

Blowing bubbles?

Foreign investor interest in the Iberian real estate market has led to a 'hotel boom', while deals are becoming bigger and more complex – however, the good news is tempered by a shortage of good assets and fears that supply could outstrip demand. Is a real estate bubble being created?

The Iberian real estate market is back with a bang, according to lawyers, with the recent glut of transactions – which are becoming larger and more intricate in nature – demonstrating that confidence has returned. Indeed, some lawyers argue that the current levels of activity show that the real estate sector is now as buoyant as it was before the crisis.

One of the most notable transactions of late was Merlin Properties Socimi's €1.79 billion purchase of Testa Inmuebles en Renta. Meanwhile, Lone Star Funds' €1 billion residential golf resort project in Vilamoura on the Algarve demonstrates that there is hot property to be found in Portugal.

"The market is now back to normal and it is expected that the share of real estate-related work in the coming years will keep increasing," says Orson Alcocer, partner at DLA Piper in Madrid. Optimism abounds in Portugal, meanwhile, where the surge in foreign capital targeting assets in the country is picking up increasing



“Buildings in the city centre of Madrid and Barcelona are highly sought after for refurbishment.”
 José Luis García-Manso Pérez-Llorca

momentum. Ricardo Reigada Pereira, a managing associate

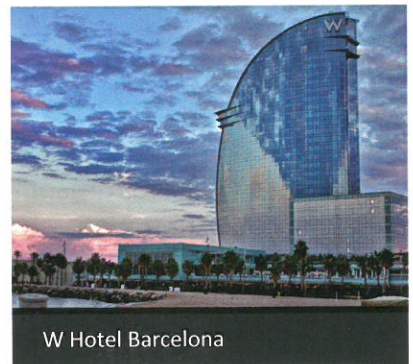
in Linklaters' Lisbon office, says: "The share of speculative investors chasing big-ticket deals remains high, but it has been recently decreasing by virtue of the arrival of the more core and traditional-type investors – in any event, distressed and opportunistic investments still represent a significant portion of the total volume."

Hotel boom

Pedro Ferreirinha, partner at Vieira de Almeida, points out that developers are, in the main, looking for buildings in Lisbon and Oporto that can be refurbished and quickly reintroduced into the residential and retail markets: "They are clearly more focused on investments with a shorter time to market that can benefit from the competitive incentives scheme that Portugal has in place for property

rehabilitation."

ABBC partner Luis Filipe Carvalho, who cites a "hotel boom" in Lisbon, adds: "This conjuncture led to an increase of the average square metre price which impacted the national market creating a greater demand for leases instead of acquisitions, due to the lack of access to credit for housing



purposes."
 Madrid and Barcelona have been the hubs for investors in Spain, according to lawyers.



José Luis García-Manso, partner at Pérez-Llorca, says: "Buildings in the city centre of Madrid and Barcelona are highly sought after for refurbishment, while residential development is growing again in specific areas. In addition, the hotel sector in Barcelona and Madrid is booming. Last but not least, we are seeing growth in logistics developments." However,



Edificio España, Madrid

García-Manso points out that the core assets in these cities are becoming harder to come by, leaving investors looking for opportunities in different regions.

Diego Armero, partner at Uría Menéndez, concurs: "Most investment funds are looking for yielding assets, not only prime assets in Madrid and Barcelona, but also assets in secondary locations. Some are even focusing on buying land and investing in the development of new properties, this being very recent and promising news."

It has largely been private equity funds, REITs and international investors snapping up assets but lawyers say many different types of players are moving into the market. "US opportunity and hedge funds, European fund managers and investment banks should remain active in the sector whereas core investors are expected to increase their appetite for Portuguese real estate assets," Reigada Pereira claims. "It

remains to be seen whether players most affected by Portuguese turmoil recover their *mojo* – the recent legal changes introduced in the tax framework applicable to Undertakings for Collective Investment may prove to be pivotal in that regard, as well as the Portuguese REITs which are expected to take off and enhance the ability to attract new investors."

More innovative deals

The emergence of a more sophisticated client base is resulting in ever-more intricate transactions too. Emilio Gómez, head of real estate at Hogan Lovells in Madrid, observes that lawyers are "facing more complex and innovative deals now compared to those 10 years ago". Bernat Mullerat, partner at

Cuatrecasas Gonçalves Pereira, adds: "The current real estate market has brought larger and more complex deals. This allows

“ Lawyers are facing more complex and innovative deals now compared to those 10 years ago. ”
Emilio Gómez
Hogan Lovells



law firms to increase the size of teams involved in the deals and to bring together expertise from a range of practice areas related to real estate, such as private equity, contract, financing, planning, litigation and restructuring. More complex deals require in-depth knowledge of legal requirements and of market practice."

