2017 Global Market Outlook

Trends in real estate private equity

EY
Building a better working world

Brazil — improving fundamentals

With Brazil's political situation on a more stable footing as Michel Temer has taken the reins from his impeached predecessor Dilma Rousseff, confidence is now improving in the economy after a difficult few years. The government revised its GDP growth forecasts in August for 2017, up from 1.2% to 1.6% — a marked improvement on several years of negative numbers and, indeed, on forecasts for 2016, which suggested the economy would shrink by over 3%.

This renewed optimism looks set to feed through to Brazil's real estate market over the next 12–18 months. The last year has seen low levels of activity in the country, with just $2.2b of commercial real estate deals completed in the 12 months to June 2016, according to RCA figures, significantly down on the peak year of 2011, when $11.7b of deals were struck.

The few deals that have been agreed over the last year have largely involved vacant office buildings acquired from developers, with some vacant residential assets that developers have been unable to sell as individual units. These opportunistic acquisitions have been secured at a discount where developers have been under stress. Debt-based deals have also played into the market, where refinancings have resulted in longer repayment schedules, higher interest rates and more guarantees for borrowers. Yet the Brazilian market's aversion among sellers to sell at discounts and a preference to hold where possible has meant that few deals have come to market, and where they have, they are often characterized by earn-out-type arrangements or equity kickers (in the case of debt funds), leaving the door open for developers to earn some upside should the market pick up.

With an improving economic outlook, many in the market believe that the Brazilian real estate market is at, or approaching, the bottom of the cycle. We expect deal volume to pick up over 2017 should valuations start to tick up, with the window for opportunistic, distress-driven deals closing by 2018. While many of the larger real estate investors already have a strong foothold in the market, there are signs that others may join them. And while many of the country's domestic institutional investors may have their hands tied, overseas institutions are taking an active interest in completing direct real estate deals, with the Canadian investors leading the way.