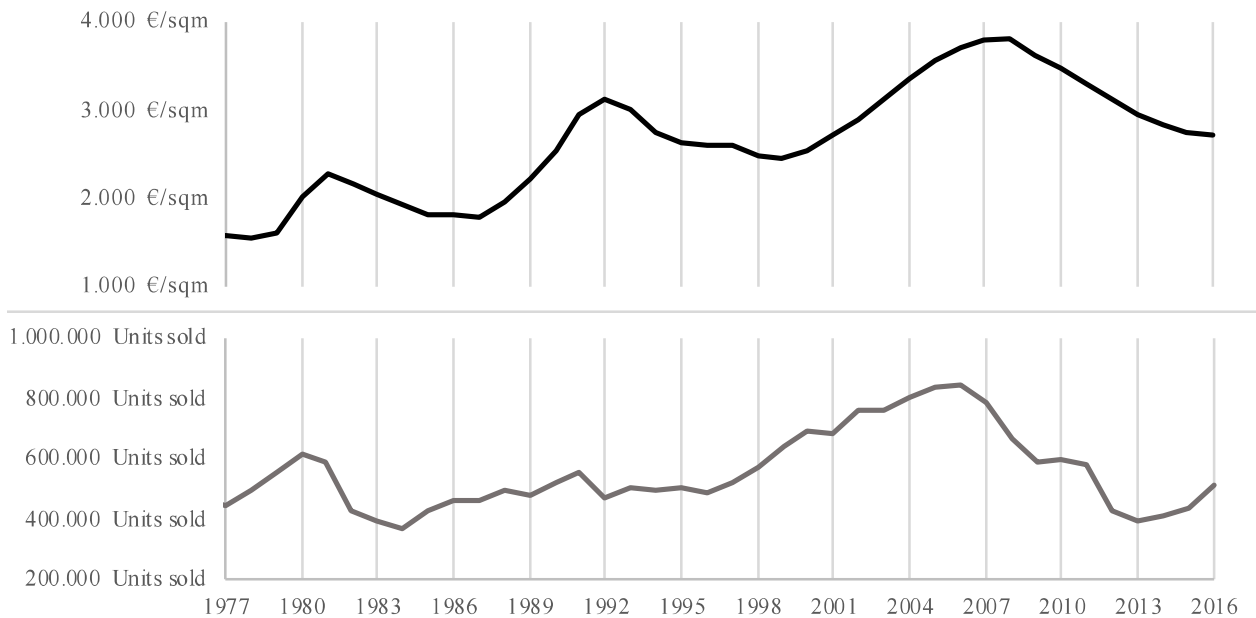
Italian Real Estate Market and Its Bad Performances

The difficult situation in Italian real estate market that we are going to study in the following Figure 3 has certainly had negative effects on NPLs. The drop in the number of sales, and the constant reduction in value, observed starting from the year 2008 constantly increased the number of NPLs. Figure 3 represents Italian €/sqm compared to number of sales in residential asset class. Real estate market is always cyclic, therefore is characterized by periods where prices (€/mq) tend to increase (market expansion) and periods in which prices tend to decrease (market recession). Starting from 2008, Italy was in a decreasing period. This is relevant for banks that have granted mortgages during the market expansion and now have to sell NPLs during market recession. This is obviously a loss for the bank and for the debtor in a market recession period. Real estate market cycle can affect NPLs in two ways:

- It prevents the debtor from recovering his debt by selling the asset (because asset value is reduced)
- It causes a loss for the bank (because credit value can be higher than asset)

On the contrary, during the periods of expansion, real estate market cycle, can cause gains for banks and debtors.

