

Investment Management and Real Estate

Global Real Estate Now

Insights, observations and research*

March 2007



*connectedthinking

PRICEWATERHOUSECOOPERS 

Contents

FEATURE ARTICLES

02 Islamic Real Estate Finance: A 2007 View

By David Roach, Partner, Real Estate Tax Services, PricewaterhouseCoopers, Luxembourg

A growing array of Shariah compliant investment strategies and opportunities are arising around the world

08 Emerging Trends in Real Estate® Europe 2007 Overview: Looking outside the box

By Chuck DiRocco, Managing Director, Industry Trends and Analysis, Urban Land Institute, Washington, DC
Growing sophistication, broader opportunities mark the evolution of the European commercial real estate marketplace in 2007

14 Three drivers of change: The transformation of global real estate capital markets

By Steven Laposa, Ph.D., Director, Global Real Estate Research, PricewaterhouseCoopers, Denver and David Seaman, Partner, Real Estate Business Advisory Services, PricewaterhouseCoopers, New York
The dance between public and private real estate capital markets has shifted from a measured tango to a high-powered mosh competition

EYE ON EUROPE

22 European REIT Update

By John Forbes, Partner, UK Real Estate Tax Leader, PricewaterhouseCoopers, London, and Uwe Stoschek, Partner, Global Real Estate Tax Leader, PricewaterhouseCoopers, Berlin
The continued introduction of REITs into European countries is changing the face of global real estate investing

28 Wish of Europe: Italy launches REITs

By Fabrizio Acerbis, Partner and Daniele Di Michele, Senior Manager, TLS Associazione Professionale di Avvocati Commercialisti, member firm of PricewaterhouseCoopers – Tax & Legal Services Network, Milan
Italian REIT legislation looms on the horizon

36 2006: Central and Eastern Europe (“CEE”) property market comes of age

By Glen Lonie, Partner, Tax and Legal Services Group, PricewaterhouseCoopers, Prague and Brian Arnold, Director, Financial Services (Tax) Group, PricewaterhouseCoopers, Moscow
Real estate in the diverse region of Central and Eastern Europe is fast becoming a key factor for overall growth and economic development

42 Internationalisation: Spanish companies launch into foreign markets

By Fernando Beltran, Director, Real Estate Transactions, PricewaterhouseCoopers, Madrid; and Fernando Herrero, Manager, Real Estate Transactions, PricewaterhouseCoopers, Madrid
Growing strength and sophistication has Spanish real estate interests adopting an increasingly global perspective

50 Irish investors show continued confidence in real estate – at home and abroad

By Enda Faughnan, Partner-in-Charge, PricewaterhouseCoopers Real Estate Tax Group, Dublin
Irish investors are taking a lead role in the growth of European property markets and elsewhere

EYE ON ASIA

54 India: Realty check

By Gautam Mehra, Partner, India Real Estate Tax Leader and Radhakishan Rawal, Manager, PricewaterhouseCoopers, India
Loosening restrictions and an influx of new investment capital are helping to revolutionise India's commercial real estate markets

EYE ON AMERICAS

62 Colombia on the rebound: Favourable outlook for real estate investments

By Wilson Herrera Robles, Senior Associate Legal Services and Diego Vega Ramirez, Assistant Legal Services, PricewaterhouseCoopers Bogotá. and Martin van der Zwan, Senior Tax Manager, Real Estate, PricewaterhouseCoopers, Amsterdam
A revitalised economy and enhanced cultural and political stability are helping attract global investors to Colombia

TECH CORNER

68 The technology controls that Sarbanes-Oxley doesn't care about

By Scott Metro, Partner, Real Estate Systems and Process Assurance, PricewaterhouseCoopers, Boston
The challenges of maintaining adequate information controls and processes do not end with Sarbanes-Oxley requirements

Dear Reader:

Welcome to the March 2007 edition of PricewaterhouseCoopers Global Real Estate Now.

Over the past few years, we have observed a seismic shift in the real estate marketplace – in terms of global capital flows, evolving financial structures, emerging market opportunities, and many other exciting developments.

Without a doubt, one of the most significant trends to overtake the international property markets in recent months has been the veritable deluge of private equity-financed mega-deals. Indeed, as this edition goes to print, the ink is barely dry on what has been called the largest deal in history – the \$39 billion acquisition of Equity Office Properties by private equity kingpin Blackstone Group, which fought off a determined last-minute challenge from a group led by the US REIT, Vornado Realty. In addition, the board of directors of the landmark Four Seasons luxury hotel group accepted a \$3.37 billion bid to be taken private by a consortium that includes Microsoft founder Bill Gates and a Saudi prince.

These recent examples may be just the tip of the iceberg in terms of what is yet to come in the weeks and months ahead as more REITs and global property companies find themselves on the radar screens of private equity investors.

What are the key drivers behind this movement, and what does this mean for the global real estate capital markets? That is the focus of a feature article by Steven Lapos, Ph.D., Director of Global Real Estate Research, and David Seaman, Partner in PricewaterhouseCoopers Real Estate Business Advisory Services practice based in New York, in which they explore the fundamentals underlying this

key trend, as well as the strategies and objectives of the major players involved.

One of the more significant projects we undertake during the course of the year is our series of annual Emerging Trends in Real Estate® surveys, which we do in conjunction with the Urban Land Institute (ULI) in order to track and report on the many trends and changes that have taken place in the U.S., Asia/Pacific, and European markets. In February, Emerging Trends in Real Estate® Europe 2007 was released. Key trends and other findings are featured in an article provided by Chuck DiRocco, Managing Director, Industry Trends and Analysis at ULI.

In addition, we are again pleased to offer a number of timely regional overviews by real estate professionals across the PricewaterhouseCoopers global practice. Our Islamic Real Estate Finance group explores the fundamentals (and challenges) of Shari'ah compliant financing structures and real estate's steadily growing participation in this movement.

Our "Eye on Europe" section offers an assortment of country by country assessments looking at key developments in Ireland, the U.K., Spain and Italy. Our "Eye on Asia" section includes an overview of the exciting developments taking place in India and showcases why this country has become a major target for private

equity interests and other investors. In addition, our "Eye on the Americas" section looks at Colombia's steadily growing real estate sector and its transformation into an attractive enticement for international investors.

Finally, our "Tech Corner" feature reminds us that the need for secure, reliable, accessible financial records go far beyond Sarbanes-Oxley and related financial disclosure requirements. While such information is vital for requisite historical decision-making records and "paper trails" we must not forget that good, solid information is also key to day-to-day business.

As a final note, I would like to take this opportunity to welcome our many friends and colleagues attending MIPI in Cannes, the world's largest global real estate fair – scheduled for March 13th through 16th. We all look forward to renewing old acquaintances, establishing new ones, and discussing the wealth of the opportunities and challenges facing the real estate industry today.

Kind regards,



William E. Croteau
Global Real Estate Assurance and
US Real Estate Sector Leader

Islamic Real Estate Finance: A 2007 View

By David Roach, Partner, Real Estate Tax Services, PricewaterhouseCoopers, Luxembourg

Investment in real estate structured to meet the needs of Islamic religious observance – Shariah compliant investment – continues to grow in importance and increasingly become a more mainstream part of the global real estate marketplace. Banks and fund managers are increasingly setting up real estate funds targeted at Shariah compliant investors.

The PricewaterhouseCoopers global Islamic Real Estate Finance group, established in 2003, has been at the forefront in developing tax-effective structuring techniques for such funds, and also in considering the accounting issues arising from these and other Shariah-compliant transactions.

Another rapidly emerging trend has been the growth in Shariah compliant bond issuance (sukuk), which is generally backed by real estate assets in some form. Although to date centred on Malaysia and the Middle East, Sukuk issuance is likely to become a globally familiar feature of the markets in 2007.

How do the principles of Shariah law affect real estate investment?

When investing, observant Muslims must follow the precepts of Shariah law, which has as its basis the words of the Quran, Islamic tradition (hadith) and decisions of Islamic scholars (fatwa).

A fundamental consideration is that Shariah prohibits any form of usury (riba). Shariah is thus generally regarded as forbidding any kind of interest taking and paying, rather than simply precluding the use of an excessive interest rate. Therefore, the acquisition of any direct or indirect investment in real estate must not be financed by any arrangements that involve the payment of interest. Equally, businesses wishing to raise funding cannot do so by any method that involves the payment of interest, and must instead do so by offering to share the profits of a business venture. Shariah also proscribes speculation (gharar) and the selling of assets that the vendor does not own. Derivative instruments and equivalent arrangements are thus heavily circumscribed and further restrict the ways in which real estate investment can be funded.

Lastly, assets used for purposes in conflict with the principles of Islam (haram) may not be acquired. Real

estate leased to tenants in the defence, gambling and drinks sectors is thus generally not appropriate for Shariah compliant investment, and issues sometimes arise over hotel premises.

Despite – or indeed because of – the requirements of Shariah, real estate as an asset class for Islamic investors is notably attractive. In particular, leased property offers a relatively fixed income stream and periodic cash distributions, thus analogous to many bond or debt products that are inaccessible. Furthermore, even with recent yield compression experienced in European and US markets, the prospect of capital appreciation in many cases still offers investors relatively reliable overall returns that cannot be matched readily by other Shariah-compliant products.

The economic similarities between lease rental yields and pure interest flows also are a fundamental factor in the

development in the last five years of the Shariah compliant asset-backed bond (sukuk) market.

The Islamic real estate finance marketplace – a 2007 overview

Initially Shariah compliant real estate investment with an international aspect was principally conducted by Islamic institutions and ultra-high net wealth individuals investors who acquired direct ownership of real estate that was used in a Shariah compliant manner. Such investment was usually undertaken as a growing part of a balanced portfolio. This sector remains strongly active, although in the last five years the principal focus of investment has arguably shifted to Europe and back to the Middle East, and away from the US.



Investment in infrastructure by Islamic institutions also has been significant – with the landmark transaction to date being the acquisition in early 2006 by Dubai Ports World of P&O’s international ports assets.

However, in the last five years, banks and finance houses have moved to the centre of the stage. This rapidly-growing focus on Shariah-compliant real estate linked activities has by no means been restricted to institutions that are themselves Shariah compliant. The marketplace can be segmented as follows.

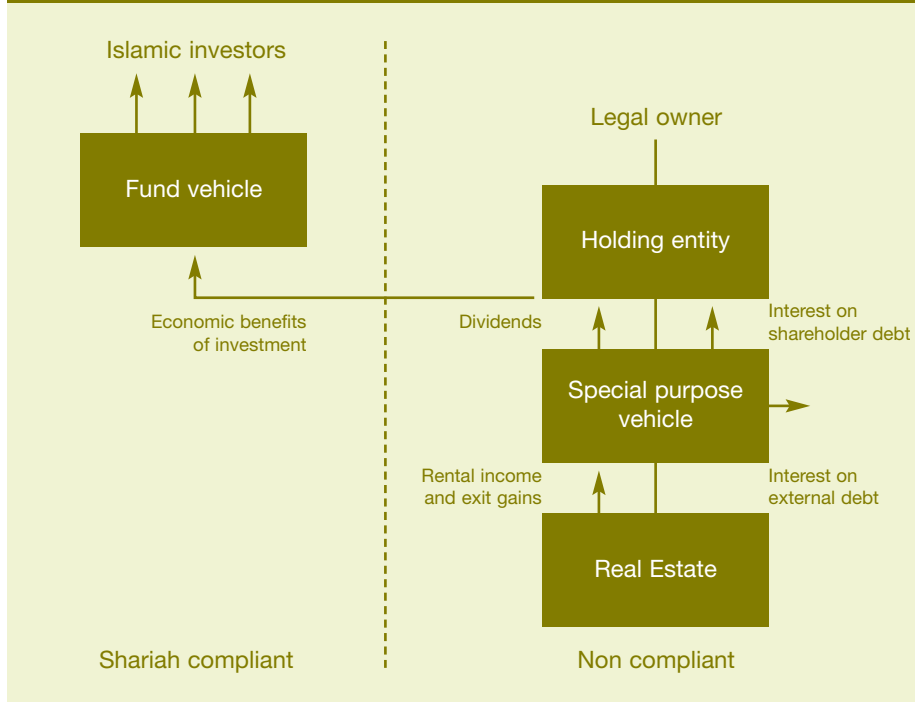
- Islamic and other Middle East banks, seeking to offer Shariah-compliant real estate linked products as part of their overall service. As well as providing real estate development and retail housing finance, these banks are particularly active in managing sukuk bond issues.
- Globally active institutions operating through an “Islamic window” or otherwise, offering products that are Shariah compliant. Some European banks (notably Barclays, HSBC,

Deutsche Bank and UBS) have participated in sukuk bond issues. However, the main focus of activity has generally been real estate fund management, often but not exclusively as an element of a wider wealth management service offering, targeted at ultra-high net wealth individuals. To date, few Shariah compliant real estate funds have been in the regulated sector.

Property finance – structuring for the Islamic investor

The prohibition on the payment of interest (riba) applies to the leveraged purchase of real estate. The investor cannot himself borrow to make the investment, and also – significantly – borrowing from an external source by a special purpose vehicle (“SPV”), set up to own real estate, would generally not be Shariah compliant. Conversely, the lending of funds by an investor to an SPV owned by that investor is often not considered as problematic: such arrangements might generally be regarded as “self-lending”. Nevertheless, in order to offer competitive rates of return to Shariah compliant investors,

The prohibition on the payment of interest (riba) applies to the leveraged purchase of real estate. The investor cannot himself borrow to make the investment, and also – significantly – borrowing from an external source by a special purpose vehicle (“SPV”), set up to own real estate, would generally not be Shariah compliant.



Source: PricewaterhouseCoopers

leverage in some form is often essential. Real estate fund managers now have at their disposal increasingly well-established techniques which reconcile the conflicting needs of Shariah compliance and third party debt financing.

These structuring techniques can take several forms, with the particular approach being determined to a great extent by characteristics of the legal system of the territory into which investment is planned. However, a common underlying feature of such structures is a division between legal ownership of the real estate, and economic ownership, as outlined in Diagram 1.

The Shariah compliant investors derive the benefits of their investment via economic ownership, and this absence of legal ownership is often accepted as bringing the structure as a whole within Shariah compliance. A fatwa – a decision by Islamic scholars – is however frequently sought before any structure is marketed to Shariah compliant investors.

The need for the legal/economic ownership divide adds an extra layer of complexity to the already demanding needs for tax efficiency within the fund ownership structure. Additional issues that have to be addressed commonly include:

- Averting any possibility of a further charge to real estate transfer taxes on implementing the arrangements for passing the economic benefits of the investments to the Shariah compliant structure.
- Being certain that these arrangements do not give rise to adverse VAT consequences.
- Addressing ownership disclosure requirements to prevent imposition of onerous taxes otherwise due by owners of real estate in certain territories – e.g., the annual 3% tax on fair market value on French real estate.
- In cases where the non-Shariah compliant entity cannot be in a tax-free jurisdiction, ensuring tax-deductibility of payments under these arrangements.

Sukuk are bond-type instruments which offer a Shariah compliant yield. Investors receive a defined share of the cash flow of the entity issuing the sukuk. As investors are exposed to the business risks of the issuer, they are not regarded as having lent money at interest.

- Conversely, ensuring that this income flow is not heavily taxed in the fund vehicle or other entity receiving the flow.

Whilst the “super-structure” needed to deliver Shariah compliance in this type of situation is often set up in a tax-free jurisdiction, Luxembourg and Singapore are beginning to emerge as alternatives.

Sukuk – Islamic bond financing

Sukuk are bond-type instruments which offer a Shariah compliant yield. Investors receive a defined share of the cash flow of the entity issuing the sukuk. As investors are exposed to the business risks of the issuer, they are not regarded as having lent money at interest. However, in the case of sukuk that are marketable, the sukuk will almost inevitably have a very secure and defined cash flow, emanating from an asset or portfolio of assets that are held as the sole asset of an SPV sukuk issuer. The stability of the yield is thus sufficient for the sukuk to be marketable and be rated in the same way as conventional bonds.

Although sukuk as a niche type of finance has existed for many years, the sector has developed strongly since 2001, most significantly in Malaysia, where even today some 70% of the \$45 billion plus of bonds issued since 1996 have been arranged and issued. Buyers of sukuk are increasingly not just Shariah compliant investors, but also a broader spectrum of investors looking for exposure to the Middle East, and a secondary market in sukuk is now beginning to emerge, with London announcing in early February 2007 that it intends to have a secondary market up and running in the coming months. Last year, 2006, saw the largest single sukuk issue to date – a \$3.52 billion finance raising by Dubai-based property developer Nakheel Development – with some 40% being taken by European investors. Some sources expect a 30% plus increase in 2007 over the \$15 billion total raised through sukuk in 2006.

The categories of assets that back sukuk, and the methods for generating an income stream, can be very varied (the Accounting and Auditing Organisation for Islamic Financial

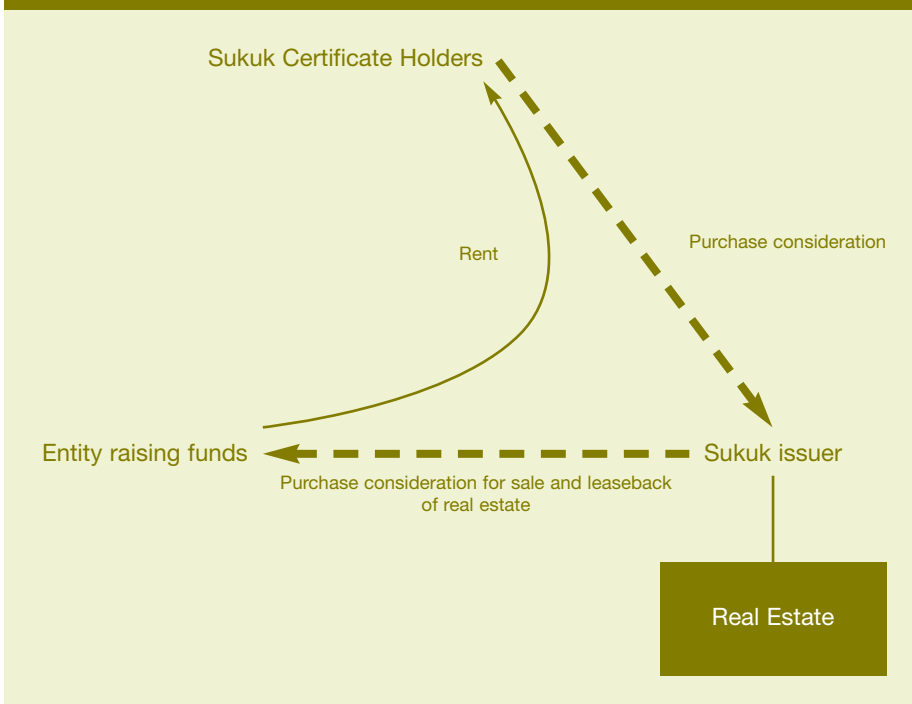
Institutions recognises 14 different types of sukuk) but the most popular structure is the ijara sukuk, where the sukuk issuer acquires real estate immediately capable of generating a fixed rental flow from an entity wishing to raise funds, and leases the real estate back to that entity under a Shariah compliant lease or ijara. The structure is outlined in concept in Diagram 2.

To the extent that the entity raising the funds is resident in a tax free territory, or is a government organisation, tax considerations arising from a sukuk issue are not complex. However if the entity raising the funds – or the real estate to be used to back the sukuk – is in a normally taxable territory, then tax complications are likely to arise and potentially will require significant tailoring of the structuring. A major issue will be the potential tax cost – either through real estate transfer taxes or the crystallisation of latent gains – of the sale and leaseback transaction between the entity raising funds and the sukuk issuer.

Notably, Malaysia has enacted tax legislation that disregards for all purposes any disposals of assets required solely for Shariah purposes, and has taken energetic steps to ensure that its tax system favours, rather than obstructs, sukuk issuance. The UK has also recognised that there are potential conflicts between its tax regime and cost-effective sukuk issuance, and the UK government recently embarked on a process of consultations with interested parties on how UK tax law needs to be modified to facilitate the issuance of sukuk from the UK. For example, the requirement for a sukuk issuer to be able to deduct for tax purposes the payments made to sukuk holders against the stream of income derived from the assets the sukuk issuer uses to back the sukuk is a fundamental issue, for which clear legislation is as yet needed.