Spanish real estate market Q&A

What are currently the biggest opportunities for law firms?

Fernando Azofra, partner, Uría Menéndez says: "Assisting in real estate investments, including structuring and setting-up tax efficient schemes such as SOCIMIs, and advising developers in new commercial space projects."

What assets are developers targeting?

Orson Alcocer, partner, DLA Piper says: "As the profitability of investing in existing properties shrinks, we are seeing an appetite for new developments of all kinds – residential, commercial, offices, hospitality and logistics. The investors and developers, however, are focusing on high quality plots of land."

What have been the latest developments in the real estate finance market?

Orson Alcocer, partner, DLA Piper says: "After many years of drought, when there only were refinancing deals, the real estate finance market is now booming and we are seeing not only acquisition finance but also development finance for the first time in five years."

What are currently the biggest challenges for law firms?

Bernat Mullerat, partner, Cuatrecasas Gonçalves Pereira says: "The real estate market is coming back at a much faster pace. The biggest challenge is to find a robust and sustainable business model. Political uncertainty and regulatory changes threaten recovery of the industry."



Briefing: The Portuguese real estate market

What are currently the biggest opportunities for law firms?

The Portuguese real estate market is booming, according to Tiago Mendonça de Castro, partner at PLMJ. "This boom is a result of the depreciation of real estate assets prices and the efforts of several public policies aimed at promoting Portugal abroad, with the purpose of highlighting Portugal as a safe and open place for foreign investment and a prime living or tourist destination," he says. "Several tax schemes have recently been designed for attracting foreign investors to Portugal, which has a real estate market that is highly sought after by foreign investors and companies from all around the world." Mendonça de Castro adds that the biggest opportunities for law firms lie in their "ability to advise and assist foreign clients in such a way that they feel safe investing within a legal context which is foreign to them".

Providing advice to international investors acquiring real estate assets in Portugal is a significant source of work for Lisbon firms. "Structuring foreign real estate investments is currently one of the biggest opportunities for law firms," says Sofia Galvão, name partner at real estate boutique Sofia Galvão Advogados. The most significant opportunities exist in the commercial sector – specifically retail, hotels, shopping centres and offices – according to MLGTS partner Filipa Arantes Pedroso. She adds: "Urban redevelopment is also an opportunity with tax benefits in place."

What have been the latest developments in the real estate finance market?

"Depending on the quality of the underlying assets, banks, equity investors and other sponsors have increasingly become available to finance real estate acquisitions and development based on more appropriate loan to value ratio," says Pedro Ferreirinha, partner at Vieira de Almeida. However, there is still a feeling that banks are largely reluctant to fund real estate projects. Tiago Mendonça de Castro, partner at PLMJ, says: "The Portuguese real estate finance market is still licking its wounds and proceeds extremely carefully – the financing for real estate investment is very low when it comes to individual investors, banks are sometimes more willing when the investor is a well renowned foreign company but the banks' approach is still generally cautious with respect to real estate." However, Hugo Nunes, partner at Sofia Galvão Advogados, says there are opportunities for law firms in this area: "New rules on available public funds in Portugal mean there is demand for legal advice in light of the very interesting opportunities for alternative sources of funding."

What assets are developers targeting?

There are two main categories of asset that developers are seeking, according to PLMJ partner Tiago Mendonça de Castro. "They are commercial assets – such as shopping centres and new retail stores in prime areas for street shopping – as well as houses or touristic assets, or assets with a high tourism potential, such as services apartments or boutique hotels all in prime areas," he adds. ABBC partner Luis Filipe Carvalho says developers are focusing on properties in "strategic localisations in city downtowns" to reconstruct or refurbish in order to sell as prime real estate to foreign investors either for residential or commercial purposes. He continues: "Additionally, investors are also looking for bigger properties to develop office spaces."

Gómez argues that this complexity extends to investment and financing structures, which is the "driver that real estate lawyers have to play with". Other lawyers in Spain say that the financing market, especially the alternative financing market, is driving investments. "The leading traditional credit institutions are financing real estate projects again and new market participants have entered the Spanish lending market, for example, direct lenders such as hedge funds," García-Manso comments. "We have also seen certain projects financed by insurance companies – the pricing of loans, in terms of margin, is relatively low if compared to other financings such as project and acquisition financings."