FIGURE 3
€/SQM AT COSTANT PRICE AND NUMBER OF SALES DURING THE YEARS



Source of data: Nomisma's database

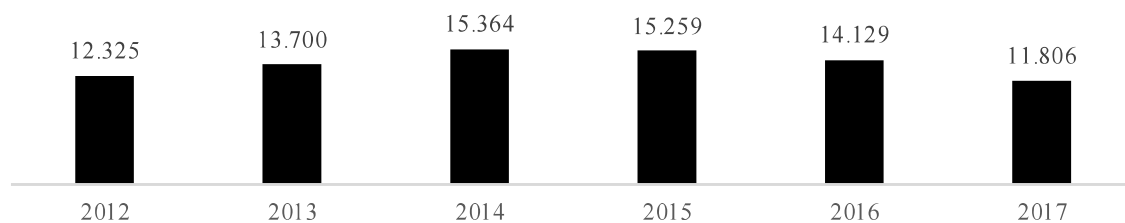
Italian Bad Past Management

NPL is due to poor provision and management of credit to businesses, in other words banks granted credits of doubtful future collectability. This is why, in Italy, mortgages are given on the value of appraisals, and not based on transactions value. Probably, in the past, the value of the appraisals was too optimistic and had not predicted the real estate crisis (or forecasted real estate cycles). Banks overestimated assets also to increase the mortgages to be given.

The Performance of Italian Companies

Italian banks are historically closely linked with the performances of Italian companies, especially the small and medium size ones. The collapse of SMEs (small and medium enterprises) coincided with an increase in banks' impaired exposures, precisely because Italian companies, due to adverse economic difficulties, failed to pay their debts. This situation affected Italian families, also struggling to pay mortgages. Italian economy is indeed mainly based on SME, for this reason, the economic issues inside this category damaged the whole economy. Between 2012 and 2014 bankruptcies have increased considerably from 12.325 to 15.364.

FIGURE 4
EVOLUTION OF THE NUMBER OF BANKRUPTCIES IN ITALY



Source of Data: KPMG 2018, I Non-Performing Loan in Italia

Recovery Time

This is specific to Italian bureaucracy, which is very slow. There are collaterals in Italy stuck on the market even for 10 years. The legal procedure for debt collecting is long and complex, because of the very slow legal procedure. Today, recovery time is much better than pre-crisis level. In any case, it is still very slow, when compared with other countries. Long recovery time damages also the asset (due to loss in maintenance) and therefore the credit.

TABLE 2
PAYMENT RECOVERY TIME (DAYS REQUIRED)