David Roach can be reached via email at: david.roach@lu.pwc.com

Diagram 2: Ijara sukuk structure



Emerging Trends in Real Estate® Europe 2007 Overview: Looking outside the box

By Chuck DiRocco, Managing Director, Industry Trends and Analysis, Urban Land Institute, Washington, DC

Main centers in western Europe continue to draw the investment dollar; however, with opportunities now limited, capital is starting to look at emerging markets and second-tier cities.

European real estate investors are beginning to believe they have neared the peak of the investment cycle, as indicated by surveys and interviews with more than 390 leading authorities conducted for the Emerging Trends in Real Estate® Europe 2007 publication. According to the annual forecasting and trends report from the Urban Land Institute and PricewaterhouseCoopers, prime yields will largely stabilise this year, although some slight further compression is possible.

Overall, investors are anticipating single-digit core returns and a calmer environment in 2007. One interviewee opined, "In some markets, it's just going to be an income return." Therefore, many investors are going to have to work hard to find value where they can and explore other suitable opportunities that might be a bit outside of the box of their standard investment strategies.

Regardless, most European real estate executives are very optimistic about the economy in 2007, following the strongest gross domestic product (GDP) growth in the last six years. Within the Eurozone, Spain and Ireland are considered economic hot spots; however, the latter has the greatest forecasted GDP growth in western Europe, coming in at 4.2 percent. Topping all of Europe is Turkey, with expected GDP growth exceeding 6.4 percent. This expected growth leads to a mix of opinions on the country. Its economy is still expected to outperform that of the rest of Europe; however, the Turkish lira has weakened and has pushed inflation to over 10 percent. In addition, talks on Turkey joining the European Union continue, but remain slow and unsettling to foreign investors. Even with different economic predictions in 2007, European real estate firm profitability is expected to remain good,

with prospects up slightly over those for 2006. However, higher oil prices, an elevation in interest rates, value-added tax increases in Germany, and tax hikes in Italy will have some dampening effect. For example, the upward swing in interest rates has already forced some highly leveraged private buyers out of the market.

Even with these changes, capital investors are starting to recognise real estate as a global asset class; therefore, equity keeps on pouring into the European real estate market from many sources. This continued flow has led to equity capital markets remaining largely oversupplied. The main source of this investment capital continues to flow across different continents, with strong growth in investors coming from the Middle East, Asia, and Australia. As can be seen in Exhibit 1, the majority of capital seems to be generated from

opportunity funds, private investors, pension funds, and private property vehicles, as these groups will lead real estate investing in 2007.

Increases in debt capital are expected as well, with new growth coming from international and cross-border lenders used to fund real estate. "Some savings or smaller banks now feel comfortable enough to enter the real estate market," noted an interviewee. The Emerging Trends survey also indicates, however, that the market should not expect debt to expand quite as robustly as it did in the past few years. This is not a surprise considering that European interest rates and property yields seem to be moving in opposite directions.

The commercial mortgage-backed security (CMBS) market in Europe continues to grow, setting a record of US\$67 billion (52 billion) issued in 2006, with even more predicted in 2007.



Just as investors look from city to city for value, they are forced to find that extra yield among property sectors. In 2007, eight out of ten property sectors are expected to offer modestly good prospects for total returns. Overall, ratings for risk-adjusted total return expectations for the ten sectors have increased substantially over 2006 figures.

This investment area not only is growing at an astronomical pace, but also is becoming much more diverse with pan-European and continental issues, as well as with a much wider range of property types being used as backing.

Regardless of the overabundance of capital, investors remain positive about the outlook for most European cities in 2007. Compared with 2006, European real estate markets now provide less risk, higher return prospects, a better

Exhibit 1: Changes in Availability of Equity Capital for Real Estate by Source Type

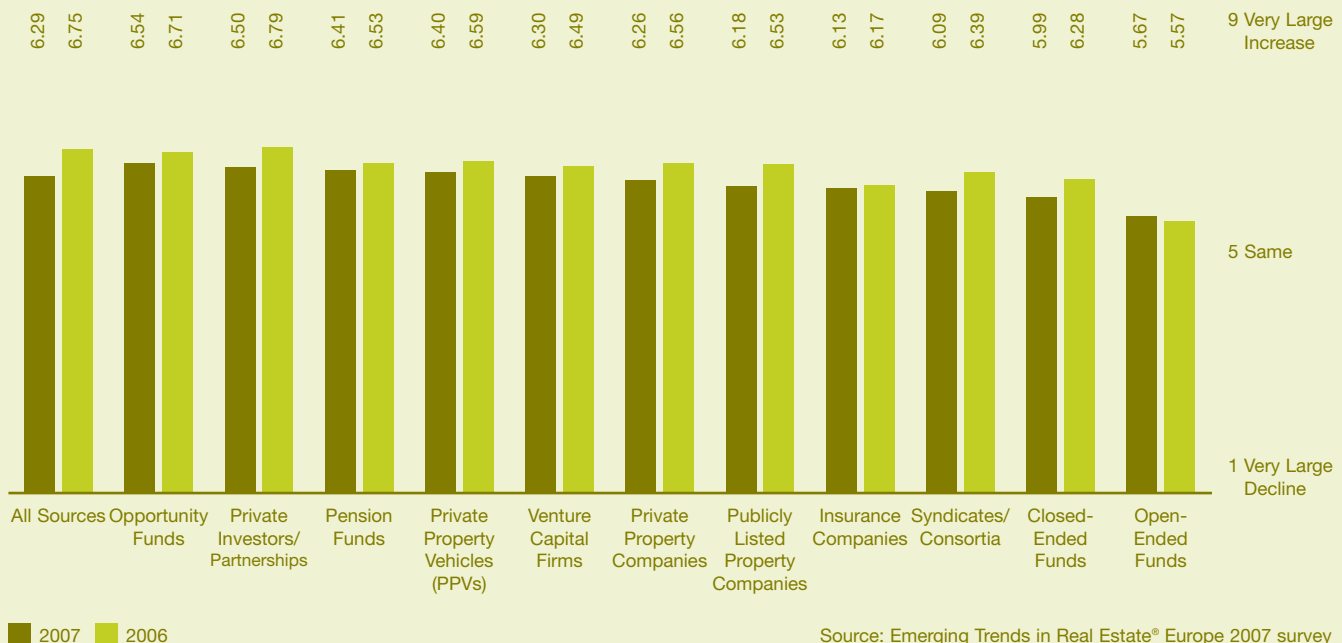
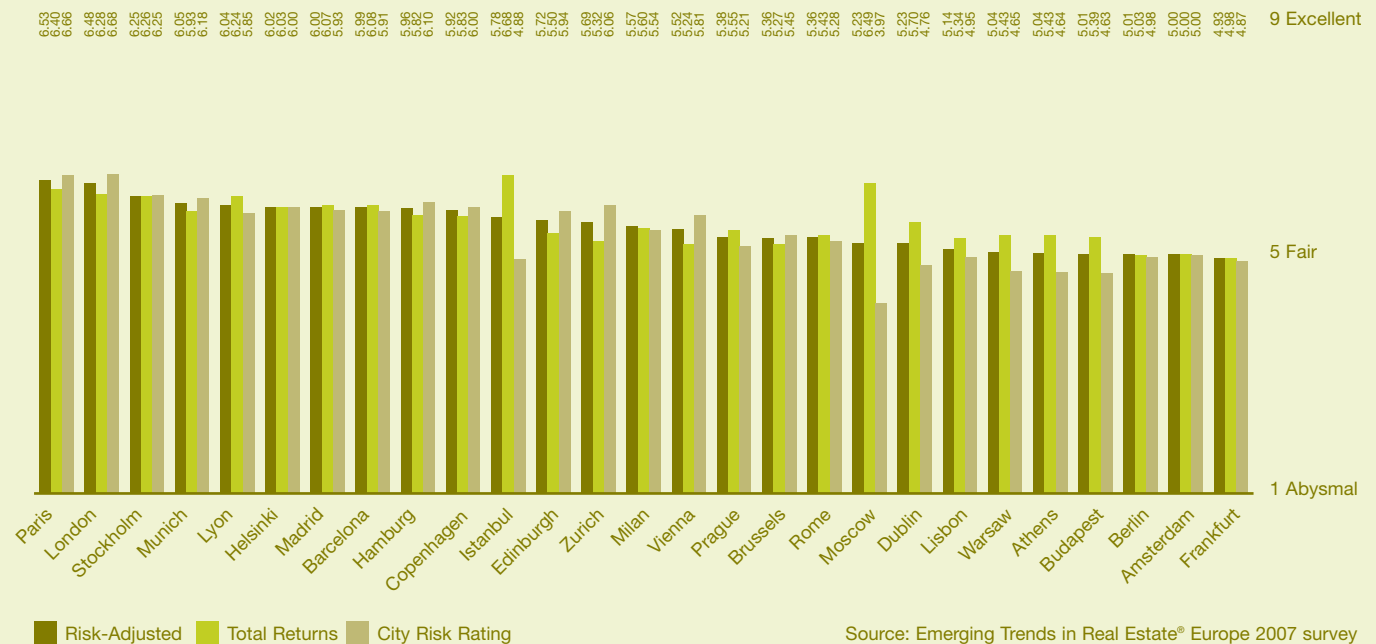


Exhibit 2: City Return/Risk Prospects



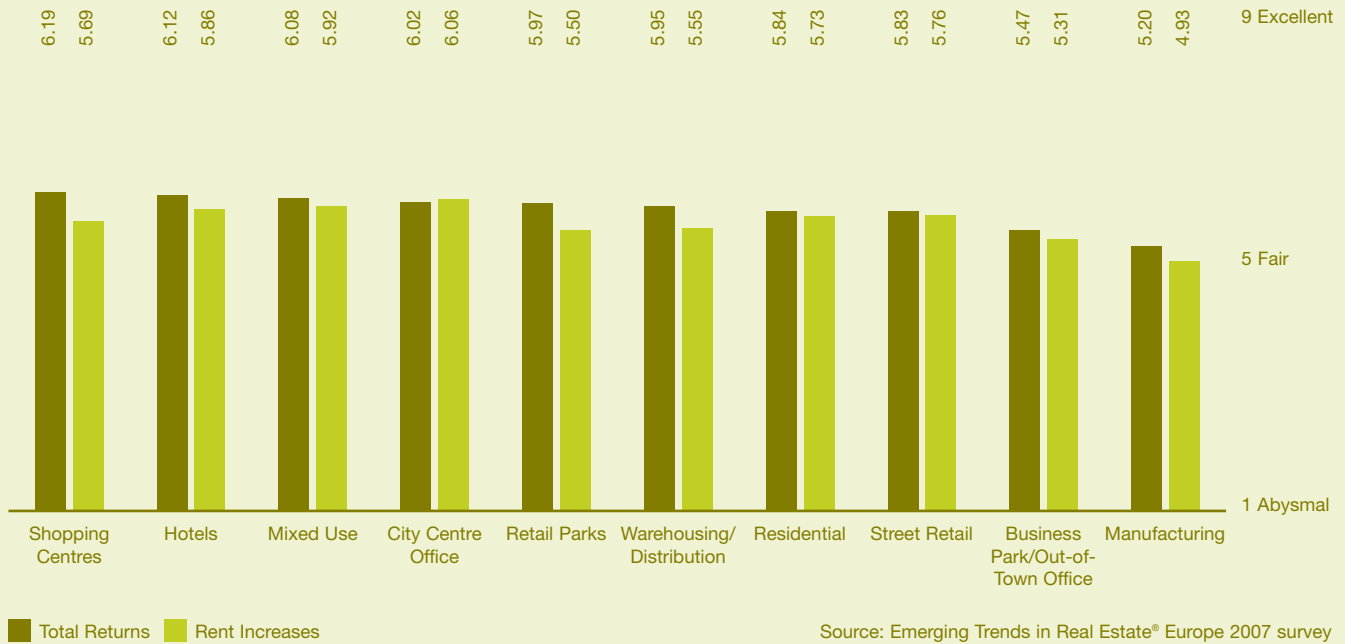
supply/demand balance, and improved development prospects. According to Emerging Trends, the top five markets to invest in are Paris, London, Stockholm, Munich, and Lyon (Exhibit 2). Even though many individuals believe Paris real estate is expensive, they are aware of and appreciate its stability. That sentiment was acknowledged by survey participants, considering this is the city's third year in a row in the number-one slot. London comes in a close second, offering investors the best rental growth prospects, as well as carrying the lowest risk of all 27 cities ranked.

The real winners in 2007 are German cities, which languished toward the bottom of the risk-adjusted league last year. Munich and Hamburg have entered the top ten cities, making a large jump to fourth and ninth place, respectively, while even Frankfurt's ratings have improved from its continued low ranking. Changes in German city rankings are a strong sign that the country's recovery is finally getting underway. Rental growth is expected to emerge at a moderate level, particularly in the office sector.

Main centers in western Europe continue to draw the investment dollar; however, with opportunities now limited, capital is starting to look at emerging markets and second-tier cities. For example, Moscow's and Istanbul's rankings have soared, rising to eighth and seventh place, respectively, between 2006 and 2007. "Growth rates in Moscow and Istanbul will continue to drive demand through increases in job growth and disposable income," explained one respondent.

Just as investors look from city to city for value, they are forced to find that extra yield among property sectors. In 2007, eight out of ten property sectors are expected to offer modestly good prospects for total returns. Overall, ratings for risk-adjusted total return expectations for the ten sectors have increased substantially over 2006 figures. In addition, rental growth and development prospects have improved for all of these property types. As seen in Exhibit 3, shopping centres lead investor interest, with hotels and mixed-use properties ranked second and third

Exhibit 3: Real Estate Sector Performance Prospects for 2007



for the best return performance in 2007. Often viewed in the past as products for only investor specialists, both the hotel and mixed-use sectors are now considered mainstream properties. With buyers having fewer and fewer opportunities for strong returns within the traditional sectors, investors' mind-sets have shifted to alternative investments, including gas stations, student housing, marinas, motorway services, trade parks, prisons, garages, and even windmills. "You have to look beyond traditional sectors, to others that have real estate and create value from that," responded one interview participant.

As it becomes more difficult to acquire assets, larger portions of capital are flowing into the development arena. Competition in more mature western European markets is so intense that many core investors are increasingly prepared to undertake or fund a new building. "Many funds are changing their strategy to include direct development as a way of getting money invested faster," noted one interviewee. Some emerging markets do not offer high-end assets, and development

is the only way to obtain high-quality assets. Hence, Istanbul and Moscow are rated as the cities with the best development prospects, followed by Paris and London.

In an effort to invest their capital in properties, investors now are also pursuing publicly traded real estate securities. Often referred to as real estate investment trusts (REITs) or real estate operating companies (REOCs) in the United States, these vehicles are in high demand, with more than 100 companies traded throughout Europe representing a market capitalisation exceeding US\$194 billion (150 billion). The tax-efficient REIT structure has caught on, with seven REIT-like instruments currently up and running throughout Europe, including the 2007 launch of a UK REIT. Launches are being planned for REITs in Germany and Italy, too.

Even though many investors claim that returns are peaking and that cap rate compression is ending, there still remains a steady flow of debt and equity capital into European real estate. However, buyers are dealing with that

As it becomes more difficult to acquire assets, larger portions of capital are flowing into the development arena. Competition in more mature western European markets is so intense that many core investors are increasingly prepared to undertake or fund a new building.

and enhancing returns through better leasing and management of their properties. In addition, real estate acquisitions are no longer limited to primary locations as dollars are starting to move to secondary and tertiary markets. Regardless of the strategy,

real estate throughout Europe continues to be an interest to investors locally and worldwide.

Chuck DiRocco can be reached via email at: cdirocco@uli.org



Three drivers of change: The transformation of global real estate capital markets

By Steven Laposa, Ph.D., Director, Global Real Estate Research, PricewaterhouseCoopers, Denver and David Seaman, Partner, Real Estate Business Advisory Services, PricewaterhouseCoopers, New York

The dynamics of today's global real estate capital markets are transforming the basic real estate capital market quadrants of private equity, private debt, public equity, and public debt. Although global private equity firms are currently capturing media headlines and industry publications, there are other factors just as significant that are driving change in the global real estate capital markets.

There's a mystique regarding real estate's capital markets – what causes changes and transformations? How do domestic real estate capital markets evolve and change? Why are foreign real estate capital flows encouraged, active, and important in some countries and not others? Although private equity is at the forefront of change in U.S. commercial real estate capital markets, public equity is altering the real estate capital market landscape in Europe as more private equity firms relocate to the public equity quadrant. In Asia, the private equity and public equity real estate capital markets provide a one-two punch to fuel expansion while the private and public debt markets slowly emerge. Explaining recent events and trends is difficult enough let alone attempting to even predict future drivers of change in global real estate capital markets.

Attempts to explain the transformation of global real estate capital markets need to account for more than the dominant role of private equity capital

flows. For example, there are mergers and acquisitions within and between countries and continents, an exponential growth of public equity real estate market capitalisations and peaking values internationally, public to private and private to public transactions, and the development and introductions of new global real estate investment financial vehicles and funds that stretch the imagination of how far and advanced capital markets have evolved over the last decades.

Sources, destinations, and motivations of global real estate capital flows continue to prove that understanding real estate capital market's simple two x two matrix (Exhibit 1, dating from the early 1990s), does not fully prepare real estate investors and owners for the brave new world of tomorrow. The two-dimension illustration does not fully account for the speed of reallocations between two or more quadrants. For example, the recent acquisition of Equity Office Properties (EOP) by Blackstone

rapidly distributed EOP's market capitalisation from the public equity to private equity and private debt ledgers virtually overnight. An additional shortfall of the four quadrants framework is the lack of a spatial dimension that identifies geographies of global real estate capital flows or the distributions within any quadrant. In the last few years, firms such as Jones Lang LaSalle and RREEF have attempted to chart originations and destinations of international real estate capital flows on a regional basis. This new research is an initial step to provide analysis similar to that used in foreign direct investment, tracking foreign direct inflows and outflows so prevalent in international business research.

This article briefly discusses three of the major trends driving the changes in global real estate capital markets in 2007, specifically focusing on the role of private equity. There are other factors that potentially influence changes in

global real estate capital markets such as domestic legislation regarding tax laws and property rights, economic policies fostering growth, inflation and interest rates. The three trends are:

1. The role and significance of private equity
2. Private versus public real estate ownership and investment debate
3. The expanding definition of real estate's universe

The role of private equity: Mega-private equity and real estate – a match made in heaven?

Two recent events have tremendous implications for the future of real estate investing and transformation of the real estate capital markets. These events, the first being the titanic battle over the future of Equity Office Properties



(“EOP”), and the second being the initial public offering of Fortress Investment Group LLC. These two events have proven that the world of mega-private equity and real estate investment and ownership have collided. Who are these private equity investors, what is motivating them, and it is possible to explain or predict their behavior? According to *Emerging Trends in Real Estate® 2007*, private equity accounts for approximately 17% of the total \$4.258 trillion in U.S. institutional real estate. Do these two events imply that private equity’s share of the four quadrants will increase in years to come?

What does the term “mega-private equity” imply? The term is intended to differentiate those financial institutions such as Blackstone, Cerberus, Fortress Investment Group, Kohlberg, Kravis & Roberts, and others that have amassed very significant pools of capital, more than \$30 billion, to dedicate to the acquisition of real estate as well as all manner of other assets, from the more typical real estate private equity funds, most less than \$10 billion in assets, who have been active participants in the real

estate investment community over many years.

One of the important concepts that underlies the basic philosophy behind the merger of mega-private equity and real estate is the simple but fundamental notion of what drives the private equity world – arbitrage. At their heart, all private equity firms are constructed to take advantage of a mis-pricing of assets. This mis-pricing may be between a public market valuation and what a private buyer might pay. Alternatively, private equity firms may take advantage of their ability to aggregate assets in the private market and obtain a positive arbitrage by exiting such assets through a public market execution to buyers who are willing to accept a yield much less than the private buyer of the same asset. At the end of the day, the ability to arbitrage assets is driven in large part by the ability to:

- Deploy capital quickly,
- Aggregate assets,
- Execute a strategy that may be seen as contrarian, and

At their heart, all private equity firms are constructed to take advantage of a mis-pricing of assets. This mis-pricing may be between a public market valuation and what a private buyer might pay.

