Real estate investment in Brazil – 2008

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The Brazilian economy is coping quite well with the US sub-prime crisis. The economy continues to expand at increasing rates; foreign investments keep coming in, the country recently obtained investment grade rating from one of the major international credit rating companies; the Real, the Brazilian currency, remains strong and has appreciated significantly over the last 12 months against all major international currencies. Domestic interests have been consistently reduced over the last years, but seem to have now stabilized, in view of the threat of an upturn in inflation. The level where interest rates stabilized, however, is still very high for international standards. Indeed, a base rate (SELIC) of 11.3% per annum is probably one of the largest interest rates in the world, particularly if the currency remains stable.

Nonetheless, the combination of a growing economy, low inflation and reduced interest rates (at least from a domestic stand point), brought back the possibility of long term financing, which has not existed in Brazil for a long period of time, particularly in the housing sector. Several opportunities also appeared in the rent sector, especially in shopping centres and other large commercial or industrial premises for rent, such as built-to-suit facilities. All this tremendously increased the real estate market and created a series of new investment opportunities, but it has also increased access to long term funding and financing. This is probably the most important challenge faced by the real estate companies: to structure and match their companies and operations in a manner which ensures continued access to capital and funding. The simple buying, constructing and selling activities were suddenly transformed into a much more sophisticated business, with an important financial component to it.

Many companies decided to go public. During 2006, six real estate related companies went public. In 2007 this number grew to 24, .for example., four times more than in 2006. Only those companies raised something like R$ 14 billion (roughly US$ 7.8 billion), foreign investors having contributed over 75% of those funds. Other companies are also expected to make their initial public offerings, depending on the evolution of the market. Thus, Brazil now has over thirty real estate related companies publicly listed and traded. Some analysts believe, however, that this number might be excessive and that consolidation might soon begin.

Several other companies took a different path. Some entered into strategic alliances with international investors. Others resorted to sophisticated structures, using some of the financial vehicles available in Brazil. This includes the Real Estate Investment Fund (*Fundo de Investimento Imobiliário*), the Brazilian equivalent to the US REIT, and the Private Equity Investment Funds (*FIP – Fundo de Investimento em Participações*). Both vehicles may afford some significant tax incentives for long term investments, particularly from abroad.

Still other companies simply took advantage of the financing instruments and transactions which are now available in the market. This may include, for instance, the securitization of receivables (locally known as *CRIs – Certificados de Recebíveis Imobiliários*) or simply long term financing, which is now available not only to the customer, but also to real estate companies.

As a consequence, the Brazilian real estate market is blooming and is growing at a tremendous pace. There is a boom in attractive projects and many companies are very much capitalized and willing to pursue them. Their operational volume continues to grow very fast. However, sustaining such a great volume of transactions is also a challenge. Not all companies will succeed. Launching and selling more and more new buildings and projects may not be sufficient to guarantee their future in the market. Much will depend on their capability to deliver the projects and deal with the cash flow, credit and other financial and legal aspects.

In this situation, legal advisers play a key role. They need to be ready to help create and put together new financing structures and to assist their clients in keeping pace with the changing environment. But they may not overlook some very down to earth and traditional matters, such as revision of title, enforceability of transaction agreements and the like. Indeed, lawyers should not get carried away with the moment in order to assist their clients in making this growth a sustainable one.