Italy	France	Germany	Spain	UK
1.120	395	499	510	437

Source of Data: KPMG 2018, I Non-Performing Loan in Italia

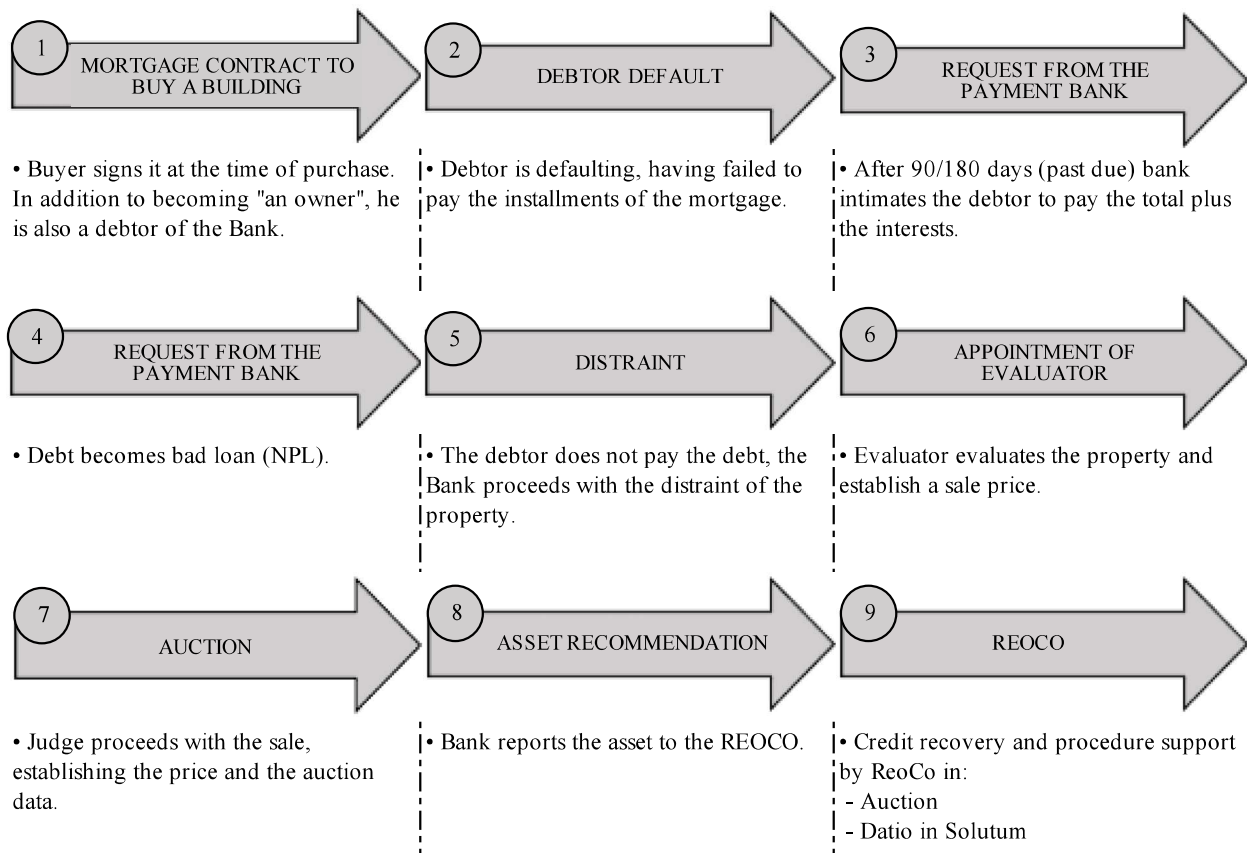
CREDIT TRANSFORMATION INTO NPL

The whole process starts from the buyer and the asset purchase. If the credit becomes first past due and after bad loan, the whole executive procedure begins and the repossession activities can be considered.

In the next page, in Table 3, are presented the steps that transform a bank credit into NPL. ReoCo is only active in the last steps due to his nature of credit recovery. The other steps are generally managed inside the bank mainly in risk center, credit recovery department/workout. ReoCo is a solution for credit recovery, in Table 3 a process involving also a ReoCo is presented.

- Appointment of evaluator (point 6 in Table 3) is a crucial point where a technician is involved. In this process, the asset is valued not only based on market price but also based on technical conditions and maintenance. The evaluator (CTU) writes a public report that can be consulted by anyone interested in the future auction.
- Auction (point 7 in Table 3) starts with a price based on what the evaluator estimated. This value will be lowered by 25% (sometimes less) if the auction will be deserted.
- Asset recommendation (point 8 in Table 3) is the point that links the bank and its ReoCo; the auction has been deserted several times, or the asset is considered interesting for the bank, for this reason, the bank, in order to preserve its credit, contacts ReoCo. The asset is recommended mainly based on GBV and NBV (see paragraph "Repossession Valuation") because the bank wants to preserve its credit as much as possible.

**TABLE 3
CREDIT PROCESS**



ReoCo

ReoCo is a company which is part of the originator bank, since it is included in the consolidated financial statements of the bank itself. Its purpose is to purchase, to manage and to preserve the value of assets coming from NPLs. Its aim is the resale of assets in short time, in order to recover money for the bank. ReoCo is an instrument, used by banks for credit recovery, on risky assets. This is not the main instrument for credit recovery, also because banks are not real estate companies, and this activity is outside their core business.

The legal structure of the company can be complicated, since ReoCo has to be independent in choices, to avoid any possible conflict of interest. Conflicts of interest can arise because the bank may want credit recovery in order to reduce also the NPL ratio. In order to do that, the bank can boost ReoCo in the auctions. When the Real Estate Owned Company purchases an asset, the credit is recovered for the bank, but, in reality, it is temporarily moved in ReoCo's asset and it is indeed still in the bank as both companies are in the same consolidated financial statements. For this reason, the independence of ReoCo is fundamental, otherwise the risk is to move bank credits in assets inside another company without recovering money. Real Estate Owned Company has its Board of Directors and its Chairman and is composed by real estate professionals. The activities made inside are manifold, and the aim is to stop the losses on these assets. ReoCo can acquire the assets in two ways:

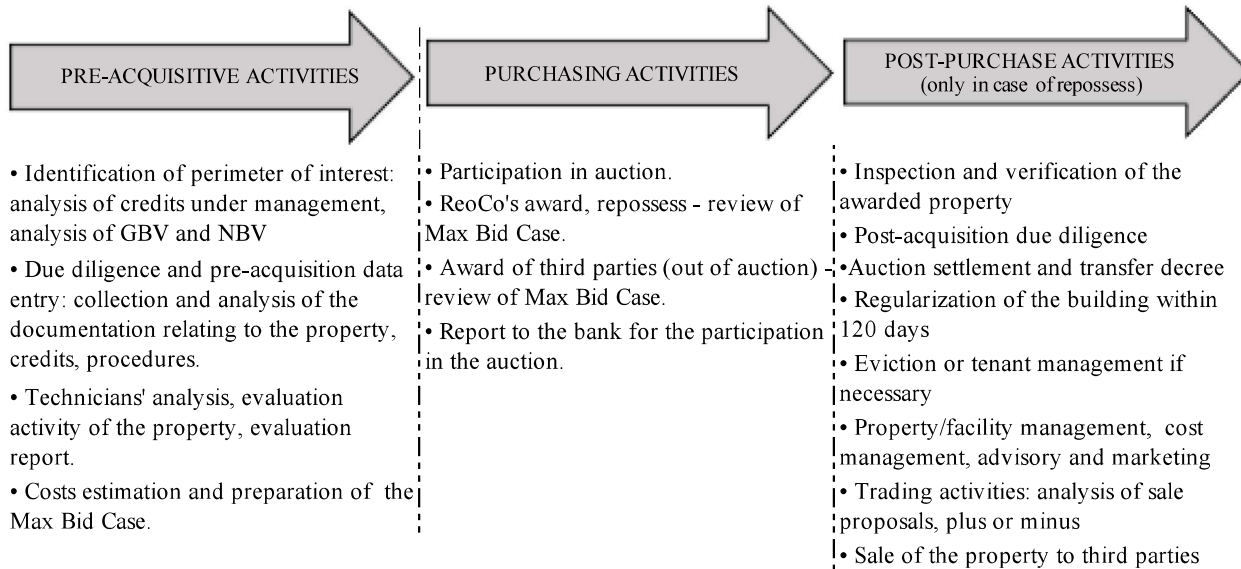
- Auctions
- *Datio in solutum*

Acquisition in Auction

Acquisition in auction is the most common way in which ReoCo can receive assets. The main activities can be divided into three macro areas:

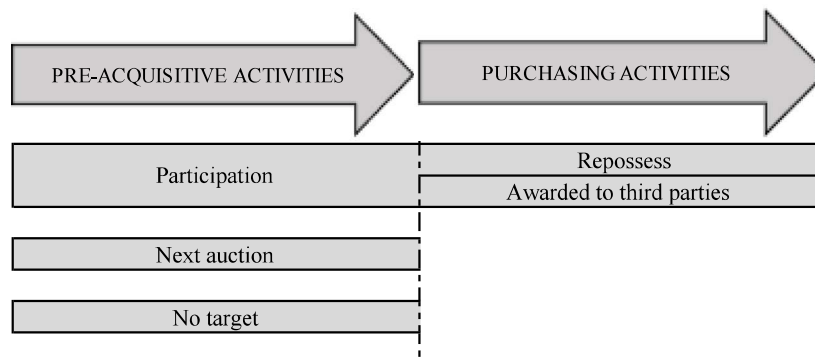
- Pre-acquisitive activities – All the activities to be done before the auction
- Purchasing activities – All the activities to be done during the auction
- Post-purchase activities – All the activities to be done after the auction

**TABLE 4
ACTIVITIES DURING THE AUCTION**



Pre-acquisitive activity is very important because it is when ReoCo can decide whether to participate in the auction or not. Instead, purchasing activities depend on the result of the auction.