Private equity

Public equity

Private debt

Public debt

- Employ all levers of financial engineering such as debt financing and public market takeout, to ensure the least risk to capital with the greatest return to the equity deployed.

So why was the battle over EOP so interesting and why was this evidence of a tectonic shift in the real estate world and transformation of the global real estate capital markets?

The acquisition of public companies for the purpose of taking them private is really nothing new. In the modern real estate investment trust (REIT) era, one can point to the acquisition of Gables Residential Trust by ING Clarion Partners in June 2005 as the primary starting point for a wave of transactions that have resulted in the privatization flood of billions of dollars of public real estate companies that is still raging today. What made the EOP deal so unique are two aspects, one was the sheer size – effectively, a \$39 billion buyout. This was the largest buyout in history on a gross dollar basis, rivaled only by the \$31 billion RJ Reynolds Tobacco Company acquisition by KKR

in 1988 (that still holds the title of biggest buyout ever in inflation-adjusted terms). The second element of this buyout that made it so unique was the dramatic struggle between the two potential bidders, the first being Blackstone, the mega-private equity firm that ultimately won the bid and Vornado, the public real estate company (REIT) that challenged and almost won the contest up to the very last moments of the struggle.

What was so interesting about the battle between Blackstone and Vornado was the question of what both firms would do with EOP once they had won the prize. To be sure, both firms were reading similar tea leaves about the current real estate cycle that seems to be favoring the notion that holders of office buildings will be experiencing fairly significant increases in rents for the coming few years. Both firms also indicated a desire to divest some of the portfolio shortly after they acquired the company.

Vornado intended to team up and liquidate a large portion of EOP's assets to Starwood Capital and Walton Street

Capital. Having won the EOP property battle, Blackstone reportedly has already sold or agreed to sell approximately \$22 billion worth of properties to various buyers, including: almost \$7 billion worth of Manhattan office properties to Macklowe Properties; 19 properties in Washington and 17 in Seattle to Beacon Capital Partners for \$6.35 billion, 17 buildings in Portland, Oregon, to Shorenstein for \$1.2 billion; 23 properties in Los Angeles and Orange Counties to Maguire Properties for \$3 billion; and 10 buildings in San Francisco to Morgan Stanley for \$2.65 billion.

The big difference that truly favored the likelihood that mega-private equity would win the fight over Vornado (which some might consider a mega-REIT given both its size and the status of its management team within the REIT world), was the ability to deploy significant amounts of debt and at historically low rates. While the typical REIT maintains relatively low leverage (50% or less), the private equity firms have no such concerns. Indeed, according to some observers, Blackstone's initial equity investment of \$3.6 billion would be doubled if it could sell the assets it bought in the public market (otherwise known as "wholesale") for 10% more than it paid when it sells the assets on a one-off or small portfolio basis into the private market (otherwise known as "retail"). Vornado, while willing to stretch to meet the price offered by Blackstone could not pursue such a strategy for several reasons: first, the market would not tolerate its leveraging EOP's assets to such an extent; and second the short-term liquidation of a significant number of assets from the EOP portfolio (which is expected to be Blackstone's strategy) could trigger unpleasant tax implications that imperil Vornado's REIT status.

At the end of the day, Vornado would have had to hold and operate a large portion of the portfolio. Blackstone, the

mega-private equity player in this drama can either operate the portfolio if it chooses (provided that rents and returns increase steadily) and exiting at some future point through taking some portion of the company public again, or simply liquidating the portfolio over time in a manner that maximises proceeds. As described above, all Blackstone needs to do to double its money is to sell assets "retail" for ten percent more than it paid "wholesale." The internal rate of return that Blackstone will earn will primarily be dictated by how fast it can execute on its strategy before any macro market turndown.

The second event previously mentioned is the potential public listing of private equity firms themselves such as Fortress Investment Group LLC ("Fortress"), a private equity/hedge fund that controls almost \$30 billion dollars under management as of the end of 2006. Assets under management are largely real estate related. Fortress became the first private equity and hedge fund manager to sell shares to the US public in early February 2007, selling an 8.6% interest in the firm to the public, while retaining over 77.7% to management and 13.7% to Nomura Holdings Inc. who purchased an interest in the firm last year. The stock, which was priced at \$18.50 shot up to \$35 per share the first day before settling back to \$31 per share. Given such interest in the shares of Fortress and the fact that such valuation indicates that the holdings of the original Fortress principals would be close to \$9.7 billion, one can safely assume that much of the mega-private equity world will take a keen interest in this potential exit for their own funds. The inevitable result, one would rationally presume, is the continued expansion of private equity funds, including those significantly targeted to real estate such as Fortress, as well as the potential entry of new funds and a proliferation of the private equity "style" of investing.

So what does all of this mean for the average real estate investor, owner or manager? The role of mega-private equity interest in real estate is apparently a significant and permanent sector in the US, and also internationally. US-based private equity firms such as Fortress, Cerberus and others acquired large portfolios of commercial real estate in Germany recently privatized from state ownership, or sold off by large non-real estate companies. According to Jones Lang LaSalle, private equity firms accounted for 51% of European hotels during the first half of 2006 and are also active in countries such as India and China.

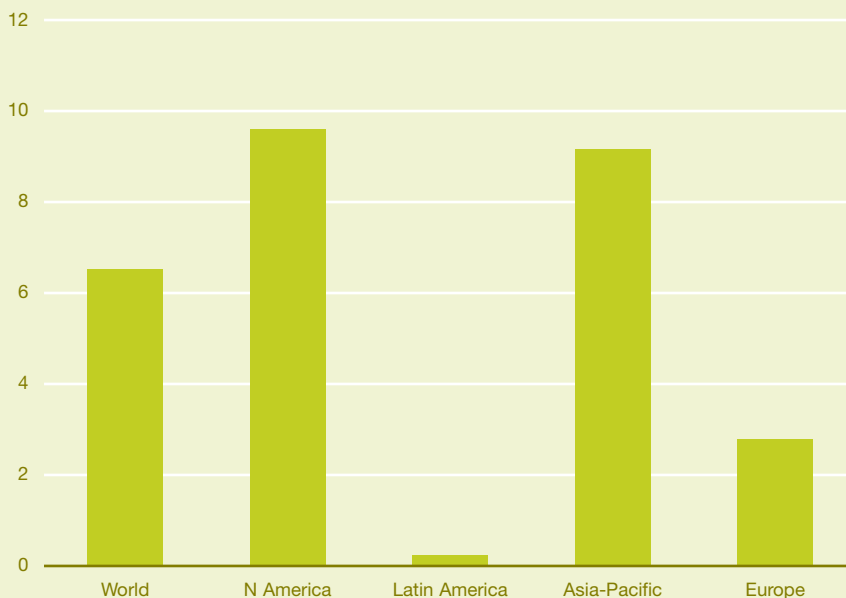
The question raised by mega-private equity's role and activity in the real estate marketplace is: "Does anybody want to really own real estate or has real estate just become a trading commodity no different than stocks, bonds or other commodities?" The answer lies in whether a real estate arbitrage exists or not and what happens in the global real estate capital market matrix when the arbitrage opportunities start to dry up as markets reach greater efficiency.

The 'dance' between public and private real estate quadrants

The investment activities of private equity firms in real estate also raise questions on the ownership of real estate. Are the returns of properties managed and owned in the public equity market significantly different from similar properties managed and owned in the private equity market? Why does the arbitrage phenomenon, apparent in the US commercial real estate market, exist and does the existence of an arbitrage between private and public real estate valuations predict a 'dance' between the private and public real estate quadrants? Is it possible to explain why public real estate debt quadrants increase in some countries and not others?

Exhibit 2 shows the value of securitized commercial real estate as a percentage of the total value of commercial real estate. The average for the world is 6.59% with North America and Asia-Pacific in the 9% range, Europe at 2.83% and Latin America at a minimal 0.33%. If securitization of real estate is a natural

Exhibit 2: Securitized Real Estate % Total Real Estate Value



Source: GPR, NAREIT, FTSE, EPRA (Dec 2006)

phase of a maturing market, does that imply that Europe and Latin America will provide opportunities for foreign and domestic real estate capital investors once their respective markets reach a certain level? Do the trends of the privatisation in the US public real estate equity market foretell of a time in the future when public Asian-Pacific, European and Latin American real estate firms waltz from the public real estate quadrant to the private real estate quadrant?

The reallocation between public and private real estate quadrants takes time to develop. For example, in the US, there were 8 REIT takeovers in 2004, 11 in 2005 and 22 in 2006. In addition the conditions that created the arbitrage between public and private real estate valuations gradually developed such that the transfer between the public and private real estate quadrants occurred. One of the factors of a perfect storm for the public to private real estate dance is performance. As Exhibit 3 proves, real estate securities outperformed global equities and global bonds in 2006 and over the last five years. Future performance of public and

private real estate will highly influence alterations of the global real estate capital market matrix.

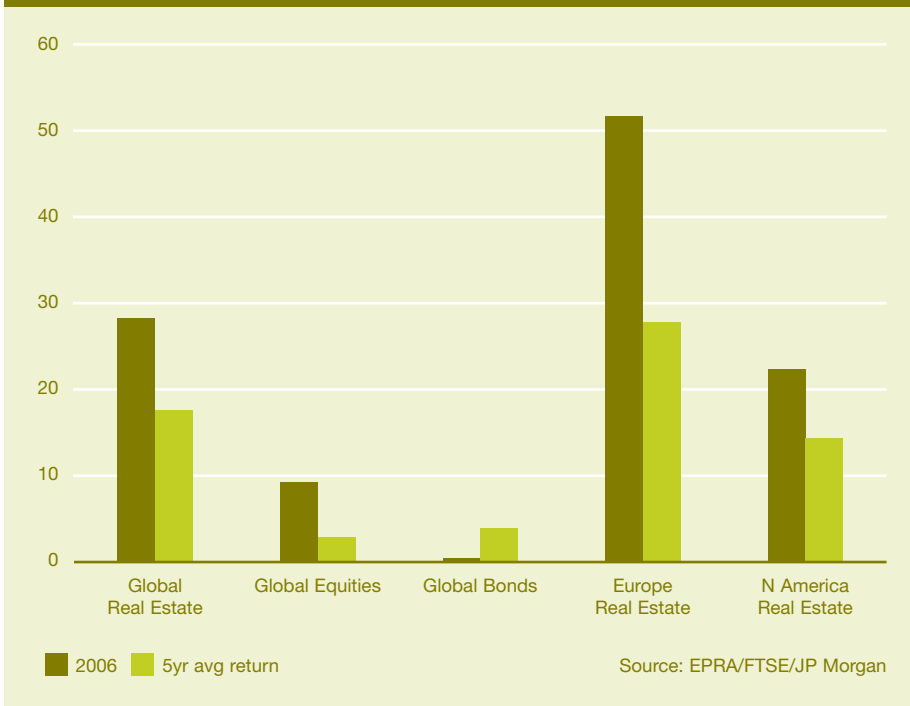
The expanding definition of real estate

The universe of what constitutes real estate continues to expand. It is no longer 'core' assets of office, warehouse, retail, multifamily and hotel; today's definitions include infrastructure, timber, storage facilities, prisons, hospitals and potentially British pubs. Has real estate as an asset classed increased so much in stature with investors that other property or quasi-property sectors ride the it's coattails? Apparently so.

As more of the world's fixed assets become part of the commercial real estate universe, there is a transformation of the shape of the global real estate capital market matrix due to the addition of new property sectors. The vast holdings of real estate by corporations is also an awakening frontier to unlock global real estate. There are opportunities to restructure and resell heavily property-dependant firms such

As more of the world's fixed assets become part of the commercial real estate universe, there is a transformation of the shape of the global real estate capital market matrix due to the addition of new property sectors.

Exhibit 3: Real Estate Securities vs. Equities and Bonds % per annum



as grocery stores, casinos and retailers. For example Vornado, with Kohlberg Kravis Roberts & Co. and Bain Capital LLC, bought the Toys “R” Us retail chain for \$6.6 billion in 2005. The future direction and sustainability of high commercial real estate values may dictate whether future retailers, or other corporations with significant real estate holdings, decide to sell into the institutional real estate investment sector thus altering the global real estate capital market matrix.

The three drivers of change

As individual domestic real estate capital markets transform causing changes in the dynamic global real estate capital matrix through the significant role of the private equity market, the healthy debate and dance between public versus private ownership, and the

expanding universe of property sectors, what does it mean for real estate owners in emerging markets or transitioning economies, real estate investors in the BRICs (Brazil, Russia, India and China), pension funds in Europe, REITs throughout the world, private real estate firms in Argentina or U.S. real estate investors? It means we need to anticipate change and we need to adapt to change.

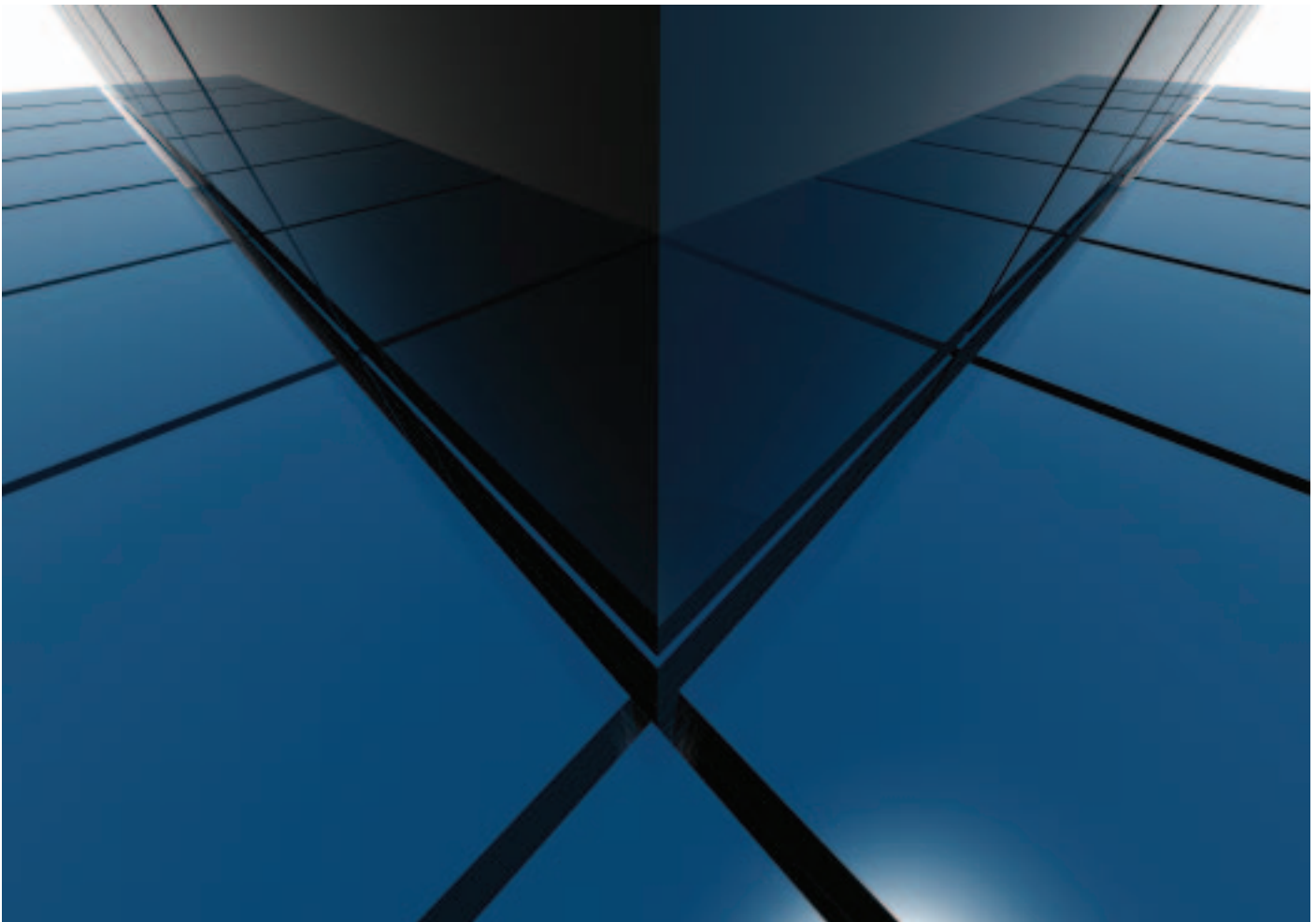
Steven Laposa, Ph.D, can be reached via email at: steve.laposa@us.pwc.com

David Seaman can be reached via email at: david.p.seaman@us.pwc.com

EYE ON EUROPE

European REIT update

By John Forbes, Partner, UK Real Estate Tax Leader, PricewaterhouseCoopers, London
and Uwe Stoschek, Partner, Global Real Estate Tax Leader, PricewaterhouseCoopers, Berlin



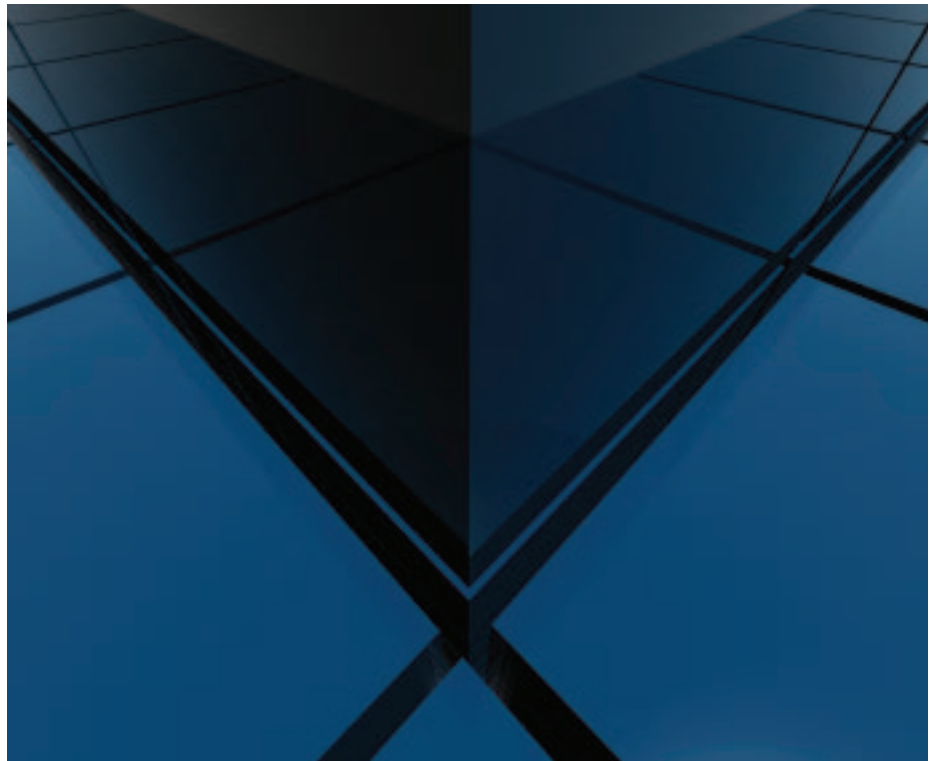
Elsewhere in this issue of Global Real Estate Now there is an article summarising the findings of the Emerging Trends in Real Estate® Europe 2007 survey published by PricewaterhouseCoopers and the Urban Land Institute. A key theme of the report again this year is the impact of the weight of equity capital being channelled into European markets.

Money continues to pile into real estate as an asset class. Much of the attention has focussed on the impact on the value of real estate assets – too much capital chasing too few assets has seen transactions completed at yields that would have been regarded as suicidal a few years ago. Another aspect of this phenomenon has been the performance of public real estate markets which are booming globally. The introduction of tax-efficient REIT type vehicles is accentuating this process, and there have been significant developments in Europe. According to the Emerging Trends survey, “2007 is all about what happens in public markets – if REITs take off in Europe, there will be lots of activity as people reposition themselves.”