Fernando Azofra, partner at Uría Menéndez, agrees that most Spanish and international banks, and also some investment funds, are "back on track to finance transactions", adding that this includes development finance. Meanwhile, Ferreirinha cites the availability of significant funds in the Portuguese market as an influence: "We have witnessed some major international players entering the market with the acquisitions of significant retail portfolios, stand-alone retail and hospitality projects and sale and lease back transactions."

High office vacancy rate

Despite the positive messages, there is a degree of caution about the future. Many observers believe it will be a challenge to maintain the current momentum, especially in Portugal, if the market does not develop in a sustainable and balanced way. "Low inflation is a risk for the economy and therefore for the real estate market," warns Filipa Arantes

Pedroso, a partner at Morais Leitão, Galvão Teles, Soares da Silva & Associados in Lisbon. "The vacancy rate in offices is still high, the higher demand last year and this year has not increased the rents – the increase of hotels in Lisbon and Oporto is enormous and there is a risk of the offer being higher than the demand."

Ferreirinha expands on this point, claiming the biggest concern for investors in the retail and office sectors is the performance of the economy and the capacity of tenants to pay their rent. Meanwhile, the main challenge for developers is the optimisation of the "time to market" of their products.

In Spain, uncertainty regarding the result of this year's parliamentary general elections has not helped investor confidence. In addition, anxiety

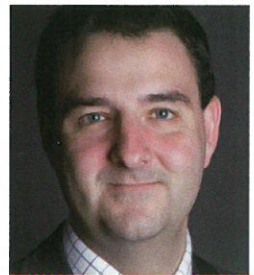
over the shortage of good assets and the rising prices of assets is expected to limit opportunities in the market. "I believe that competition has become tougher in the last two years, and clients must now find their own niche to be able to still find true opportunities," Alcocer adds.

Gómez has further concerns: "Office occupiers, for instance, demand more efficient spaces since many workers work remotely, but in turn require some new common areas for leisure and teamwork. Online sellers demand new high-

tech logistics spaces. Finally, shopping centres must be

“Most investment funds are looking for yielding assets, not only prime assets in Madrid and Barcelona, but also assets in secondary locations.”

Diego Armero
Uría Menéndez



“repackaged” in terms of tenants and uses.”

The real estate market may now have reached pre-recession levels but – after the painful crash in 2008 and the effects on commercial and residential property – lawyers know not to take anything for granted.

Real estate market boosted by deals in tourism and retail sectors

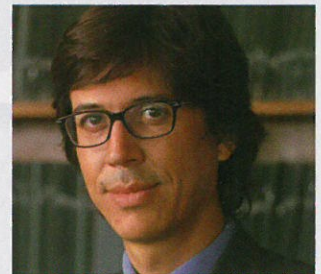
Real estate investors from around the world targeted opportunities in Portugal in the recent months, making this year one of the best for some time, according to Nuno Sá Carvalho, partner responsible for the real estate practice at Cuatrecasas, Gonçalves Pereira in Lisbon. "During the current year, very significant real estate transactions were closed in sectors such as tourism, retail and offices," he says. "Important international players from the real estate and tourism sectors have recently turned their attention to Portugal as they are seeking alternative markets for their investments."

Sá Carvalho says this trend gave rise to "impressive and remarkable changes" in the Portuguese real estate sector including the arrival of a wide range of investors not only in terms of their geographic origin – Europe, the US, Thailand, China, the Middle East, Angola, Mozambique and Brazil – but also in terms of their investment profiles: foreign investment

funds, venture capital funds, family offices and individual investors.

Sá Carvalho points out that the boom – in part helped by the 'Golden Visa' programme and the non-habitual resident tax regime – has revitalised the real estate market and created significant opportunities for law firms. As examples, he cites matters relating to urban leases, licensing, town planning and the rehabilitation of old buildings.

"In law firms like ours, the most relevant work normally consists of advice on the sale and purchase of real estate portfolios, the development of real estate projects, and the restructuring of distressed assets as these transactions require specific skills and the involvement of professionals with different areas of expertise," he explains. However, Sá Carvalho adds that investors' main challenge now is being able to find new business opportunities, which often involve "going outside of their comfort zone with more aggressive risk profiles.



Nuno Sá Carvalho