**TABLE 5
AUCTION DECISIONS AND RESULTS**



- Participation is obviously the bank's expectancy; it is the active participation of ReoCo in the auction
- Next Auction is the postponed participation, ReoCo will not participate in this auction but will participate in the future auction if the asset will not be awarded

- No target is when ReoCo decides to not participate in the auction

Participation in the auction can lead to two results: repossession and awarded to third parties. Awarded to third parties is the best result, for both bank and ReoCo. In this situation, ReoCo increased the auction price without purchasing the asset, so the company instantly recovers the money for the bank. Instead, repossession is when ReoCo bought the asset because the auction price did not reach Max Bid (see paragraph “Repossession Valuation”). Next auction can be decided for different reasons, ReoCo would participate in the auction but there is not enough time for the participation or for other reasons, for example:

- The asset is overpriced, for this reason ReoCo can decide to wait the next auction and price reduction. In fact, when the auction is deserted, the starting price is lowered by 25%
- There is a due diligence to be done, because there is the suspect of asbestos or legal and taxes issues and there is no time to perform these activities (therefore there are possible hidden costs)
- The auction after the announcement is postponed, for example because the debtor asked to close his debt with the bank (the debtor will be in a private contract with the bank)

Instead, no target situation is when ReoCo believes, after analysis, that there are issues in the auction, for example:

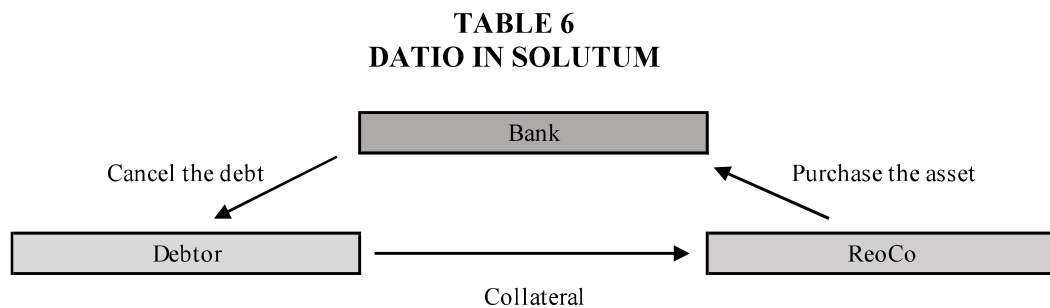
- The asset is considered not marketable
- There are issues that may affect the reputation of the group (for example minors inside the asset or environmental problems)

Acquisition in *Datio in Solutum*

Datio in solutum is as frequently as auction for the acquisition because there are far fewer assets to which the procedure allows this kind of contracts. *Datio in solutum* is defined as follows:

“Contract in which borrowers who cannot repay their mortgages are released in full of the underlying debt by handing their mortgaged property over to the lender”.

When inside the process ReoCo is involved this is the structure:



Datio is generally used for companies with valuable assets. When there is a valuable asset, sale at auction is difficult due to liquidity required to participate; for this reason, it is easier for the bank to cancel the debt, allowing to take the asset back by a ReoCo. As described in Table 6, ReoCo acquires the asset from the bank, the bank cancels the debtor’s mortgage and the asset/collateral is moved inside ReoCo which becomes the new owner. In this case, the analysis has to be very accurate. Assets in *datio in solutum* are generally valuable so there is a potential risk for both bank and ReoCo in keeping an overpriced asset without market inside the group.

Repossess Valuation

Max Bid is the way generally used by ReoCo in order to evaluate the asset. Max Bid is the maximum value that ReoCo can offer during the auction. It is the value used as repossess decision during the auction; Max Bid is the threshold, ReoCo participates in the auction up to this value. Therefore, if during the auction this value will not be reached, the asset will be repossessed by ReoCo, if Max Bid will be exceeded, the asset will not be bought. In fact, ReoCo is not using the typical financial ways in order to evaluate credit recovery. Real estate investments are generally based on financial measures like: NPV, IRR or payback period. Instead, ReoCo works in a slightly different way, because:

- It is not a real estate investment but a credit recovery
- The goal is not a value creation but a stop loss
- There is no leverage
- The duration is very short
- ReoCo must not create losses or profits, but closes the financial statement