Although Belgium and the Netherlands have had REIT regimes for many years, since the 1960s for the Dutch, much of the impetus for the development of European REIT regimes was triggered by the introduction in 2003 of a REIT

vehicle in France, the Societe d’Investissement Immobiliers Cotees (SIIC). The SIIC allowed for the creation of a listed property investment company exempt from tax on its rental income and capital gains, provided that it distributed annually a minimum of 85% of its rental income and 50% of its capital gains.

The conversion charge on unrealised gains of approximately half the tax due if charged at normal rates, which can be spread over four years, was sufficiently attractive to encourage qualifying companies to convert, and the resulting tax exempt vehicles were attractive to buyers, resulting in significant takeover activity since the introduction of SIICs in 2003. Changes introduced from 1 January 2005 added further to the attractiveness of the SIIC. In particular, the changes allow corporate taxpayers to contribute real estate assets in exchange for the issue of shares in a SIIC, the gain arising being taxed at approximately half the normal rates.



Strong investor enthusiasm

Enthusiasm from local and overseas investors has been considerable. As the generosity of the regime has become apparent enthusiasm from the government for some of the features of the regime has paled slightly, resulting in changes to the SIIC regime being announced last December, although the regime still remains more generous than that recently introduced in the UK and proposed in Germany. Shareholders or shareholders working in concert will not be allowed to own more than 60% of the share capital of an existing SIIC beginning 1 January 2009. Any new SIIC will be subject to the new rule beginning 1 January 2007. In addition, a minimum 15% free float needs to be respected, free float in this context being defined as a maximum of 2% per shareholder. SIICs will also be subject to a new 20% tax on distributions made to shareholders (other than individuals) owning directly or indirectly 10% of the share capital, if the shareholders are not subject to corporate income tax on their SIIC dividends or the tax is lower than one third of the amount that would have been paid in France. This provision

would not apply where the shareholder of the SIIC is a SIIC vehicle or a foreign company with similar status.

This year, the UK joined the select but expanding club of countries with a REIT regime. The regime came into effect in the UK on 1st January, and nine quoted property companies converted to REIT status that day. A number of other companies have announced that they will convert during the first half of 2007. The UK Government made changes to the legislation in December, immediately prior to the rules coming into effect. The changes addressed some of the concerns raised by the UK real estate industry, and included some relaxation of the rules on REITs that will make it easier for new REITs to be launched. Further consultation is ongoing on a number of areas of uncertainty, so further guidance from the authorities can be expected.

In Germany, draft REIT legislation was published in late October, with the legislation anticipated in March. The major change from previous proposals is that residential property is now excluded from eligible assets. In a comprehensive

This year, the UK joined the select but expanding club of countries with a REIT regime. The regime came into effect in the UK on 1st January, and nine quoted property companies converted to REIT status that day. A number of other companies have announced that they will convert during the first half of 2007.

resolution in December, the lower house of the German parliament (Bundesrat) raised the possibility of significant amendments. These and other comments on the draft are currently being considered by the government and will be discussed in the upper house. Various politicians are still in favour of the inclusion of residential assets. Although the legislation is still in draft form and is unlikely to be agreed upon until at least March, the intention is that the legislation will be introduced with retroactive effect from 1 January. In view of the uncertainties, it is unlikely that anyone will seek to take advantage of the retroactive aspect of the legislation.

More European REITs

Over the last two years as interest in European REITs has grown, one of the ongoing debates has been whether or not the existing Italian real estate fund regime was a REIT. The question has now become of academic interest as Italy also announced the introduction of a REIT vehicle. The Financial Law for 2007 which was approved on 21 December provides for the introduction

of the SIIQ – Società di Investimento Immobiliare Quotate). Detailed rules will be published by the Ministry of Economy and Finance by 30 April 2007. Companies will be able to elect for SIIQ status for accounting periods starting after 30 June 2007. For companies with a financial year that coincides with the calendar year, the SIIQ option may therefore have effect from 1 January 2008.

In the Netherlands, the existing REIT regime “Fiscale Beleggingsinstelling” (FBI) has been in place since 1969. The government has announced changes that will make the regime more attractive, particularly for foreign investors. The changes will broaden the range of entities that may qualify for REIT regime, and will broaden the range of permitted investment activities. Currently an FBI must be Dutch resident. It is proposed to abolish this residency requirement. The FBI rules currently include restrictions on foreign shareholders. A single non-resident fund for joint account or a single non-resident company, may not own a direct interest of 25% or more in the FBI. This too would be abolished under proposed

Exhibit 1: Key features of the various European REIT regimes

| | Belgium | France | Germany | Italy | Netherlands | UK |
|----------------------------------|---------------|--|---------------|---------------|----------------------------|---------------------------|
| No of public REITs | 13 | 3 | N/A | N/A | 13 | 9 |
| Size of market (US\$ billion) | 5 | 18.8 | N/A | N/A | 17 | 68 |
| Requirement to be listed? | Yes | Yes | Yes | Yes | No | Yes |
| Shares must be widely held? | Yes | Yes (see above) | Yes | Yes | Yes | Yes |
| Locally tax resident | Yes | Yes or with dual listing | Yes | Yes | Yes, but see changes above | Yes |
| Borrowing restrictions | 65% | No | 60% | Not yet known | 60% of RE 20% of others | Interest cover 1.25 times |
| Distribution requirement | 80% | 85% of rent 50% of gains 100% of other | 90% | 85% | 100% of income | 90% of income |
| Withholding tax on distributions | 15% (pre DDT) | 25% (pre DDT) | 25% (pre DDT) | 20% | 25% (pre DDT) | 22% (pre DDT) |
| Withholding tax on distributions | 15% (pre DDT) | 25% (pre DDT) | 25% (pre DDT) | 20% | 25% (pre DDT) | 22% (pre DDT) |

Source: PricewaterhouseCoopers

changes. Limits on shareholders will also be eased by proposals to abolish the distinction between listed and non-listed FBIs. Currently for an FBI listed on the Amsterdam stock exchange there is a limitation on control of shares in the REIT to 45% held by a single entity, whereas for an FBI not listed on Amsterdam stock exchange, 75% or more of the shares in a REIT must be held by individuals, tax exempt entities and/or REITs listed on the Amsterdam stock exchange. Finally, the Government is proposing a reduction in the domestic withholding tax rate from 25% to 15%.

Market Reaction

What activity can we expect in the market as a result of this flurry of REIT activity? REITs are clearly an attractive and tax efficient vehicle for domestic investment in real estate. Arguably the withholding tax provisions make REITs and other real estate companies less appealing for cross border investors than funds, although this does not appear to have diminished enthusiasm. The Emerging Trends in Real Estate® Europe survey identifies a significant growth in the number of real estate

securities funds: “A headcount by AME Capital reckons that there are now over 100 global securities funds specialising in real estate and some 50 that focus exclusively on Europe – 35 were launched last year alone. Altogether, these funds manage US\$39 billion of real estate securities.” We are also seeing an interest in the development of funds of REITs. It is not only the securities and specialist REIT funds that are potential investors in the expanding range of REITs. One of the key changes in the real estate funds markets in the last two years has been the growth of open-ended funds. Ten years ago the product that fund managers aspired to was a closed-ended pan-European real estate opportunity fund. Now it is an open-ended, global core or core-plus fund. Open-ended fund of funds are also starting to appear. Quoted real estate securities provide a way for such funds to find liquidity on a temporary basis, so we should see the traditional real estate funds function as REIT investors too. It will be interesting to see the speed with which capital market players seek to mitigate some of the tax disadvantages of investing in REIT

The other area of potential impact of the introduction of REITs is the effect that this will have on domestic real estate market. From the perspective of property companies becoming REITs, the attention would be expected to turn rapidly from the immediate issues surrounding conversion, to the strategy that will follow. For many this is a strategy of growth, and particular, growth by acquisition.

shares through equity derivatives, as has been the case with other securities in the past.

The other area of potential impact of the introduction of REITs is the effect that this will have on domestic real estate market. From the perspective of property companies becoming REITs, the attention would be expected to turn rapidly from the immediate issues surrounding conversion, to the strategy that will follow. For many this is a strategy of growth, and particular, growth by acquisition. This is certainly the trend that would be expected from looking at other countries – what happened historically in the United States and more recently in France. One of the advantages that the REITs hold in corporate acquisitions is their capacity to use their tax exempt status to dilute the inherent deferred tax liabilities in the companies to be acquired. The conversion to REIT status of the newly acquired subsidiary will typically require the acquiring company to pay a one-off conversion charge. In France, the charge is 16.5%, roughly half the normal tax rate on the notional gain, spread over four years. In return for the upfront cost,

the company will subsequently be able to dispose of properties without triggering a tax liability on subsequent or inherited capital gains. This gives the REIT a significant competitive advantage. In other new REIT regimes the conversion charge is potentially even less onerous.

It is too early to tell if 2007 really will be “the year of the public market” as the findings of the Emerging Trends survey suggest, but even at this stage, the introduction of REITs is at the very least a major focus of attention.

John Forbes can be reached via email at: john.forbes@uk.pwc.com

Uwe Stoschek can be reached via email at: uwe.stoschek@de.pwc.com

Information for this article was drawn from:
Emerging Trends in Real Estate® Europe 2007.
Details of this publication are covered elsewhere in this edition of Global Real Estate Now.
PricewaterhouseCoopers Worldwide REIT regimes country summaries (various). If you would like further information please email merryn.stewart@uk.pwc.com

EYE ON EUROPE

Wish of Europe: Italy launches REITs

By Fabrizio Acerbis, Partner and Daniele Di Michele, Senior Manager, TLS Associazione Professionale di Avvocati e Commercialisti, member firm of PricewaterhouseCoopers – Tax & Legal Services Network, Milan



Listed real estate companies will be able to opt for not paying income taxes on their real estate lease business. Widespread shareholding, taxation upon dividend distribution, soft entry taxes: May SIIQs represent a new opportunity? The answer will arrive shortly!

Real Estate Investment Trusts (REITs) are going to take off in Italy, under the name of “SIIQ” (Società di Investimento Immobiliare Quotata). Introduced by the Law N° 296 of 27 December 2006 (the Budget Law for year 2007), the SIIQ qualifies as a listed real estate investment company, the Italian version of the better known REITs and similar entities with same purposes in force in other countries, and represents a new vehicle for investments in the real estate market.

The qualification of SIIQ is reserved to specific resident companies limited by shares

Paragraphs 119-141 of the sole article forming the 2007 Budget Law have introduced a special civil and tax regime, applicable, upon option, to resident companies limited by shares (Società per Azioni, or S.p.A.s), provided that the following conditions are met:

- The shares of the company shall be listed on an Italian regulated stock market;
- The company’s “prevalent” business is the real estate lease (locazione immobiliare);
- No shareholder shall hold, directly or indirectly, more than 51 percent of the voting rights in the general meetings and 51 percent of participation to the company’s profit;
- At least 35 percent of shares shall be held by shareholders each one not holding, directly or indirectly, more than one percent of the voting rights in the general meetings and one percent of participation to the company’s profit.

The special regime may be extended, always upon option, to non-listed Italian companies limited by shares (S.p.A.s) carrying out the real estate lease as “prevalent” business, controlled by a SIIQ, also jointly with other SIIQs, for at



least 95 percent of the voting rights in the general meetings and 95 percent of participation to the company's profit.

The option for the special regime by the controlled non-listed companies implies, in addition to the application of all rules provided for the SIIQs (contained in paragraphs 119-141 of the 2007 Budget Law), the preparation of financial statements in accordance with IAS/IFRS.

The real estate lease is to be the company's "prevalent" activity

Pursuant to the institutive law, the real estate lease business is deemed to be "prevalent" when both the following conditions are fulfilled:

- At least 80 percent of the balance sheet assets is represented by leased real estate properties (held in property or under another real right), or shareholdings in other SIIQs and/or companies which have opted for the special regime held as investments;

- At least 80 percent of the annual proceeds derives from leases or dividends distributed by related SIIQs and/or other companies which have opted for the special regime, provided that such companies' profits are realised through the conduct of real estate lease business.

For this purpose, SIIQs are required to keep accounting records concerning the real estate lease business separate from those concerning other activities eventually performed.

Should the company not comply with the "prevalence" requirement for two subsequent financial years, the special regime is interrupted, with consequent application of the ordinary income tax rules, starting from the latter of these two financial years.

At least 85 percent of the annual net profit deriving from the real estate lease business is to be distributed to shareholders

SIIQs, as well as other companies entitled to opt for the special regime, are

SIIQs, as well as other companies entitled to opt for the special regime, are required to distribute dividends on an annual basis for at least 85 percent of the net profit deriving from the real estate lease business and from shareholdings in related SIIQs and other companies which have opted for the special regime.

required to distribute dividends on an annual basis for at least 85 percent of the net profit deriving from the real estate lease business and from shareholdings in related SIIQs and other companies which have opted for the special regime. If SIIQ's overall net profit is lower than the net profit originated by real estate leases, the minimum distribution percentage is applied to this lower amount.

Non-compliance with this requirement implies the termination of the special regime and accordingly the application of the ordinary income tax rules, starting from the financial year of realisation of the undistributed profit.

Profit from real estate lease is not taxed at the SIIQ level

From the perspective of taxation at entity level, SIIQ appears to be designed as a "transparent" entity – although different from an Italian partnership, whose yearly taxable profit is attributed annually to the partners and taxed in their hands, regardless of the actual profit distribution: starting from the tax period where the special regime applies,

income deriving from real estate leases is exempt from the corporate income tax (IRES, with ordinary rate of 33 percent) and from the regional tax on production (IRAP, with ordinary rate of 4.25 percent).

The exempt income also includes dividends distributed by related SIIQs and/or by other companies which have opted for the special regime, provided that their profits are originated from real estate lease.

Specific tax treatment is provided for:

- income and costs referring to the tax periods prior to the one eligible for the special regime, relevant for tax purposes in the following tax periods according to specific tax rules;
- tax losses incurred in the tax periods prior to the one eligible for the special tax regime;
- reserves set up with retained profits referring to previous tax periods subject to the ordinary income tax regime.

Withholding tax is applied as an advance payment in the case of resident individual entrepreneurs and corporate entities subject to business income ordinary tax rules.

Dividends distributed to shareholders are taxed by means of withholding tax

Dividends in whatever form distributed to shareholders, other than other SIIQ, deriving from real estate lease business directly or indirectly carried out, are subject to withholding tax at the source with the rate of 20 percent.

Net profit related to specific residential building lease contracts may benefit from a reduced withholding tax rate of 15 percent.

Withholding tax is applied as an advance payment in the case of resident individual entrepreneurs and corporate entities subject to business income ordinary tax rules (i.e., entities subject to the corporate income tax, IRES, among which: limited liability companies and Italian permanent establishments of foreign entities), and as a definitive payment in the other cases.

The withholding tax is not applied for distributions to:

- other SIIQ;
- Italian pension funds;

- Italian undertakings for collective investments;
- private wealth management for which the “managed saving” substitute tax regime is opted.

The dividend regime as described applies also to dividends distributed by companies entitled to opt for the SIIQ status.

The institutive law does not expressly provide any specific rule as regard the taxation of dividends distributed to non-resident investors/shareholders.

Dividends distributed by SIIQs and by other companies which have opted for the special regime cannot benefit from the “dividends exemption” (i.e., partial exclusion of dividends from the income taxable base, with different rules according to the collector’s tax status).

Similarly, the disposal of shareholdings in SIIQs and other companies which have opted for the special regime cannot benefit from the “participation exemption” (i.e., partial exemption of capital gains from income taxes, also in this case with different rules according to the seller’s tax status).

The special tax regime option exercise implies the realisation of leased real estate properties at their “fair market value”, with possible substitute taxation

Transition to the SIIQ status implies the realisation at “fair market value” (valore normale) of real estate properties and real rights on properties under lease and owned at the end of the last financial year subject to ordinary taxation.

Related capital gains, net of potential capital losses, may be taxed through a 20 percent substitute tax in place of the corporate income tax (IRES) and of the regional tax on production (IRAP). The substitute tax may be paid out in equal annual instalments, up to five.

Real estate properties available for sale (i.e., inventory) may also be subject to the substitute tax; even in this case, the evaluation at “fair market value” applies.

Alternatively, capital gains can be subject to ordinary taxation in the tax period prior to the one in which the special regime applies, or in equal instalments in that period and in subsequent periods, up to four. In this case, however, the capital gains do not concur in determining the real estate lease income for the purpose of the “prevalence”/assets test.

The “fair market value” (valore normale) will represent the new tax value of real estate properties, also for the purpose of the “prevalence”/assets test, starting from the fourth tax period under the special regime. In case of disposal of the real estate properties before this term, capital gain/loss will be subject to ordinary income taxation and it will be determined on the basis of the previous tax value; the substitute tax paid out on transition, and proportionally attributable to the disposed properties, will represent a tax credit.

Contributions in kind in favour of SIIQs may benefit from favourable tax treatments

Capital gains realised upon contribution of real estate properties and real rights on such properties to SIIQs and to companies which have opted for the special regime (or which exercise the option by the end of the transferor’s tax period in which the contribution is made) may be taxed, alternatively:

- according to the ordinary income tax rules;
- with application of a 20 percent substitute tax, payable in equal annual instalments, up to five, to the extent that the aforesaid assets will be held for at least three years by the SIIQ.

Contributions of lots of real estate properties, most of which are to be leased, to SIIQs and companies which have opted for the SIIQ status, fall out of the VAT scope. For these contributions, despite the nature of the transferor, registration tax, mortgage tax and cadastral tax apply on a lump sum basis.

For sales and contributions, other than those mentioned above, to SIIQs and companies which have opted for the special regime, mortgage and cadastral taxes apply on an aggregated reduced rate of two percent (the ordinary aggregated rate being four percent).

The option for the special regime is irrevocable

The option for the SIIQ status is irrevocable and has to be expressed within the end of the tax period prior to the one from which this regime is intended to be applied; the procedure to apply the option has not yet been set out.



Most of the players may access to the SIIQ status from 2008. Several implementation aspects have still to be regulated

According to the institutive law, this regime will be applicable starting from the tax period following to the one current on June 30th, 2007. Companies entitled to exercise the option whose financial year corresponds to the calendar year, will be able to apply for this special regime starting from 2008.

The institutive law does not provide an exhaustive discipline of SIIQs. It has provided only the main and basic features of this new special regime, in term of subjective and objective requirements and tax regimes applicable at SIIQ level and in the hands of investors/shareholders, on one hand, and in terms of introduction of a favourable tax treatment for the transition to the special regime in order to make this new vehicle appealing, on the other. The regulation of several implementation aspects has been delegated to specific ministerial decrees to be issued by April 30th, 2007.

The institutive law provides neither restriction on the holding of foreign assets nor on the presence of foreign shareholders. Also, at present no specific investment allocations are required, excluding the “prevalent” investment in leased real estate properties, and no borrowing restrictions are imposed. The regulation of these aspects does not seem to be expressly delegated to the issuing ministerial decrees. However, it cannot be ruled out that such decrees, empowered by the institutive law to provide, inter alia, rules concerning the prudential supervision to be performed on SIIQs, may introduce some constraints in regard to these aspects.

In particular, these decrees shall regulate:

- the prudential supervision to be performed on SIIQs by the relevant authorities;
- the determination of the “fair market value” (valore normale) of the real estate properties and real rights falling under the special regime;

According to the institutive law, this regime will be applicable starting from the tax period following to the one current on June 30th, 2007. Companies entitled to exercise the option whose financial year corresponds to the calendar year, will be able to apply for this special regime starting from 2008.

- the utilisation of the carried-forward tax losses incurred in the tax periods in which the special regime applies;
- the determination of the tax value for shareholdings in SIIQs and other companies with the SIIQ status;
- the determination of the tax value of the assets and liabilities in case of interruption, for whatever reason, of the special regime;
- the consequences of reorganisations involving SIIQs and companies controlled by the latest;
- the utilisation of tax credits pre-existent to the option for the special regime;
- the effects of the interruption of the special regime not expressly regulated by the institutive law or by the general principles of the income tax system;
- the accounting and formal obligations to be fulfilled in order to apply the 15 percent reduced withholding tax on dividend distributions, where admitted.

