

## **Brazil: Overview of the Real Estate Market “Trends in 2009 and Beyond”**

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### *Economic Fundamentals*

The general sentiment is that the Brazilian economy is already in recovery from the global financial crisis and showing strong fundamentals for long term business. The local currency (the Real) has appreciated 20% since Jan 1<sup>st</sup>, 2009, the Central Bank interest rate is at a historic record low of 9.25%\*, the country has maintained investment-grade status since '08, Brazil has a very stable banking system, and there is a stable political environment moving into the 2010 elections. Looking at the demographics, Brazil has a population of 192 million with a historic growth rate of 1.1% from '04-'08, disposable income over R\$15,000 grew by 34% in 2007, 60% of the population is <39 years, and consumer spending between '02-'07 grew 9.7% in real terms. When comparing to its peer BRIC members – Brazil appeals as much as India and China.

The fundamentals are driving real estate opportunities in office, industrial and retail, entertainment and recreation, residential, healthcare and medical, and build-to-suit and sale-leaseback projects. Challenges exist in the market including fragmented ownership of real estate assets, varying real estate negotiations customs, complex law and tax codes including the real estate legal framework, currency variance exposure, and capital and investment deficiencies. To overcome and better understand these challenges, international companies utilize local services/partners who understand the market.

### *Investment*

At the end of 2008, lending halted and demand decreased as many investors were foreign funds or local funds managing foreign money. In 2009, real estate is still a target for investors, companies that raised money before the crisis are still looking to invest, and local pension funds are actively back and purchasing. In São Paulo, historical Cap rates have been trending down, currently settling around 11.8%-12.5% for office and 12.0% – 12.5% for industrial. We expect this to decrease slightly in 2010.

### *Office*

The majority of office buildings in São Paulo have multiple owners and many buildings have been/are built as separate suites. In both the office and industrial market, there is a presence of international investors, national pension funds, and national private investors, with many foreign investors partnering with local firms. Real estate laws in Brazil are more complex as commercial real estate laws are based on residential real estate laws and certain landlord/tenant rights exist outside of the standard lease contract.

In the second quarter of 2009, the vacancy rate for Class A+ and A buildings in São Paulo increased slightly from 6% to 6.6%. New inventory expectations for 2009 are 1.8 million square feet, partly pre-leased, with a potential of 16.4 million square feet by 2012. Given this, vacancy rates are expected to increase over the next couple of years. Asking lease and sale prices have dropped by 4% but are expected to remain constant over 2009. In the current market, tenants and investors are more cautious and their time to make decisions has increased.

### *Industrial*

Over the years there has been a growth of build-to-suit and sale-leaseback projects. The growth in build-to-suits has been driven by the entrance of modern real estate logistics companies over the last 10 years demanding more modern facilities. In São Paulo, the highest demand for land and/or warehouse is 100 km around the city, before the tolls. Infrastructure is improving in the country, making particular note of the construction of the Rodoanel (Ring Road) surrounding São Paulo.

Vacancy in the São Paulo industrial market is around 2-5% and new supply is not meeting demand. Industrial production slightly declined at the start of 2009 but is recovering quickly, and the transport logistics segment is expected to remain strong in 2009. Lease and sale prices are and are expected to remain stable and investors are more demanding in terms of higher IRR's and stronger warranties.

### *Opportunities*

Many investors focus on the major cities of São Paulo and Rio de Janeiro but there are opportunities outside these major centers including Santos, due to oil discoveries, Brasília, with a low vacancy rate, and the North and Northeast of Brazil, where lower classes are increasing their purchasing power. There are also increasing opportunities for land close to railroads, due to improvements in infrastructure, and land close to ports, driven by the agriculture sector.

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*Sources: Thompson Reuters, Euromonitor, Colliers International Brazil, Brasil Central Bank*

*\*Since creating this report, the interest rate has dropped to 8.75%*