Therefore, the process is a little bit different from real estate investments, also because the aim of ReoCo is to not to keep the asset, but to resell it in a very short time, generally within one to three years. For the same reason, ReoCo is also against CAPEX, its aim is not value creation but credit recovery. This point is fundamental also to understand the ethics behind the whole process. These assets are coming from bankrupt people or companies. CAPEX is a risk for ReoCo for two reasons:

- CAPEX increases the risk exposure, raising the possibility of creating further losses to what is already a loss, because it is an NPL
- CAPEX increases the possibility of creating profit (plus)

These are crucial points because this kind of companies cannot create other losses (minus), otherwise their existence would be pointless, and they cannot create too much plus. In fact, too much plus would not be ethical, because these assets were owned by people in need; therefore, speculation on these people is not ethical and a reputational damage for the bank.

The first step for the credit recovery is GBV and NBV valuation. GBV and NBV valuation is fundamental in order to establish the credit to recover. GBV and NBV are value based on an estimated recovery time, expressed in years. GBV is the gross book value, and it is calculated as follows:

$$GBV = \sum_{t=1}^n \frac{f_t}{(1+i)^t}$$

The discount formula considers time value of money; according to IAS, banks must use the original effective interest rate, i , of the loan itself as discount factor, where f indicates expected cash flows. This method is also used to determine the net value of NPLs. Instead, NBV is the net book value and it is the GBV minus provisions, NBV is what the bank is expecting to recover on the asset. GBV and NBV are the starting point of credit valuation, in fact if they are too low or there is not a preferred mortgage on credit, ReoCo will not recover money, but it will give money to the procedure, losing banks resources. In this part of the process, some kind of due diligence may be involved. This because, for Italian law, even if there is a mortgage on the asset, legal issue or unpaid taxes can cause the loss in priority on credit.

The second step is the valuation of the asset. In this case, the issue consists in establishing a Max Bid for ReoCo. Max Bid is the maximum value of the asset for ReoCo. As mentioned above, the valuation is generally based on cash flows and it is not made on discounted cash flows and NPV. Max Bid for ReoCo is calculated considering an exit value, a reselling period and costs during an estimated period. The formula to calculate Max Bid is very simple:

$$\text{Max Bid} = \text{Resale Price} - \text{Costs in the Period}$$

Costs in the period are generally divided into three categories:

- A. Acquisition Costs
- B. Management Costs
- C. Reselling Costs

Therefore, Max Bid valuation has three fundamental variables to define:

- Time - estimated time for the resale of the asset and estimated costs in the period
- Max Bid - maximum value to be offered in the auction
- Resale price - expected value for the reselling of the asset

In case of repossession, time, Max Bid and resale price will become the program to be respected.

**TABLE 7
MAX BID EXAMPLE**

Auction Starting Price	95.641
Minimum Raise	1.000
Resale Price	177.000
Cost Items	
Costs in 12 Months	
A) Acquisition Costs	-16.200
Registration Tax (VAT)	-11.700
Mortgage Tax	-50
Cadastral Tax	-50
Procedure Expenses	-1.300
Transfer Expenses	-1.300
Legal Costs	-1.800
B) Management Costs	-6.961
Insurance	-280
Security Costs	-500
Taxes	-1.412
Property Fee	-3.120
Financial Costs	-1.649
C) Reselling Costs	-18.010
Eviction - Legal	-2.800
Eviction - Costs	-2.000
Regularization	-5.000
Certification	-500
Fee broker	-5.310
Unexpected Costs	-2.400
Total Costs	-41.171
Max Bid	135.829

In this example, 95.641 is the starting price in the auction, and 135.829 (177.000 minus 41.171) is the Max Bid. This means that ReoCo can participate in the auction and increase the price up to 135.829, this because, it is planned and estimated to resell the asset within 12 months at 177.000. Therefore, the bank considers its asset in the auction undervalued, and cash balance for the operation in 12 months is 0. With a reselling price of 177.000, ReoCo is therefore able to covers all the 41.171 estimated costs in 12 months. The table is generally what is represented as a result, but costs are analyzed as cash flow in 12 months like in the following Table 8.