Final considerations

SIIQ should represent an alternative instrument to closed-end real estate funds which have not grown as expected. SIIQ should aim at increasing liquidity of real estate investments. Although the appeal of SIIQs to real estate investors will be wholly appreciated only after the implementation regulations have been enacted, as of today the most relevant benefit appears to be the step-up of the real estate properties at their “fair market values” at a discounted tax rate.

Fabrizio Acerbis can be reached via email at: fabrizio.acerbis@it.pwc.com

Daniele Di Michele can be reached via email at: daniele.di.michele@it.pwc.com

EYE ON EUROPE

2006: Central and Eastern Europe (“CEE”) property markets come of age

By Glen Lonie, Partner, Tax and Legal Services Group, PricewaterhouseCoopers, Prague and Brian Arnold, Director, Financial Services (Tax) Group, PricewaterhouseCoopers, Moscow



CEE is a diverse region covering some 27 countries, stretching across some 12 time zones from Slovenia in the West to the far east of Russia. It represents a large population base of over 400 million people.

With its well educated, low cost, productive workforce; a history of scientific and engineering excellence; significant energy and raw materials stocks (particularly for Russia and other members of the CIS); and access to European markets the region attracts a considerable amount of foreign direct investment (FDI). This FDI and consequent growth in consumer demand give rise to all types of demand for property.

Regional overview

The CEE region breaks down into three country groups (Chart 1), all having different characteristics.

The first group, which was the initial focus for property investors into the CEE region, is Central Europe and the Baltic states (CEB). These countries have all been EU member states since 1 May 2004. They have attracted large amounts of FDI and have close geographic and historical links to

Western Europe. Within this group Poland is notable for its large population of some 38.5 million people including six cities with populations in excess of one million people. The Baltic states, while small in population terms, are notable for their high GDP growth rates: 7.5% for Lithuania, 9.8% for Estonia and 10.2% for Latvia. The economies of this group have generally proven to be quite stable, both in political terms and also in having quite low inflation.

The second group, the new wave for property investors, is South Eastern Europe (SEE). Among this group are the new EU member states since 1 January 2007 of Romania and Bulgaria. Within this group Romania is notable for its population of some 22 million people. In GDP terms the region is generally not as wealthy as the CEB states, but certain countries, particularly Croatia and Montenegro, benefit from their attractiveness as tourism destinations. Political stability is now improving which offers a positive impact on the appetite

| Central Europe & Baltic states (CEB) | |
|--------------------------------------|-----------|
| Czech Republic | Slovenia |
| Hungary | Estonia |
| Poland | Latvia |
| Slovakia | Lithuania |

| South-eastern Europe (SEE) | |
|----------------------------|------------|
| Albania | Macedonia |
| Bosnia | Romania |
| Bulgaria | Serbia |
| Croatia | Montenegro |

| Russia & Commonwealth of Independent states (CIS) | |
|---|--------------|
| Russia | Kyrgyzstan |
| Armenia | Moldova |
| Azerbaijan | Tajikistan |
| Belarus | Turkmenistan |
| Georgia | Ukraine |
| Kazakhstan | Uzbekistan |

Chart 1: The CEE region – three country groups



for FDI and real estate investments into these countries.

The final group, representing the new frontier, is Russia and the Commonwealth of Independent States (CIS). In general the property markets are less developed in these countries compared with the wider CEE region. Russia in particular with its huge population of 142 million, its historical leadership position and natural resource base is starting to see considerable real estate investment activity. Ukraine, with its increasing engagement with the EU and a population of 46 million, and Kazakhstan, also with a significant resource base, are interesting markets for the future as well.

Real estate market trends

CEE, like the rest of the global market, has seen a flood of money looking for real estate investment opportunities. An ongoing situation of demand outstripping supply has meant that CEE has been very much a seller's market. There also has been a considerable impact on returns with yields (relationship of a property's rental

income to its capital value) coming into line with those of Western European markets. This has led to certain changes in investor behaviour to secure both investment opportunities and appropriate returns.

In real estate investment terms 2006 may be seen as a year for breaking psychological barriers. For the first time total real estate investments in CEE exceeded Euro 10 billion (Chart 2).

Looking to where the money was spent – Poland, with its large population, continues to be the major destination with the Czech Republic, Hungary and Slovakia as a smaller market, all maintaining interest. More interesting is the clear emergence of Russia and Romania as significant investment markets. Bulgaria and Croatia also are seeing increasing activity.

Although the 2006 investment volume shows substantial growth over the previous year total of some Eur 6 billion, this needs to be considered in light of the amount of raised funds looking to be put to work in this part of the world.

Chart 2: Investment Volumes in CEE

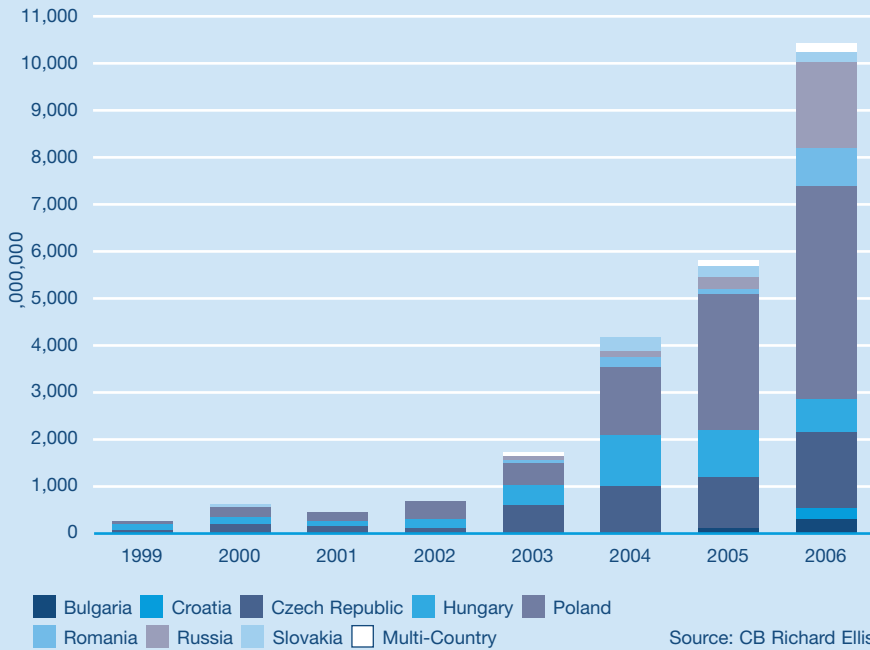
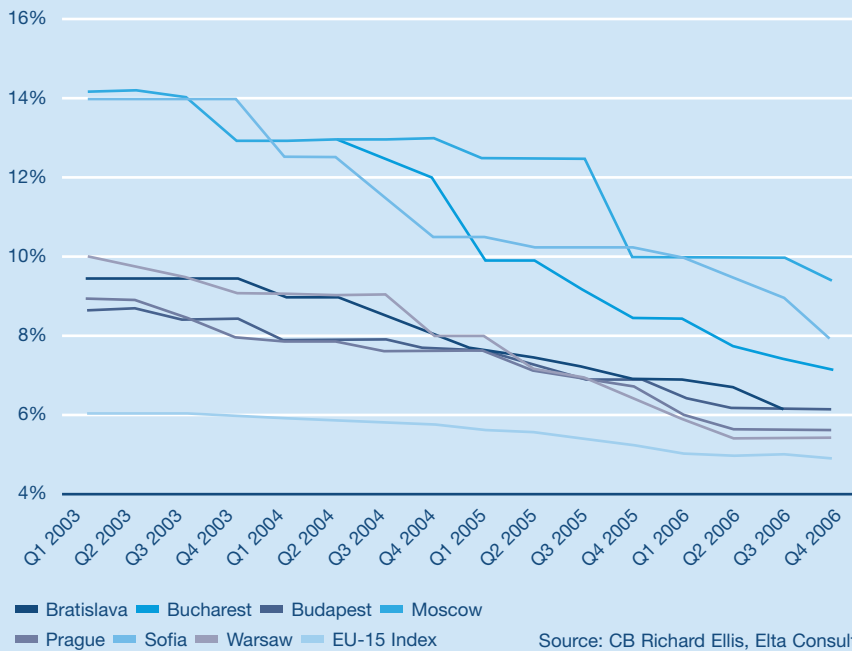


Chart 3: Prime Office Yields in CEE



As fund managers continue to raise specific CEE funds, or increasingly have a Central European allocation from their pan-European funds, demand is still thought to outstrip current investment volumes by a factor of three to one or more.

Ongoing investor demands have led to rapid yield compression (Chart 3) with prime office yields having dropped below the 6% barrier in the Central European capital cities of Prague and Warsaw. Prime retail and industrial yields have closely followed this downward trend in these markets as well as in the

To enhance returns, investors also are looking at locking in investment commitments and taking on development risk. This has been accomplished in a number of ways, but increasingly investors are looking to forward-purchase properties under development and to buy into platforms by (for example) taking an equity stake in a developer to secure a pipeline of investments products or to secure the development return.

other Central European capitals of Budapest and Bratislava. At the current levels yields are approaching the levels of those achievable in Western Europe for equivalent investment opportunities.

Other investment countries of the CEE region also have experienced dramatic yield compression of 400 basis points or more over a four year period. Russia still offers higher returns, although yields have also been compressing with prime yield rates of around 9% for office, 10% for retail and 11% for logistics. The capital cities of the new EU member states of Bucharest in Romania and Sofia in Bulgaria are also showing a similar trend, offering yields somewhere between those in CEB and CIS.

What these yield movements suggest is that the capital cities of Central Europe in particular are now becoming more “core” markets – meaning that more opportunistic investors are looking elsewhere to invest. This desire on the part of investors to generate higher returns has led to a number of different outcomes. Clearly the move eastwards while allowing investors to secure greater returns, needs to be considered

on a risk – return basis. In this respect it appears investors are starting to get more comfortable with Russia country risk, and that there is also a move into the more emerging markets of SEE.

To enhance returns, investors also are looking at locking in investment commitments and taking on development risk. This has been accomplished in a number of ways, but increasingly investors are looking to forward-purchase properties under development and to buy into platforms by (for example) taking an equity stake in a developer to secure a pipeline of investments products or to secure the development return. There are also shifts in investments and developments to all real estate asset classes and away from the national capital cities, also to regional cities and other locations – such as in the case of logistics properties. Residential development also has been very popular due to the need to remedy shortages in a number of countries across the CEE region. The pressure to get money invested has also led to a number of larger deals with some large retail portfolios in particular changing hands.



The year ahead

Coming off a record year there is much optimism for continuing real estate investment into CEE. Declining yields are leading to a change in investment patterns with more focus on higher return opportunities either through development or moving into the as yet less invested countries of SEE and CIS. Even against this backdrop we see no slowdown in the countries of CEB, with Poland in particular showing increases in deal activity. Russia also seems to offer big possibilities for the future. One thing that becomes increasingly clear as more of a core mindset moves across the region, is that there will be greater focus on getting good deals with less scope for error around the fundamentals.

Glen Lonie can be reached via email at:
glen.lonie@cz.pwc.com

Brian Arnold can be reached via email at:
brian.arnold@ru.pwc.com

EYE ON EUROPE

Internationalisation: Spanish companies launch into foreign markets

By Fernando Beltran, Director, Real Estate Transactions, PricewaterhouseCoopers, Madrid; and Fernando Herrero, Manager, Real Estate Transactions, PricewaterhouseCoopers, Madrid



Spanish Real Estate Boom, 1997 – present

The Spanish real estate sector has experienced a spectacular boom since 1997 in both price and volume. Between January 1997 and June 2006, nominal housing prices grew annually by double figures; volumes reached a peak in 2006 with new housing starts on 800,000 units, 3.5 times the figure in the UK.

The value of the construction sector in nominal GDP grew from 5.9% in 1998 to 11.0% in 2005. The principle reasons for this growth were mainly economic and demographic factors, as well as the amount of foreign investment:

Economic:

- low interest rates (see Figure 1) and solid employment levels have had a positive impact on disposable income consumption;
- an increase in mortgage competition assisted the strong development in the housing market;
- the Spanish tax system provides subsidies for buyers and landlords, which has boosted purchases and attracted speculative money;
- as a result of low interest rates, the appeal of housing as an investment increased relative to bank deposits or government and corporate bonds. This attracted speculative money as

well as buy-to-let investors, some of them using 'black' money.

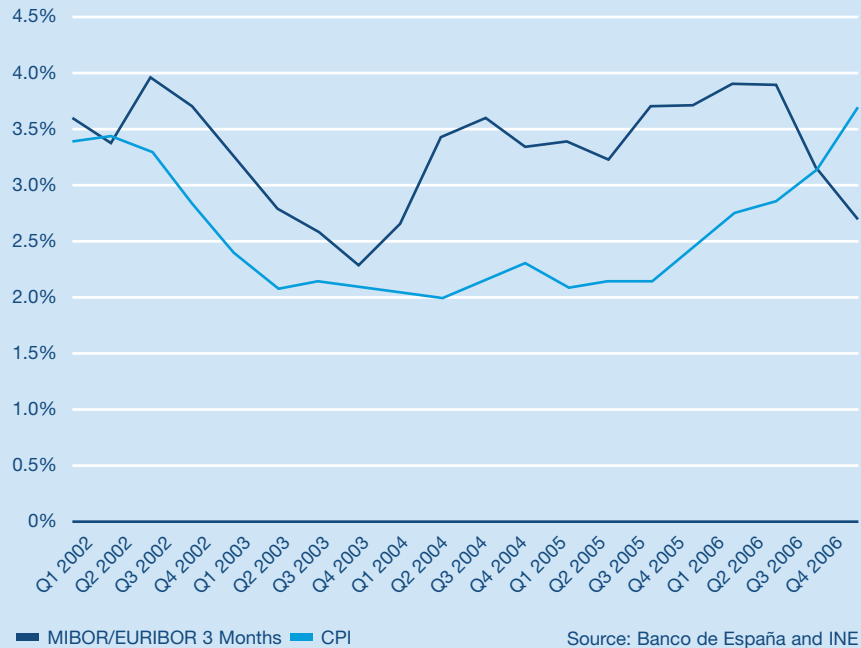
Demographics:

- The arrival of immigrants and the increase in divorce rates both help to increase the number of new households;
- Demand has been increased by younger 'baby boomers' buying first homes and elder baby boomers buying second homes;
- An additional reason is the traditional preference to buy a house instead of renting one (Spain's level of home ownership is almost double the ratio in Germany).

Foreign investment:

- The improved quality of life in Spain and the expansion of low cost airlines has turned Spain into an easily accessible destination for Northern Europeans.

Figure 1: Interest rate (Euribor 3 Months) vs CPI



Forecasts

Some voices are calling for prudence. The Bank of Spain estimates a 24-35% overvaluation of the housing market since December 2004, while most experts anticipate prices growing slightly above CPI in 2007, but will not be surprised to see no growth in nominal terms within the next 18-24 months in areas with excessive supply, mainly the outskirts of big cities and large developments by the coast. However, this outcome is not likely to have the same impact across all locations and segments. The intensity and speed of the deceleration should be primarily led by interest rates, employment behaviour and demographics/household performance.

In the experts' view supply should decrease in an initial stage (in the next two-to-three years) to approximately 500-600,000 houses/year, from 800,000 in 2006 (See Figure 3).

The real estate sector in Spain

The Spanish real estate sector displays strong growth, underscored by the large

number of small and medium companies, which represent approximately 73% of the real estate sector. In spite of a strong process of consolidation that is strongly developing, the ten top companies by size will soon represent about 8% of total transactions, with the top 100 comprising 27% of this number.

An important part of the transactions undertaken by real estate companies is concentrated in the sale of constructions, which constitutes around 79% of the total income, whereas land sales constitute 12% and rentals 9%.

The market forecast, in the context of a bullish cycle practically exhausted, has encouraged companies to maintain their growth through acquisitions taking advantage of the reduced debt levels.

In the last few months a good number of transactions corporate operations have been seen in the Spanish sector; in the ten largest operations the total value has reached 25,000 million. All type of situations have been seen, companies of an appropriate size to conduct operations in the European

Figure 2: Gross Domestic Product

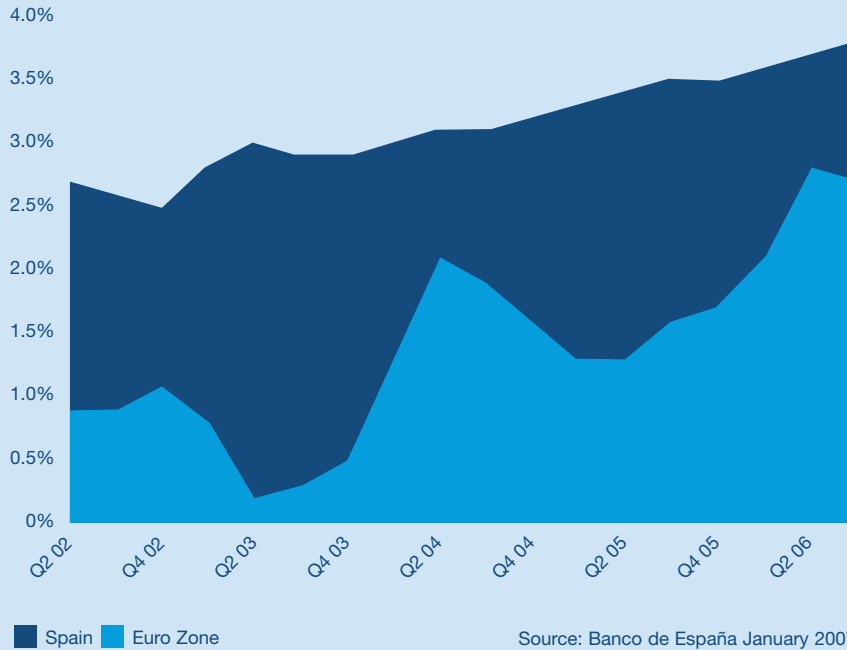
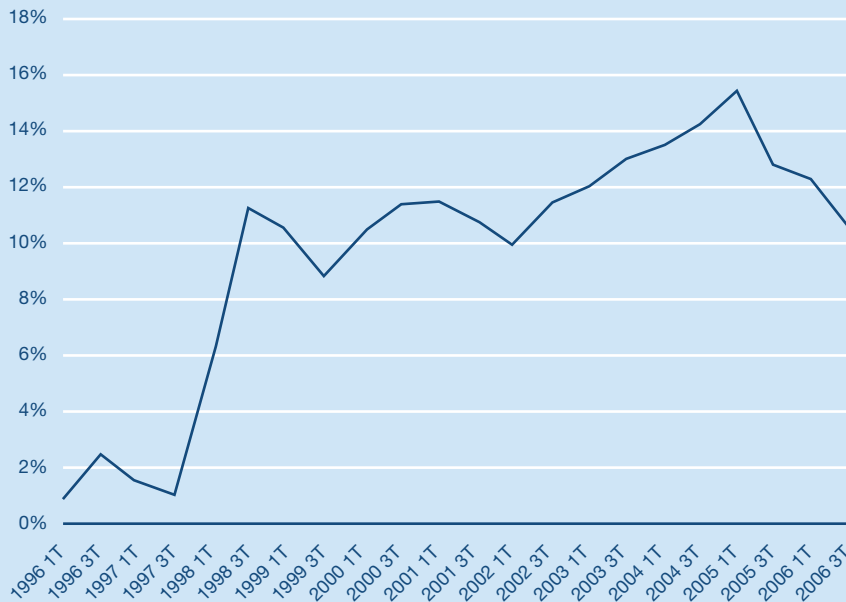


Figure 3: Annual price growth by quarters. New housing



market (Metrovacesa – Gecina); targets for medium size quoted companies by other quoted competitors (like: Reyal – Urbis, Martinsa – Fadesa, Constructor San Jose – Parquesol); and even small companies buying much larger ones (Inmocaral – Colonial – Riofisa).

In general, there has been a generalised removal of investment from the real estate divisions of financial organisations, not only for the larger companies, but also among mid-sized banks and saving banks, where multiple movements have taken place. The Bank of Spain is somewhat responsible for

The Spanish real estate sector displays strong growth, underscored by the large number of small and medium companies, which represent approximately 73% of the real estate sector.

these movements, since it has reinforced control of real estate investments by financial organisations.

The growth plans of the great electrical and construction companies need liquidity to finance the important acquisitions that they are carrying out anywhere in the world, and also for generating movements within their real estate divisions; e.g., Ferrovial Inmobiliaria acquired by the Grupo Habitat; Realia (property of Caja Madrid and FCC) will join the stock market the present year; Iberdrola buying Scottish Power, will it sell its real estate division?

Opportunities in other markets

One of the likely ongoing objectives of these latest corporate movements is diversification into new markets in light of the forecasted deceleration in the return on investment in the Spanish market.

The Spanish sector is expected to continue investing mainly in European markets, although in the last few months it has focussed strongly on other

markets, in particular Latin America, but with additional activity expected in Asia Pacific and the United States.

In Europe, developed countries such as Germany, France and Portugal will continue to be the target of Spanish companies, although the greatest growth will likely take place in countries of central and Eastern Europe such as Romania, Croatia, Slovenia, and secondary cities in Poland and the Czech Republic. These markets, without doubt, will be more interesting for investors when restoration efforts and new work promotion improves the outlook. Other European countries with investment potential from Spanish companies are Bulgaria, Hungary and Russia.

Other areas of interest include India, where the growth in urban population offers large scale opportunities. In Latin America, Mexico and Brazil, and in North Africa, Morocco all offer the most outstanding markets for the Spanish investor.

Following are some basic insights into several countries whose respective

Figure 4: Spanish companies in select international markets

| Portugal | Poland | Mexico | Romania | Hungary | France | Morocco | Bulgaria | Brazil | Panama | USA |
|----------------------|------------------------|----------------------|-------------|-------------|-------------|-------------|----------|---------------|------------|------------------------|
| Grupo Azabache | Grupo Azabache | Grupo Mall | Grupo Lar | Grupo Lar | Fadesa | Fadesa | Fadesa | Grupo Sánchez | Grupo Mall | Chamartin Inmobiliaria |
| Grupo Lar | Agofer | Grupo Lar | Fadesa | Fadesa | Grupo Riera | Grupo Prasa | Riofisa | | | |
| Fadesa | Grupo Lar | Fadesa | Grupo Detea | Grupo Riera | | | | | | |
| Acciona Inmobiliaria | Fadesa | Acciona Inmobiliaria | Hercesa | Habitat | | | | | | |
| Vallehermoso | Acciona Inmobiliaria | Anida | Grupo Prasa | | | | | | | |
| Grupo Pinar | Chamartin Inmobiliaria | Hansa Urbana | | | | | | | | |
| Hercesa | Grupo Prasa | Habitat | | | | | | | | |
| Nozar | | | | | | | | | | |
| Grupo Prasa | | | | | | | | | | |
| Grupo Riera | | | | | | | | | | |
| Habitat | | | | | | | | | | |

Source: PricewaterhouseCoopers

real estate markets could draw potential investment interest from Spanish companies.

Romania

Relatively low prices and high yields have made Romania an attractive and highly sought-after country for property investors world-wide. Risks are, nonetheless, higher than in other markets, such as Poland or the Czech Republic.¹

Bucharest is the most important real estate market in the country. In 2006, Bucharest's property market saw the continuance of a boom period for all types of property that started in 2000. The prices for new residential property should continue to increase, mainly due to the fact that demand is by far exceeding supply.

Interest for investing in Romanian property is very high, mainly due to the outstanding growth potential that exists in the market, given the estimated deficit of one million houses. This is despite the latest report issued by the Central Bank restricting access to mortgage loans.

Croatia

Croatia has come to enjoy a full decade of peace and prosperity under the rule of parliamentary democracy. During that time, Croatia has joined the United Nations and become member of the NATO Partnership Peace Program. In addition, the road is being paved by which Croatia could become a member of the European Union.²

As a general rule, foreign investors, foreign entities and individuals may acquire property only after being granted a permit by the Ministry of Foreign Affairs, on the basis of reciprocity. Essentially, if a Croatian national does not have any restriction to buy property in a particular country then the nationals of that country can purchase property in Croatia, but those restrictions can be indirectly avoided, creating a company to purchase property.

Poland

The driving force behind the boom in the Polish real estate market has come from international investors.³

After 1 May 2004, the date of Poland's accession to the EU, property prices increased by an average of 10%-15% per annum. It is expected that they will continue to rise into the future. The strong growth in demand is reflected in the significant increase in apartment prices.

So why is Poland such an interesting place for real estate investors?

- The market will still be energized by successive positive events, such as easier access to land through the elimination of legal regulation issues.
- A growth in prices is forecast in the medium term due to the current high demand and lack of supply.
- The demographic factor is also important. Currently there is a balance between the number of urban and rural inhabitants, although, in a dozen or so years, urban inhabitants will dominate the country's population distribution.

Czech Republic

In July 2006 Czech interest rates rose to 2.25%, but remained the lowest in the EU. The Czech National Bank does not expect any major increase in interest rates and inflation throughout 2007.⁴

The Czech Republic is undergoing the largest boom in the construction of flats and housing since 1989. It is expected that there will be a gradual increase in interest in rented housing up to 2008 in association with the deregulation of rent and the fall in commercial leases. Currently the ratio of house owners is under 50%.

Prague is becoming a preferred location for global back offices, call centres and administration offices for foreign international companies. According to Colliers International, demand is expected to grow throughout 2007 and rental rates are expected to remain stable.

Slovenia

Local newspapers report that in the two years following Slovenia's EU accession Real Estate market increased significantly the number of transactions with a remarkable presence of buyers from European countries like England, Italy, Austria, Germany and other countries with less weight like France, Holland, US, Sweden and Spain.

Recently, Economy Minister Andrej Vizjak outlined the resolution on national development projects and government documents on promoting investments and also highlighted the advantages that Slovenia can offer to foreign investors. He enumerated stable macro-economic environment, the fact that the country was soon to adopt the Euro, its geo-strategic position, and its familiarity with SE European markets as the country's key advantages. Mr. Vizjak moreover believes that the country is also attractive due to its optimal ratio between labour costs and quality.

Mexico

According to research from BBVA "Real Estate Situation Mexico", construction in Mexico has grown in recent years, due to the availability of financial resources, the reduction of interest rates and better risk management.

The construction of housing continued to advance strongly throughout 2006, doubling the production value of 2003. This was assisted by the gradual recovery in saving levels and increase in family spending. Other assisting factors were the increase in financing and credit flexibility, which have helped the house construction growth circle.

The tourism housing market mainly consists of American buyers and relies on a good growth perspective. The increasing internationalisation of real estate investments and the positive return on investment obtained in Mexico are factors that support this trend.

Figure 5: Potential growth markets for Spanish companies

| | Poland | Czech Republic | Croatia | Slovenia | Romania | India | Mexico |
|---------------------------|------------|----------------|-----------|-----------|------------|---------------|-------------|
| Real GDP Growth 2006 | 5.0% | 6.0% | 4.6% | 4.2% | 5.5% | 8.3% | 4.0% |
| CPI 2006 | 0.9% | 2.9% | 3.5% | 2.5% | 7.8% | 5.6% | 3.5% |
| GDP per capita, (\$) 2005 | 7,110 | 10,710 | 8,060 | 17,350 | 3,830 | 720 | 7,310 |
| Interest rates (1 year) | 4.3% | 2.9% | - | - | - | 7.0% | 7.2% |
| Unemployment rate | 14.9% | 7.7% | 17.0% | 8.6% | 5.2% | - | 4.05% |
| Population | 38,435,000 | 10,010,000 | 2,001,000 | 4,440,000 | 22,033,000 | 1,128,023,000 | 109,222,000 |
| % of Urban Population | 62% | 74% | 56.5% | 51.0% | 53.7% | 29% | 76% |
| Population Growth 2005 | 0.0% | (0.2%) | 0.0% | 1.2% | (0.2%) | 1.4% | 1.0% |

Source: World Bank, United Nations, PwC Economic Research Group, Euromonitor, Bloomberg

Commercial work and services dominated the non-residential construction market, whose rate of expansion has increased over the last three years. The investment in commercial buildings offers an attractive return raising the interest of large investors.

India

According to a recent LaSalle Investment Management study, India is reaching a halfway point in its degree of transparency in the real estate sector. The situation improved between 2004 and 2006. In addition, PricewaterhouseCoopers' Emerging Trends in Real Estate® Asia Pacific 2007,

points to the possibility that later this year, India may introduce real estate investment funds for the first time.

Mumbai and Bangalore appear at the top of the ranking of residential demand in Asian cities, thanks to the growth of the middle-class. Market development is strong.

Fernando Beltran can be reached via email at: fer.beltran@es.pwc.com

Fernando Herrero can be reached via email at: fernando.herrero.aldea@es.pwc.com

¹ "Romania: New gem for international investors," Global Real Estate Now, November 2006, p. 50.

² "More and more foreign investors look to Croatia," Global Real Estate Now, November 2006, p. 62.

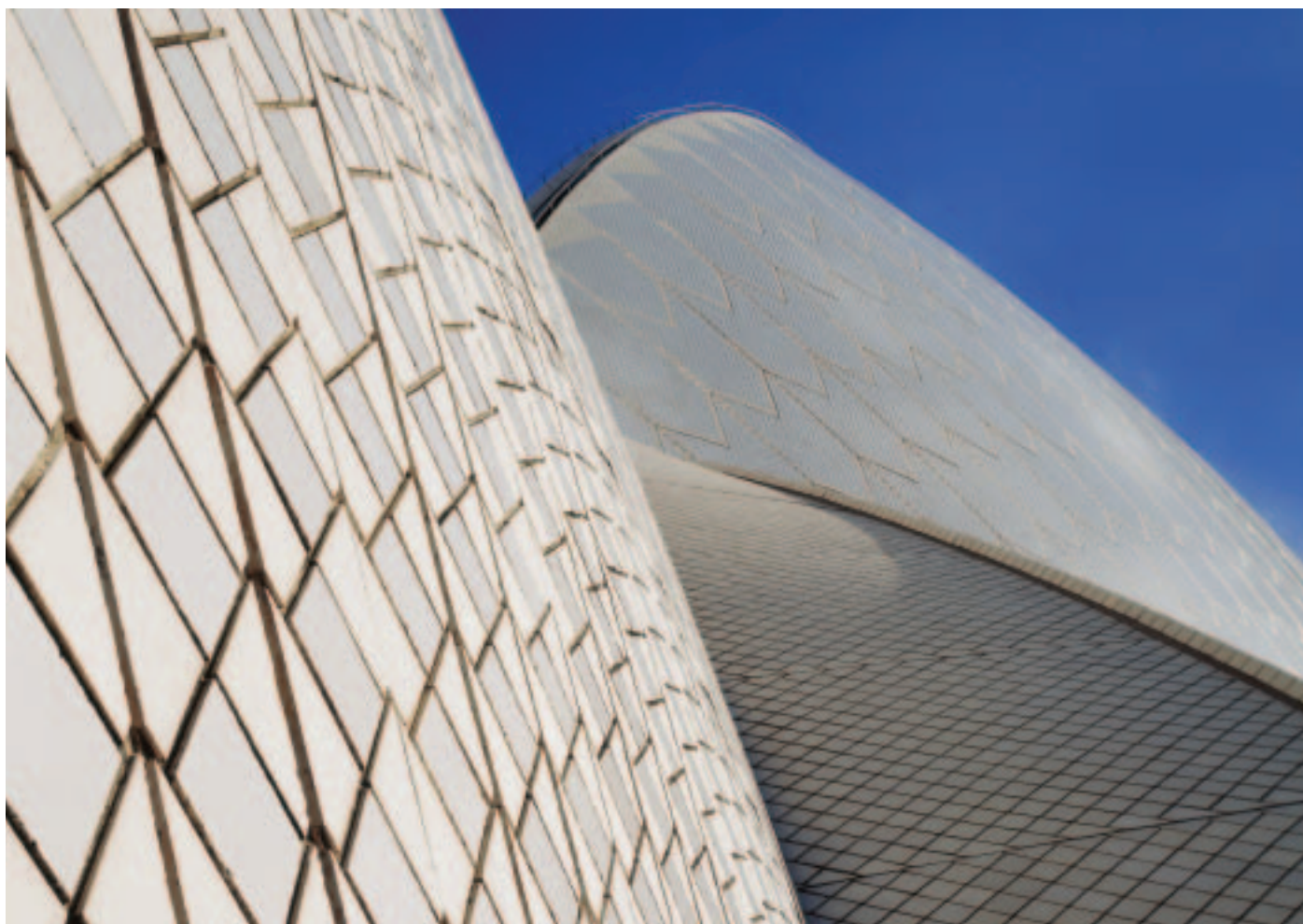
³ "Poland: Opportunity Knocks," Global Real Estate Now, November 2006, p. 36.

⁴ Commercial Property Markets Overview, Autumn 2006, DTZ and Colliers Mid-Year Real Estate Review, 2006

EYE ON EUROPE

Irish investors show continued confidence in real estate – at home and abroad

By Enda Faughnan, Partner-in-Charge, PricewaterhouseCoopers Real Estate Tax Group, Dublin



Despite Ireland's small size and population its investors have become big players in the international property market, both in terms of property development outside of Ireland and property investment generally.

Irish investment syndicates have been snapping up trophy property deals, particularly in the UK and "old" Europe but also across the globe, with deal sizes of up to 1bn not being unusually large in the Irish context.

From an economic standpoint, Ireland has experienced unprecedented growth over the past 10 to 20 years and thousands of millionaires have been born. Many of these have keen appetites for investment in property and the Irish market simply cannot satisfy demand, particularly for "trophy" deals – hence the move towards investment internationally. In response to this relatively recent demand numerous boutique firms and banking divisions have evolved which specialise on an exclusive basis in finding international property "product" in which the bigger (as well as smaller) investors might participate. The types of deals on offer include shares in listed and unlisted companies, straight forward asset deals, mezzanine finance deals and more

complex deals based on life assurance and other financial products.

Established players in the Irish property and investment market have sought to broaden their horizons internationally. As a result, the Irish property investor is now in a position to cherry pick from a wide range of property-based investment opportunities on offer. The ability to structure deals involving third party finance and risk can often prove more attractive than straightforward bank finance, and can also fill in the gap between the levels of bank debt which may be obtainable as compared with the overall project cost. Anecdotal evidence would suggest that despite the fact that the Irish investment community has become internationally mobile as regards where its money is spent, it still sticks with Irish product providers and developers much of the time – particularly in the larger deals. This can make sense from an Irish tax perspective, as when an investment structure is put together for Irish



investors, tax issues particular to the Irish investor can be planned for and managed better.

Two recent surveys give some indication as to the Irish (Dublin) property market and the mindset of the Irish investor. *Emerging Trends in Real Estate® Europe 2007*, recently published by PricewaterhouseCoopers and the Urban Land Institute, notes Dublin's drop from the top ten rankings in 2006 to 20th in 2007. This would appear to correlate with the lack of foreign investment in the city over the last year. It is worth noting that the Irish market is dominated by domestic investors who may have different motivations and strategies than foreigners in the market and the level of inward investment would be regarded as low by international standards. This result therefore is not surprising given the size and scale of the Irish market.

The results of the first independent Irish property survey were launched late last month by PricewaterhouseCoopers and Amárach Consulting. This survey shows continued confidence in Irish property investment and property investment generally despite a possible international

view on the market as being somewhat risky, particularly in the Dublin area. At the same time, it also showed an indicative preference for investing in overseas as opposed to Irish real estate in 2007. A major change in the Irish market in 2007 was not considered to be likely by respondents. The survey was carried out in January 2007 amongst leading Irish property developers, investors and other stakeholders.

Continued growth in Irish property values is anticipated for 2007, although this growth is expected to be more pronounced in the commercial property sector. Some 40% of survey participants expect growth in commercial property of 7% or more with nearly 10% expecting this growth to be 12% or more. On the other hand 10% of respondents expect negative growth for residential property in 2007, although two thirds anticipate growth of 4% or more (with 46% predicting 4%-6% growth in the sector). In addition, three quarters of those surveyed agreed with the viewpoint that banks are becoming more cautious on property lending now compared to a year ago. If this is correct it could signal

The survey also reveals a clear preference for overseas investment with three quarters of survey participants agreeing that there are far better opportunities in the overseas property market compared to Ireland.

the rise to greater prominence of other forms of finance for larger projects – e.g., the raising of equity or mezzanine finance in conjunction with corporate finance houses.

The survey also reveals a clear preference for overseas investment with three quarters of survey participants agreeing that there are far better opportunities in the overseas property market compared to Ireland. Well over half of respondents said they would be more prepared to invest in property developments abroad than in Ireland. One reason for this shift appears to be fuelled in part by stamp duty costs being seen as a key impediment (over three quarters of survey participants saying that stamp duty plays a key role in driving property investment abroad). The rate of stamp duty generally applying to transfers of Irish real estate is 9%. Currently a rate of 1% applies in the case of share deals.

Other factors which might hinder investment in Irish property include planning restrictions, with over 80% of survey participants agreeing that the planning process in Ireland hinders

investment. Other constraining factors included construction capacity and the availability of finance.

According to the survey the top six locations for property investment by Irish property investors are:

1. United Kingdom (excluding Northern Ireland);
2. Germany;
3. Poland;
4. United States;
5. Northern Ireland; and
6. China.

Recently proposed legislative changes in Ireland's Finance Bill 2007 have made the tax implications of outward investment a lot more complicated and in many cases substantially increase the tax cost of doing so, particularly where an investor has the ability to influence what assets are acquired. It is generally anticipated that there may be some modicum of a row back at the government level in relation to some of the proposed changes and final

legislation is due for publication shortly. This means the Irish investor will need to take particular care in regard to the tax implications of participating in any overseas investments and may further fuel the tendency to stick with property deals put together locally which take the impact of the new legislation into consideration.

Enda Faughnan can be reached via email at: enda.faughnan@ie.pwc.com

EYE ON ASIA

India: Realty check

By Gautam Mehra, Partner, India Real Estate Tax Leader and Radhakishan Rawal, Manager, PricewaterhouseCoopers, Mumbai



India is witnessing strong economic growth which is also spurring growth in the real estate sector. Various demand drivers coupled with liberalised policy measures are attracting both institutional and retail investment into the Indian real estate sector.

Positive trends

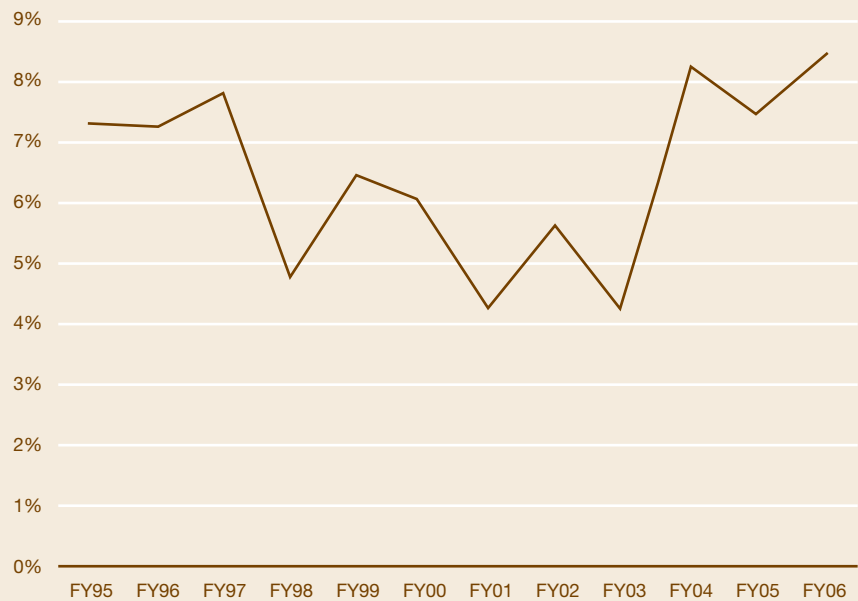
India is the world's seventh largest nation and second most populous nation with a population in excess of 1 billion people. With GDP growth at about 8.4% during financial year 2005-06 (Figure 1) and prospects of maintaining the growth rate at about 8% over the next three years, the Indian economy is one of the fastest growing in the world. India's foreign exchange reserves, which stand in excess of US\$ 165 billion¹, reflect the investor's confidence in the economy. As detailed in Goldman Sachs' BRIC Report, India's economy will become the third largest in the world by 2032, ranking just after the United States and China. The updated January 2007 assessment suggests that India's influence on the world economy will be bigger and quicker than implied in previously published research. The growth may be attributed to both, the growth of the Indian industry in general (including, in particular, the information

technology-enabled services (ITeS) and outsourcing sector and the globalisation of Indian corporates), and the growing presence of foreign businesses in India, with the rapidly increasing consumer class providing the world with a huge market potential.