TABLE 8
CASH FLOW IN 12 MONTHS

	Months	0	1	2	3	4	5	6	7	8	9	10	11	12
Resell														177.000
Auction - Down Payment		-13.583												
Auction - Settlement					-122.246									
Total Purchase Price	-135.829	-13.583			-122.246									
Registration Tax (VAT)					-11.700									
Mortgage Tax					-50									
Cadastral Tax					-50									
Procedure Expenses					-1.300									
Transfer Expenses					-1.300									
Legal Costs					-1.800									
A) Acquisition costs	-16.200				-16.200									
Insurance								-140						-140
Security Costs								-500						
Taxes								-706						-706
Property Fee								-1.560						-1.560
Financial Costs		-373				-450		-450						-376
B) Management Costs	-6.961	-373			-450			-3.356						-2.782
Eviction - Legal								-2.800						
Eviction - Costs								-2.000						
Regularization								-5.000						
Certification								-500						
Fee broker														-5.310
Unexpected Costs								-2.400						
C) Reselling Costs	-18.010							-12.700						-5.310
Cash Flow	0	-13.956			-138.896			-16.056						168.908

Valuation is very complex. The issue is related to the type of asset itself. ReoCo tends to participate in the auction when the asset is losing value, this because the auction is going to be deserted. Auction is going to be deserted when the asset is not very marketable. The intervention of ReoCo during the first auction is not very common, but on average, its intervention occurs after the third or fourth auction. The reason is simple, after every auction there is a reduction in the starting price of the auction itself of 25%; therefore, the consequence for banks is simple, credits lose greater value in time than assets. There is also another consequence, asset valuation for ReoCo is usually very complex because these assets are not very marketable, and there are few markets comparable. Auction is the main point of ReoCo activity, because its aim is to not purchase the asset during the auction but to increase its value, bidding in the auction.

As explained in paragraph “Acquisition in Auction”, the best expected result during the auction is the “awarded to third parties”, in detail:

- GBV and NBV are over auction starting price, so ReoCo can participate in the auction for the credit recovery of its bank
- The asset is evaluated, and Max Bid is calculated
- ReoCo during auction bidding reaches the value of Max Bid
- Another participant in the auction offers more than ReoCo’s Max Bid, therefore, ReoCo stops bidding
- The asset is awarded to third parties

The worst results for ReoCo, during the participation in the auction, are indeed two:

- Repossess of the asset (at auction starting price) because there is only ReoCo as a participant in the auction
- Repossess of the asset because, even if there are other participants in the auction, Max Bid is not reached

ReoCo’s aim is to not purchase the asset, it is to enliven the auction, in order to let someone else purchase the asset at a value as close as possible to Max Bid, in order to recover more money for its bank. If this is not possible during the auction, the aim becomes asset-purchasing (repossess) during the auction and the reselling as fast as possible in the market. Max Bid is also used in *datio in solutum*, in this case, the value represents the purchase value for ReoCo.

Asset and Property Management inside ReoCo

ReoCo is a real estate company. Therefore, the company must carry out typical real estate activities in case of repossession; some of them can be outsourced, others are internalized. After the auction, even with a repossession result, ReoCo is not the owner of the asset. The first activities to be completed are:

- Auction settlement – In order to participate in the auction, it has been paid, generally, only 10% of the price. So, ReoCo has still to pay the remaining 90% within 120 days. This is also represented in Table 8, down payment in time 0, 13.583 in cash out, settlement in time 4, 122.246 in cash out. According to Italian law, payments in auctions are divided into two tranches
- Obtaining transfer decree which is the most important document. This document states ReoCo as owner of the asset, it is a certificate of ownership. This document can be obtained when the two payments have been made

After these first two activities ReoCo is the owner, so the next activities are:

- Starting the eviction if the asset is inhabited (without a contract). This may involve a legal procedure
- Regularization of the asset. By law, there are 120 days after the transfer decree to do this. This is relevant, because this is the period in which potential unauthorized development, committed by the debtor, can be regularized.