These factors are helping to provide the necessary impetus for sustained growth in the real estate sector as well. In the past this sector lacked institutional and collective funding support as well as large players having a Pan-Indian or international presence. Since most players were not listed on the local stock exchanges, access to capital markets was minimal; the prime sources of finance being advances from pre-sale arrangements and bank/unorganised borrowings. However, recent policy measures have opened up the sector not only for foreign investment, but also for collective domestic investment.

Property development has surged in India in the past few years, helped by an

Figure 1: Real GDP Growth



Source: Economic Survey & RBI

annual doubling in demand for office space by firms investing into the country's information technology sector and call-centers in Mumbai, the National Capital Region (Delhi and satellite towns), Bangalore and Hyderabad, among others. Land prices have increased rapidly in these markets, the extent of the rise, however, varies from city to city and even within cities. According to Emerging Trends in Real Estate® Asia Pacific 2007, released by PricewaterhouseCoopers and the Urban Land Institute, Bangalore and Mumbai are short listed in the top five cities in Asia as strong development markets, whereas New Delhi has received strong buy signals from the survey respondents. Similar sentiments were reflected in an annual Investor Sentiment Survey carried out in 2005 by leading property consultants. According to the 2001 Census, 27.8% of India's population lived in cities. According to the Vision 2020² document released by India's planning commission, the country's urban population is expected to rise from 28% to 40% of the total population by 2020. Future growth is likely to be concentrated in and around

60 to 70 large cities with a population of one million or more.

Regulatory framework

Foreign Direct Investment (FDI) in India has seen positive growth over the past few years. Historically, the real estate sector in India was tightly regulated with FDI allowed in only four sectors: development of integrated townships, technology parks, industrial parks and special economic zones, with some of them carrying high threshold requirements. Nonresident Indians however had the advantage of enjoying liberalised investment norms. In March 2005, the Indian government announced liberalised guidelines³ allowing FDI up to 100% in townships, housing, built-up infrastructure and construction-development projects, including but not restricted to housing, commercial premises, hotels, resorts, hospitals, educational institutions, recreational facilities and city and regional level infrastructure. The policy permits FDI in construction-development projects without having to go in for a specific approval, subject to the following major conditions being met.

In March 2005, the Indian government announced liberalised guidelines allowing FDI up to 100% in townships, housing, built-up infrastructure and construction-development projects, including but not restricted to housing, commercial premises, hotels, resorts, hospitals, educational institutions, recreational facilities and city and regional level infrastructure.

The project should have a minimum area as follows:

- in case of development of serviced housing plots, 10 hectares (25 acres)
- in case of construction-development projects, built-up area of 50,000 sqm.
- in case of a combination project, any of the above two conditions

The project should have a minimum capitalisation of

- US\$ 10 million for wholly owned subsidiaries
- US\$ 5 million for JV with Indian partners, to be brought in within 6 months of commencement of business.

The original investment would be required to be locked in for a period of three years from completion of capitalisation. Earlier exits would require a prior approval from the Foreign Investment Promotion Board.

Others

- At least 50% of the project is to be developed within five years from the

date of obtaining all statutory clearances.

- The investor is not permitted to sell undeveloped plots, where roads, water supply, street lighting, drainage, sewerage and other conveniences are not available.

Foreign investors cannot directly acquire Indian real estate but are required to invest in an Indian entity which in turn makes the acquisition. Further, the investment is permitted only in construction-development projects. Accordingly, investment in fully developed existing properties under a pure rental model is not envisaged under the above relaxation. The authorities have subsequently clarified⁴ that the above conditions are not applicable in certain sectors such as construction of hotels, hospitals and Special Economic Zones ('SEZ'), investment in which is governed by different sectoral provisions of the FDI policy.

Exchange control regulations

There has been regular liberalisation in regard to exchange control regulations

Foreign investors cannot directly acquire Indian real estate but are required to invest in an Indian entity which in turn makes the acquisition. Further, the investment is permitted only in construction-development projects. Accordingly, investment in fully developed existing properties under a pure rental model is not envisaged under the above relaxation.

over the past few years and current account transactions (including profit and dividend repatriation) are generally covered under what is called the automatic route (i.e., not subject to any specific prior approvals). It is also normally possible for a transfer of shares between Indian residents and non-residents to be eligible under the automatic route subject to satisfaction of certain conditions including pricing norms.

However, another aspect of exchange control regulations which has relevance to this sector is the applicability of the External Commercial Borrowing (“ECB”) regulations⁵, which relate to commercial loans, availed of by Indian residents from non-residents. ECB regulations permit overseas debt to be raised by “eligible borrowers” from “recognised lenders” for specific end-uses, and establish various other conditions to be met including those around average maturity period and interest rate, which is linked to LIBOR. As per the present regulations, while ECB’s are permitted in certain areas like Industrial Parks, they are generally not permissible for a majority of other construction projects.

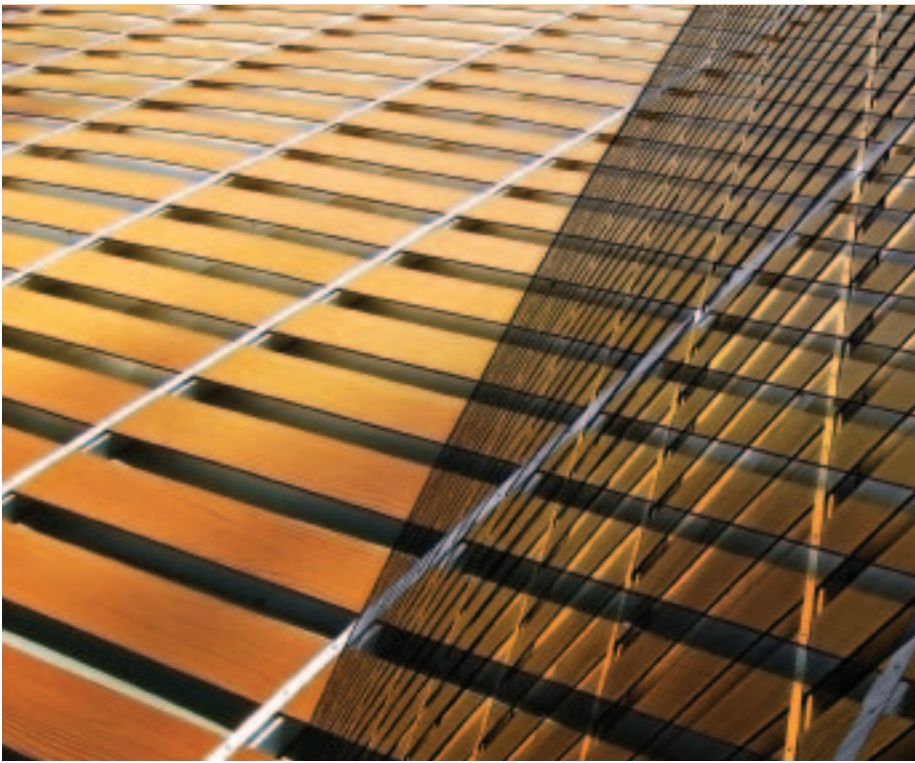
Other regulations

Urban land (Ceiling & Regulation) Act

This act basically imposes limits on the urban land which can be owned. The excess land is required to be handed over to the government or developed in a specified manner.

Rent Control Act

The prevailing tenancy laws in India have been in existence for a very long time. The Rent Control Act came into effect as a temporary measure to protect the exploitation of tenants by landlords after the Second World War. However these have continued to be in existence. The effect of rent control on the supply of new rental property is obvious and well documented. Considering that the provisions of the above legislations restrict development of the sector, these have been repealed in some states. However, this legislation still continues to apply in some other states.



Collective investment vehicles

India announces REITs

The Indian Mutual Fund Industry, first regulated in 1993 (the year which also saw the advent of private sector players) has experienced significant growth since that time.

The income of mutual funds registered with SEBI is exempt from income tax; however, certain mutual funds are subject to tax on the income distributed to unit holders. These distributions are then exempt in the hands of the unit holders. A report on the launching of real estate Investment schemes was submitted by the Association of Mutual Funds of India in 2002 to the Securities and Exchange Board of India ('the SEBI'), but pending the approval from the Regulator, this avenue was not available to retail investors. On the other hand, Offshore Real Estate Investment Trusts were permitted to invest in the Indian real estate market following the aforesaid regulatory relaxations announced in 2005. In June 2006⁶, SEBI informed that it had approved the

guidelines for REMFs, which included the following salient features:

- REMF scheme means a scheme of a mutual fund which has the investment objective to invest directly or indirectly in real estate property;
- REMFs will be governed by the provisions and guidelines of SEBI (mutual funds) Regulations;
- The structure of the REMFs initially shall be close ended;
- The units of REMFs shall be compulsorily listed on the stock exchanges and the net asset value of the scheme shall be declared daily;
- The REMFs would be required to appoint a custodian who would be granted a Certificate of Registration to carry on the business of custodian of securities by the SEBI. The custodian would safe keep the title of real estate properties held by the REMFs;
- The REMFs schemes can invest in real estate properties within India, mortgage (housing lease) backed securities, equity shares/ bonds/

debentures of listed/unlisted companies which deal in properties and also undertake property development, and in other securities.

The detailed policies and necessary amendments to the regulations are expected to be announced shortly.

Specific opportunities

Various real estate sectors including residential, commercial and retail are currently witnessing a huge growth in demand. New customer segments are emerging. Additionally, the average age for ownership of new homes is declining drastically. Younger customers and nuclear families are creating fundamentally different customer segments.

Similarly, in the retail segment, as the market grows exponentially, newer and larger formats along with the likely entry of global retail giants in the Indian market (subject to impending government policy revisions with respect to FDI in retailing) will necessitate greater variety and maturity in the retail real estate market. Mall developers are already adapting to local cultures and traditional preferences.

The recognised need for huge investments in the infrastructure space with a growing awareness for involving private participation itself creates a good opportunity for serious players in this field. The Investment Commission of India has estimated an investment requirement of around US\$100 billion in roads, airports and ports alone over the next five years.

The government of India has legislated the SEZ Act⁷ to provide a long term and stable policy framework with minimal regulation for development of these enclaves in India, wherein SEZs are specifically delineated, duty free enclaves, deemed to be outside the customs territory of India. Units operating in SEZs enjoy a corporate tax holiday on export earnings, indirect tax

exemptions and liberal exchange controls. The SEZ Act provides for substantive fiscal benefits to developers as well.

Additionally, the Industrial Park Scheme which was introduced in 2002⁸ with a view to enhance the development of infrastructure facilities for the purpose of industrial use, also enjoys tax incentives.

Challenges

Land ceiling and rent control legislations tend to deter fresh investments in the sector and curtail supply of properties, especially in cities, leading to an increase in property prices. Land is generally held by individual/families, at times with unclear land titles. This restricts organised dealing and hinders transfer of titles. Legal processes for property disputes are time consuming. Stamp duties continue to be high and in some states as much as 10-12%. The industry has repeatedly called for rationalisation and lowering of stamp duties to global levels of 2-3%. City urban planning projected smaller commercial plots and this, along with rigid building and zoning laws, makes it difficult to procure larger contiguous land areas (for example, for retail space). Land use conversion is both time consuming and complex. The advent of service tax on certain services connected with management of commercial real estate may marginally increase occupancy costs at retail outlets.

Conclusion

In India's fast-growing economy, real estate has emerged as one of the most appealing investment areas for domestic as well as foreign investors. Apart from the strong economic growth which is spurring growth in the real estate sector, the recognition of the need to invest heavily in infrastructure and of involving private participation therein, the recent legislation regarding creation of Special Economic Zones and the growth of

Various real estate sectors including residential, commercial and retail are currently witnessing a huge growth in demand. New customer segments are emerging. Additionally, the average age for ownership of new homes is declining drastically. Younger customers and nuclear families are creating fundamentally different customer segments.

second tier cities have, among other things, added to the growing demand for funds in this sector. The recent policy measures are aimed at attracting both institutional and retail investment into the Indian real estate sector and should help transform the sector into one that is more organized and robust, as well as improve this sector's potential both to contribute to and to partake in the present boom.

Gautam Mehra can be reached via email at: gautam.mehra@in.pwc.com

Radhakishan Rawal can be reached via email at: radhakishan.rawal@in.pwc.com

¹ International Banking Seminar on September 18, 2006 (www.rbi.org.in)
² Report of the Committee on India Vision 2020, December 2002 (www.planningcommission.nic.in)
³ Press note 2 (2005) dated March 3, 2005 (www.dipp.nic.in)
⁴ Press note no. 2 (2006) dated January 16, 2006 (www.dipp.nic.in)
⁵ External Commercial Borrowing Regulations-AP (Dir series) Circular No. 5 dated August 1, 2005 (www.rbi.org.in)
⁶ Press Release 166/2006 dated June 26, 2006 (www.sebi.com)
⁷ The Special Economic Zones (SEZ) Act, 2005 (www.sezindia.nic.in)
⁸ Industrial Park Scheme, 2002 (www.dipp.nic.in)

EYE ON AMERICAS

Colombia on the rebound: Favorable outlook for real estate investments

By Wilson Herrera Robles, Senior Associate Legal Services and Diego Vega Ramírez, Assistant Legal Services, PricewaterhouseCoopers Bogotá, and Martin van der Zwan, Senior Tax Manager, Real Estate, PricewaterhouseCoopers, Amsterdam



Historic perspective

For decades real estate endured as one of the strongest pillars of the Colombian economy. But during the past ten years or so, real estate property suffered a serious crisis due to the economic and political situation in the country.

As a consequence, the real estate property sector experienced a period of decline. However, over the last four years the economic and political climate – as well as the security situation – has improved. In its wake investment in real estate property has increased immensely. Today, people feel more confident investing their capital in the country, and real estate property again has become one of the most tempting sectors for investment.

Studies by the Colombian Federation of the Real Estate Property Market (hereinafter “Fedelonjas”) confirmed that 2006 was a very good year for the real estate property sector, with values of real estate property increasing significantly. Their outlook for 2007 is that values will continue to increase. As a result, Colombian real estate has become a highly attractive asset class to invest in for Colombians and foreign investors alike, especially for investors with medium term invest horizons.

According to the statistics issued by the Administrative Department of National Statistics (DANE), the construction sector in Colombia increased by 18.96% during the last quarter of 2006. This significant growth in the construction sector reflected a similarly noteworthy increase of 22.62% of the GDP for the building sector. Compared to the last quarter of 2005, construction licenses increased by 18.55% representing 15.2 million square meters available for construction.

According to a special survey carried out by the nonprofit policy research center “Fedesarrollo”, investors consider the economic, cultural and political conditions for investment in Colombia to be the best in 18 years. As a result, people feel confident and secure and as a result are investing in real estate property more and more every day.

This tendency of growth is reflected all over the major cities of the country, with Bogotá, the nation’s capital, being the



most attractive city for investors. During 2006, many foreign and national investors increased their investment in Colombian real estate property, mainly in high class areas. For one such high class area, the historical downtown of Bogotá, Fedelonjas already predicts increased interest. This area, named “La Candelaria”, is a typical Latin American colonial neighborhood that is attracting interest from investors and developers who are looking to remodel and reestablish this important area of the city. The idea of remodeling the historical downtown is in line with a global trend also visible in cities such as London and New York City. In Colombia, another clear example is Cartagena de Indias, a city that has been declared a historical heritage of humanity, which has one of the most beautiful downtowns in the world. The real estate property in the downtown of Cartagena de Indias is drawing heightened interest from investors all around the world.

Value drivers

To put the Colombian real estate market in perspective, one needs to consider the following indicative price levels

(converted to US\$). In Bogotá, the price per square meter in high class areas ranges from US\$1,000 to US\$2,000 depending on the specific location of the building, its neighborhood and year of construction. Middle class property has prices between US\$300 and US\$600 per square meter. Finally, low class property in Bogotá has prices which range from US\$100 to US\$300 per square meter.

One factor influencing Colombia’s real estate market is tourism. Cartagena is a city situated in the north of Colombia on the Caribbean Sea. The city welcomes millions of tourists every year and as a result many developers have increased their investment in the city. Domestic and foreign investors alike are increasing their investments in hotels, restaurants and other modern buildings that are rapidly turning the city into a modern paradise. High class neighborhoods have properties in which square meter prices currently range between US\$700 and US\$1,200, but are expected to increase further as the city continues to develop. These prices apply to new technological buildings situated in the main neighborhoods outside the

Domestic and foreign investors alike are increasing their investments in hotels, restaurants and other modern buildings that are rapidly turning the city into a modern paradise.

downtown such as “Bocagrande” or “Castillo Grande”. The downtown of Cartagena de Indias, as we explained before, is a historical heritage of humanity and its prices are higher than the rest of the city. These prices range between US\$1,000 and US\$3,000 depending on the location and conditions of these classic houses. In fact, the most luxurious hotels of Cartagena de Indias are situated in the downtown. Thus, compared to many other countries in the world, the Colombian real estate market still offers attractive prices.

Modernisation is another important issue to take into account. Beginning with 2000, multinational companies have entered the Colombian market in droves in order to invest in real estate property. Big global real estate property companies such as Century 21 and Global Brokers have raised the level of professionalism and have modernised the infrastructure and management of real estate property throughout the country.

Construction projects have increased as a result of the increased interest in real

estate property. Over the last decade, construction projects were typically completed with low budgets and minimal infrastructure. However, developers nowadays realise that they have to achieve higher goals and as a result they engage in bigger and more modernised projects. Developers have been locating important projects in the main cities such as Bogotá and Cartagena, with modern buildings that have adequate facilities and interesting landscaping which is very attractive for new investors.

Analysts have shared their views in local publications that the demand for Colombian real estate is matched by its current increase in new supply. Multinational companies are mostly considering opportunities in office and commercial real estate properties.

Colombian tax system relevant to real estate

Colombia offers a number of specific tax benefits if the acquired property is used as the main home of the buyer (living purposes). Consequently, if the property is purchased for investment purposes it

According to the Colombian tax legislation, individuals can contribute a portion of their taxable income either to a voluntary pension fund (managed by a private entity), or to a special savings account known as AFC. AFC (Ahorro para el Fomento de la Construcción) accounts were created by the government in 1998 in order to stimulate and support the development of the construction sector in Colombia.

will not receive the same benefits. These benefits include: qualification as non-taxable income, deduction of mortgage interests, special regime of leasing for living purposes and adjusted basis of presumptive income.

According to the Colombian tax legislation, individuals can contribute a portion of their taxable income either to a voluntary pension fund (managed by a private entity), or to a special savings account known as AFC. AFC (Ahorro para el Fomento de la Construcción) accounts were created by the government in 1998 in order to stimulate and support the development of the construction sector in Colombia. Voluntary contributions made by either the individual or the employers (in the case of a labor contract), to either a voluntary pension fund or to an AFC account, are not considered taxable income. The tax benefit is limited to 30% of the individual's total taxable income in the fiscal year.

The tax benefit is upheld as long as the contributions are kept in the mentioned accounts for at least five years unless they are used for the acquisition of a

real state property. The purchase can be made directly from the pension fund to the seller or through a financial entity using an AFC account.

On the other hand, any individual who acquires a real state property for personal use can reduce his/her income taxable base with the mortgage interest paid in Colombia, up to a maximum of US\$946.65 monthly (FY 2007).

Colombian law established another interesting regime which has notably increased the investment in real state property. The regime is called "real state leasing for living purposes", and entails a leasing agreement between a banking entity and the individual. The lease is qualified as an "operating lease", and consequently interest and financial costs paid during the year (limited to US \$946.65 monthly – FY 2007) are deductible from taxable income. At the end of the agreement, the individual has the option to buy the property. As a result, many citizens have entered into this kind of agreement, as they have favorable conditions and the facility to buy their own property for living purposes. In addition to the above,

during the agreement the value of the real state is not part of the individual's net equity to calculate either the presumptive income (alternative method to figure the income tax liability) or the equity tax.