The typical activities inside a ReoCo are similar to a real estate company. Real Estate Owned Company has to perform all the ordinary activities, like payments of insurances and taxes, bills, collecting rent (when the building is rented) and so on. ReoCo has also to perform cost management, the most important activity. Costs are fundamental because running out of costs (between the real ones and those estimated in Max Bid) nullifies all activities and transforms ReoCo into another cost for the bank. What is planned in Max Bid has to be respected. For this reason, valuation is so important inside ReoCo. Maintenance is generally a very low cost, and it is done only if strictly necessary. As described in the previous paragraph “Repossession Valuation”, CAPEX is not generally done, in order not to incur in other costs and not to increase the risk of realizing too much plus. Tenant management is an activity performed if the asset is purchased with a tenant and ReoCo decides not to do the eviction. This is quite common because if the property is rented, the eviction is not generally done. In this case, the credit recovery happens with the cash flow generated from rent and with the cash flow with the resale. The asset can be also sold with the tenant inside. Advisory and marketing activities are the aim of ReoCo, in order to recover the credit with the sale in case of repossession. Resell is the scope of the whole process, but the proposal must be evaluated, otherwise it cannot be accepted. The proposal can generate a minus or a plus. As described in paragraph “Repossession Valuation” ReoCo has to avoid minus and has to contain the plus for ethical reasons.

The study illustrated the use of Max Bid in Table 7. Table 9 presents an analysis of a proposal for the same asset presented in Table 7.

TABLE 9
VALUATION OF A PROPOSAL IN PLUS

Cost Items	Costs in 6 Months
A) Acquisition Costs	-16.200
Registration Tax (VAT)	-11.700
Mortgage Tax	-50
Cadastral Tax	-50
Procedure Expenses	-1.300
Transfer Expenses	-1.300
Legal Costs	-1.800
B) Management Costs	-4.179
Insurance	-140
Security Costs	-500
Taxes	-706
Property Fee	-1.560
Financial Costs	-1.273
C) Reselling Costs	-18.010
Eviction - Legal	-2.800
Eviction - Costs	-2.000
Regularization	-5.000
Certification	-500
Fee broker	-5.310
Unexpected Costs	-2.400
Total Costs	-38.389
Purchase Price	-135.829
Costs + Purchase Price	-174.218
Proposal Received	176.000
Plus	1.782

If the asset was purchased at Max Bid, 135.825 and after 6 months ReoCo received a proposal at 176.000 (so lower than 177.000 estimated). Then it is necessary to evaluate if the proposal can be accepted or not. In this case, ReoCo is able to sell the asset before the planned time (6 months instead of 12 months) and to also cut some management costs (4.179 instead of 6.971 estimated). The operation is able to generate 1.782 as plus, therefore, this is a result even better than the ones estimated with Max Bid. In this example, ReoCo:

- Increased the asset price from 95.641 to 135.829 and saved the asset from a potential write-off in value in the auction (in the event of only one bidder at the auction, the asset could have been sold at a devalued price of 95.641)
- Purchased the asset and resold it before the schedule
- Recovered the credit for the bank gaining a plus

This is a good result archived by ReoCo in case of repossession. Either way, the even better result in this example would have been:

- ReoCo's participation in the auction and a price raising up to Max Bid 135.829
- Subsequent offer by another third bidder, after Max Bid
- Asset awarded to third parties, so credit is recovered
- No repossession, no necessity of other real estate activities

CONCLUSIONS

NPLs are related to the bank's liquidity and therefore to the bank's possibility to lend money. The issue arises when the mortgage is blocked in the NPLs, due to macroeconomic reasons or bad management. When a bank owns too much NPLs has to recover its money. Banks are using different ways in order to recover the credits, one of these solutions is ReoCo. Italy has a high number of NPLs that increased especially after the financial crisis. ReoCo's management required skills in real estate thanks to its nature, and in order not to create other losses. GBV and NBV are the starting point, after this valuation, Max Bid is the second step. ReoCo can acquire assets with auctions or *datio in solutum*, but the best use of ReoCo is when it does not acquire any asset and it increases the price during the auction.

ReoCo's activities in case of repossession are various, because as a company, it has to perform many real estate, financial and legal activities. ReoCo required a special team of real estate professionals. ReoCo is a good instrument for credit recovery to be used wisely.

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