Finally, as mentioned at the beginning, there is another income tax benefit regarding the presumptive income. The value of real state can be excluded from the basis to compute income tax under the presumptive income (limited to US\$116,931.32 FY 2006) and the net equity (US\$98,685.68).

Real estate tax is levied annually on the ownership of land or real estate located in urban, suburban or rural areas, with or without constructions therein. The taxable base is the appraisal of the real estate, in other words, the amount fixed by the Municipal Tax Authority where the relevant taxpayer has its real estate. It is important to note that in some municipalities (including Bogotá), the owner of the real estate can fix the real estate value ("auto-appraisal"). In these cases, the property tax is applied on the Municipal Tax Authority's appraisal or the auto-appraisal, whichever is higher. The rate applicable for this tax depends on the nature of the premises, i.e., on whether they are rural, urban or suburban. This is a municipal tax, so rates depend on the place where the real estate is located. As a general rule, in the case of Bogotá, it may range from 0.002% to 0.033%.

Finally, regarding VAT, it is important to remember that the rental of real estate for living and the rental of spaces to make exhibitions and handmade samples, including artistic and cultural events are exempted from this tax. The rental of real estate for purposes different than those mentioned above, are taxed at the rate of 10%.

Conclusion

Colombia's economic, political and security situation has steadily improved over the last years and in its wake investment in real estate property has increased significantly. People nowadays feel more confident investing their capital in the country, and real estate property has become one of the most tempting sectors for investment.

Compared internationally, Colombia's real estate prices are relatively low and the size of the real estate business has shown growth figures of approximately 20% over 2006. Investors have shown interest mainly in high class areas such as Bogotá and Cartagena de Indias. Developers have reacted to the increased demand by engaging in bigger and more modernised projects, with buildings that have adequate facilities and interesting landscaping attractive for new investors.

Colombia has introduced certain tax benefits that have resulted in increased home ownership which has further stimulated the construction business.

In conclusion, Colombia's real estate market offers quality objects and a favorable outlook.

Wilson Herrera Robles can be reached
via email at: wilson.herrera@co.pwc.com

Diego Vega Ramírez can be reached
via email at: diego.vega@co.pwc.com

Martin van der Zwan can be reached
via email at:
martin.van.der.zwan@nl.pwc.com

TECH CORNER

The technology controls that Sarbanes-Oxley doesn't care about

By Scott Metro, Partner, Real Estate Systems and Process Assurance, PricewaterhouseCoopers, Boston



The Sarbanes-Oxley Act of 2002, Section 404, requires publicly-registered United States companies and foreign private issuers in the US, and their auditors, to report on the effectiveness of these companies' internal controls over financial reporting.

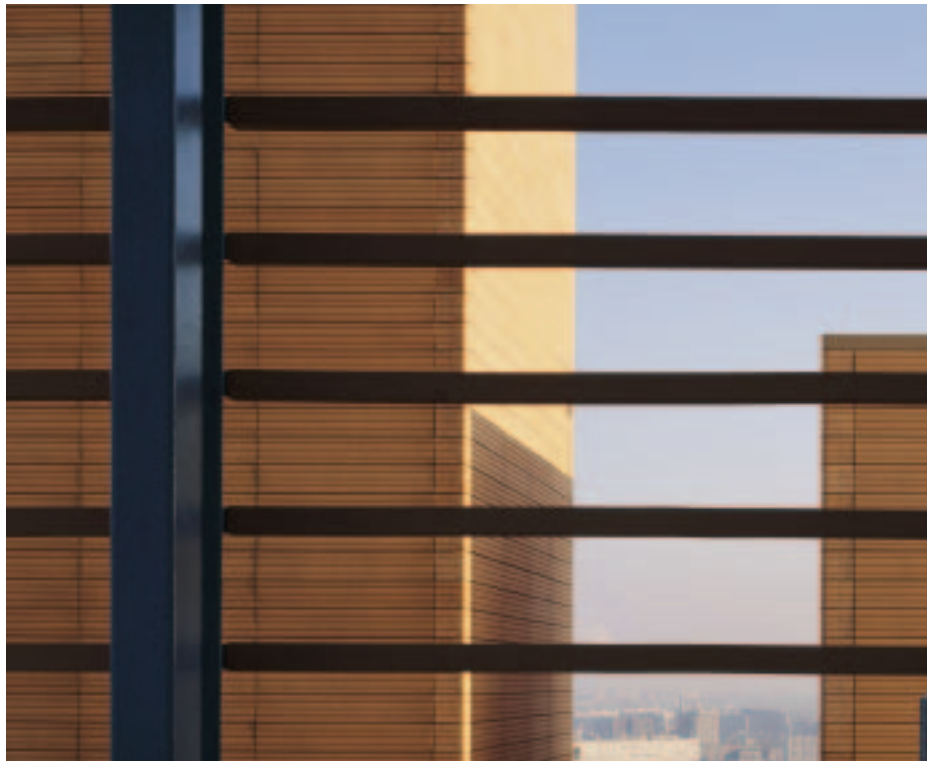
In order to comply with the requirements of this legislation, management is required to document and validate all of the controls that are material to its financial statements. External auditors are also required to review companies' controls and render an opinion on their effectiveness.

Most if not all companies covered under the Act employ information technology (IT) to some degree to process and prepare their financial statements. While in the commercial real estate industry this technology might be centred on industry "verticals" such as Yardi, MRI, CTI or Fraser-Williams, these systems may be as simple as an electronic spreadsheet. Regardless of the scale of systems used by companies, at a minimum they indirectly affect financial statements; in most cases, however, such systems have a direct impact on the data supporting a company's financial figures. It is for this reason that the Act requires companies to understand and validate

the controls that support those computer systems that directly or indirectly affect its financial statements.

By now, most real estate companies that have been required to comply with the Act since its effective date in 2004, have developed a mature process for documenting, monitoring and validating the design and effectiveness of their internal controls over financial reporting. Companies' controls over their IT systems are no exception. Real Estate IT departments have rapidly transformed themselves from organisations historically devoid of sound controls, to professional IT organisations with thorough and precise documentation addressing security, program changes and other controls necessary to ensure the integrity of its financial systems.

Unfortunately, for some companies' IT departments the Act has resulted in some unintended negative consequences. Specifically, since the Act only applies to processes and



systems that are relevant to the reliability of its financial statements, other important aspects of running a prudent information technology organisation have taken a “back seat” to the requirements of the Act. As a result, while some companies were busy plugging holes in its financial systems controls environment, they were, at the same time, neglecting areas that could cause vulnerabilities in other areas of IT.

Disaster recovery

Disaster recovery and contingency planning are among the initiatives that have suffered from lack of attention in light of Sarbanes-Oxley. While the inability to continue operations in the event of a calamity can certainly have an adverse affect on the timeliness of financial reporting, its forward-looking nature causes it to be outside the scope of Sarbanes-Oxley. As a result, since an opinion on the adequacy of a company’s disaster recovery procedures will not make it into its financial statements, resource allocations for creating and testing such procedures at many companies were deemed a lower priority. These companies are now at

risk of being unable to promptly resume business operations in the event of a disaster affecting its operations.

To be more specific, many companies, as a result of the new Act, put in place more stringent controls to ensure that their critical financial information is backed up and stored offsite on a nightly basis. So in the event of a corruption of data, or even the destruction of the hardware that houses such data, companies should be able to quickly resume processing its financial records in the event of most calamities. However, having tapes of financial data stored in a secure vault in another geographic territory requires that hardware – servers, workstations and printers – and workspaces be available to process the data. A thorough disaster recovery and contingency plan takes the data backup controls required by Sarbanes-Oxley to a higher-level, ensuring not only that data is safeguarded, but that it can be used in the event that a company’s primary premises are severely damaged or destroyed.

In the context of the Sarbanes-Oxley Act, maintaining the privacy of personal information does not help to prevent the corporate abuses that resulted in the enactment of the legislation in the first place.

Information privacy

The privacy of information maintained by publicly-traded real estate companies is also not encompassed by the tenets of Sarbanes-Oxley. Yet, some real estate companies, most notably investors in multifamily real estate, have a significant amount of private, tenant information stored on its systems. Specifically, since credit checks are often performed to assess an apartment tenant's ability to pay rent, that tenant's social security number is collected and, often, if even for a short period of time, stored on a system used by the real estate company.

In the context of the Sarbanes-Oxley Act, maintaining the privacy of personal information does not help to prevent the corporate abuses that resulted in the enactment of the legislation in the first place. Similar to disaster recovery, therefore, creating and testing controls over the privacy of information simply were not on the radar of some real estate companies during their creation of controls to comply with the Act. Nevertheless, the embarrassment that could be sustained due to the leak of

personally identifiable information – and even a single case of identity theft of a tenant – not to mention the potential violation of privacy laws enacted by individual states in the US, could create significant indirect monetary losses by companies.

To combat such embarrassment and loss, smart companies assess the risks over all of their data, and implement controls appropriate to the risk.

For data that is not relevant to financial statements but, nevertheless, is private or personally identifiable, there are several controls that can be implemented to reduce the risk.

First, limit the number of people who can collect and access such information. In the case of tenant data, at a minimum, information should be maintained in locked, immovable cabinets. If information is collected and subsequently input into computer systems, the data should be at least partially masked when displayed, and encrypted in the underlying database. The original source of the private data should be shredded if it is not required to be maintained for legal purposes. Further, if the data is not needed beyond

As with personally identifiable information, controls to protect proprietary data are also not directly required by the Sarbanes-Oxley legislation. Yet the release of data such as that existing for potential property purchases, mergers and acquisitions, financial performance data and intellectual capital, can cause irreparable harm to companies.

a specific date or purpose, it should be purged from the system to prevent future misuse.

Proprietary information

As with personally identifiable information, controls to protect proprietary data are also not directly required by the Sarbanes-Oxley legislation. Yet the release of data such as that existing for potential property purchases, mergers and acquisitions, financial performance data and intellectual capital, can cause irreparable harm to companies. Unlike the previous examples, where the lack of a key operational control was due to the resources being allocated to design of financial controls, the advancement of technology, in this case, is more to blame.

In fact, the ease-of-use in exchanging data through email has caused some companies to violate their longstanding policies on the protection of proprietary data; ironically, these policies were established when data was found only on printed pages. As an example, real estate companies often exchange legal

documents with their attorneys through email. For many of these companies, there appears to be a false level of comfort that information sent via email to its business partners is only viewable by the sender and its recipients. Unfortunately, this is untrue. Most email is sent in plain text across the internet, viewable through easily downloadable "sniffing" tools that can trace and view email traffic. Attachments in email, if unencrypted, are no exception. The bits and bytes that make up an email attachment can be caught by unauthorised recipients and reassembled into their original form.

Tools to safeguard information sent across the internet are readily available. Compression software, such as WinZip, includes features to encrypt and password protect any document. Sensitive documents attached in email should, at a minimum, use this type of protection to reduce the risk that they can be read by unintended parties. More sophisticated solutions, such as digital certificates, are also available, although they are more difficult to implement between multiple, disparate counterparties.



Succession planning and cross-training

One final area, which is in itself a sensitive subject, is also often overlooked as a prudent company-level control. Yet, many real estate companies, with complex systems and small IT departments, could be affected by the proverbial bus hitting one of its key resources. In reality, such an event is more likely (and humanely) the result of a competitive job market, where IT directors, managers and staff are actively hired away by other companies. Either way, the loss of a key IT resource can be more disabling than the loss of a key piece of computer hardware.

To mitigate this type of loss, small IT departments with minimal or no redundancy in job positions, should be cross-trained, able to fill in for one another when necessary. In particular, companies should have cross-trained staff – either permanent or on an on-call basis – when their IT department is comprised of a sole employee who has all the significant knowledge of a company's property management, accounting and reporting systems.

Both types of IT controls are important

The Sarbanes-Oxley Act has provided a significant amount of transparency into companies' financial controls, and continuing to have a focus on ensuring the integrity of financial information is of paramount importance to the financial markets. But financial controls should not be the exclusive focus of public companies and their IT departments. Prudent operational IT controls, which in some cases have lost their lustre in favour of those that are required by regulation, are extremely important to a company's health. They may not be subject to an external audit opinion, and they may not even have a direct effect on financial statements; yet they are like insurance policies in that they provide protection to companies when they need it most.

Scott Metro can be reached via email at:
scott.metro@us.pwc.com

Real Estate

Insights, observations and research from PricewaterhouseCoopers international real estate accounting, tax and business advisory services professionals and clients.*

PricewaterhouseCoopers real estate network comprises highly skilled, experienced professionals including accountants, surveyors, lawyers, analysts, consultants, tax and corporate finance specialists as well as senior executives with hands-on experience at the very top of the industry. We offer in-depth experience in a broad range of financial accounting, auditing and reporting issues, tax advice for transactions, investment fund and carried interest structuring, securitisations, asset due diligence, transaction support, valuation management, corporate finance, M&A and finance-raising.

PricewaterhouseCoopers regularly produces surveys, newsletters and brochures on real estate industry issues as well as hosting a variety of client-focused events.

- Global Real Estate Now, published two times per year (March and November).
- Global Real Estate CD Rom containing material on tax and legal implications of investing in real estate around the global, published annually in March.
- European Investment Management/Real Estate Newsletter, published quarterly.
- Asia Pacific Investment Management/Real Estate Newsletter, published twice per year.
- Brochure on PricewaterhouseCoopers' Real Estate Calculation Models service, published June 2005.
- European Real Estate Products and Solutions information folder, published January 2006.
- Emerging Trends in Real Estate® Asia Pacific, published yearly in conjunction with the Urban Land Institute.
- Emerging Trends in Real Estate® (US), published yearly in conjunction with the Urban Land Institute.
- Emerging Trends in Real Estate® Europe, published yearly in conjunction with the Urban Land Institute.
- Korpacz Real Estate Investor Survey®, published quarterly.
- PricewaterhouseCoopers Real Estate Insights (US), published quarterly in .pdf format.
- PricewaterhouseCoopers Real Estate Insights Newsletter (UK), published three times per year.
- European Real Estate Client Conference, to be held in Vienna, Austria in November 2007.
- Asia Pacific Real Estate Client Conference, to be held in December 2007. Venue to be confirmed.

If you would like to view or download one of our publications please log onto our website www.pwc.com/realestate

Disclaimer:

PricewaterhouseCoopers has exercised professional care and diligence in the collection and processing of the information in this report. However, the data used in the preparation of this report (and on which the report is based) were provided by third-party sources and PricewaterhouseCoopers has not independently verified, validated or audited such data. This report is intended to be of general interest only, and does not constitute professional advice. PricewaterhouseCoopers makes no representations or warranties with respect to the accuracy of this report. PricewaterhouseCoopers shall not be liable to any user of this report or to any other person or entity for any accuracy of information contained in this report or for any errors or omissions in its content, regardless of the cause of such inaccuracy, error or omission. Furthermore, to the extent permitted by law, PricewaterhouseCoopers, its members, employees and agents accept no liability and disclaim all responsibility for the consequences of you or anyone else acting, or refraining to act, in reliance on the information contained in this report or for any decision based on it, or for any consequential, special, incidental or punitive damages to any person or entity for any matter relating to this report even if advised of the possibility of such damages.

If you would like further information regarding our Real Estate services, please contact one of our PricewaterhouseCoopers representatives below, or your usual local PricewaterhouseCoopers contact.

Global Real Estate Leaders

Marc Saluzzi

Global Investment Management
& Real Estate Group Leader
Luxembourg
Tel: [352] 49 48 48 2009
Email: marc.saluzzi@lu.pwc.com

Uwe Stoschek

Global Real Estate Tax Leader
Berlin, Germany
Tel: [49] (30) 2636 5286
Email: uwe.stoschek@de.pwc.com

William E. Croteau

Global Real Estate Assurance Leader
San Francisco, United States of America
Tel: [1] (415) 498 7405
Email: william.croteau@us.pwc.com

Patrick Leardo

Global Real Estate Advisory Leader
New York, United States of America
Tel: [1] (646) 471 8877 or
[1] (646) 471 2666
Email: patrick.r.leardo@us.pwc.com

Asia Pacific Real Estate Leaders

Robert Grome

Asia Pacific Investment Management
& Real Estate Leader
Hong Kong
Tel: [852] 2289 1133
Email: robert.grome@hk.pwc.com

James Dunning

Asia Pacific Real Estate Assurance Leader
Sydney, Australia
Tel: [61] (2) 8266 2933
Email: james.dunning@au.pwc.com

Kwok Kay So

Asia Pacific Real Estate Tax Leader
Hong Kong
Tel: [852] 2289 3789
Email: kk.so@hk.pwc.com

European Real Estate Leaders

Henrik Steinbrecher

European Real Estate Leader
Stockholm, Sweden
Tel: [46] (8) 555 330 97
Email: henrik.steinbrecher@se.pwc.com

Uwe Stoschek

European Real Estate Tax Leader
Berlin, Germany
Tel: [49] (30) 2636 5286
Email: uwe.stoschek@de.pwc.com

Kees Hage

European Real Estate Assurance Leader
Rotterdam, The Netherlands
Tel: [31] (10) 407 6414
Email: kees.hage@nl.pwc.com

Jochen Brücken

European Real Estate Advisory Leader
Berlin, Germany
Tel: [49] (30) 26 36 1149
Email: jochen.bruecken@de.pwc.com

Glen Lonie

Real Estate Leader – Central & Eastern
Europe and CIS
Prague, Czech Republic
Tel: [420] 251 152 619
Email: glen.lonie@cz.pwc.com

United Kingdom Real Estate Leaders

John Forbes

UK Real Estate and Real Estate Tax Leader
London, United Kingdom
Tel: [44] (0) 20 7804 3161
Email: john.forbes@uk.pwc.com

Angela Crawford-Ingle

UK Real Estate Assurance Leader
London, United Kingdom
Tel: [44] (0) 20 7212 5225
Email: angela.crawford-ingle@uk.pwc.com

United States Real Estate Leaders

William E. Croteau

US Real Estate Practice Leader
US Real Estate Assurance Leader
San Francisco, United States of America
Tel: [1] (415) 498 7405
Email: william.croteau@us.pwc.com

Gary Cutson

US Real Estate Tax Leader
New York, United States of America
Tel: [1] (646) 471 8805
Email: gary.cutson@us.pwc.com

Patrick Leardo

US Real Estate Advisory Leader
New York, United States of America
Tel: [1] (646) 471 8877 or
[1] (646) 471 2666
Email: patrick.r.leardo@us.pwc.com

Middle East Real Estate Leaders

Ashruff Jamall

Middle East Real Estate Assurance Leader
Dubai, United Arab Emirates
Tel: [971] (4) 3043105
Email: ashruff.jamall@ae.pwc.com

Howard Kingsbury

Middle East Real Estate Advisory Leader
Dubai, United Arab Emirates
Tel: [971] (4) 3043 112
Email: howard.kingsbury@ae.pwc.com

Dean Rolfe

Middle East Real Estate Tax Leader
Dubai, United Arab Emirates
Tel: [971] (4) 3043351
Email: dean.rolfe@ae.pwc.com

Latin America Real Estate Tax Leader

Alvaro Taiar

Latin America Real Estate Tax Leader
Tel: [55] (11) 3674 3833
Email: alvaro.taiar@br.pwc.com

Marketing and Editorial Contacts

Merryn Stewart

Global Head of Real Estate Marketing
London, United Kingdom
Tel: [44] (0) 20 7804 3844
Email: merryn.stewart@uk.pwc.com

Thomas Derr

Editor of Global Real Estate Now
New York, United States of America
Tel: [1] (646) 471 8268
Email: thomas.derr@us.pwc.com

PricewaterhouseCoopers (www.pwc.com) provides industry-focused assurance, tax and advisory services to build public trust and enhance value for its clients and their stakeholders. More than 130,000 people in 148 countries work collaboratively using connected thinking to develop fresh perspectives and practice advice.

© 2007 PricewaterhouseCoopers. All rights reserved. PricewaterhouseCoopers refers to the network of member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity. *connectedthinking is a trademark of PricewaterhouseCoopers LLP. Designed by Court Three (03/07).

www.pwc.com