



cutting through complexity

REAL ESTATE

**2015, YEAR ZERO
FOR THE REAL ESTATE
SECTOR RECOVERY
IN SPAIN**

kpmg.es

Contents

Introduction by John M. Scott, Chairman of KPMG in Spain	3
About this report	4
Key factors for the Spanish real estate sector in 2015 (info)	6
Generating value. The aim of the real estate sector in 2015. By Javier López Torres, Partner in charge of Real Estate at KPMG in Spain	8
1/ Resurgence among some real estate companies and transformation of certain banks. New sector reality post re-financing	14
2/ Refinancing vs. Insolvency proceedings. Which has retained value?	18
3/ The return of banks and the arrival of direct lending. Towards a more diversified financing model	22
4/ Added-value, opportunistic and conservative investors. The new transactions market mix	26
5/ The golden age of SOCIMIs (Spanish REITs). Towards an indirect investment model	30
6/ Auditor rotation and changes to revenue recognition. New issues affecting the sector	34
7/ Beyond the rates. Major changes to the industry as a result of the tax reform	38
8/ Challenges facing the public sector. Flexibility and empathy to successfully manage its assets	42
9/ Rent and reforms. Public authorities' solutions to ensure access to housing	46
Survey	54
Contact	54

Introduction



It is my pleasure to present this report, "2015: year zero for the real estate sector recovery in Spain", which takes stock of a market that is being redefined, and projects its future. In this report, the team of real estate experts at KPMG in Spain analyses the challenges faced by the sector, using their in-depth multidisciplinary knowledge of the economic, regulatory and financial context that is the backdrop to its crucial recovery.

Real estate's contribution to the Spanish economy plummeted during the crisis, but recovery could be on the cards for 2015, bolstered by the general improvement in macroeconomic conditions and growing confidence among foreign investors. However, this does not mean going back to square one. Markets are changing rapidly, and in recent years the real estate sector has shifted to a very different model, with new players, a greater variety of products and new approaches to management and financing.

I hope this report will provide you with the keys to the future of the sector, and that our experts will add value to your decision-making process.

John M. Scott, *Chairman of KPMG in Spain*



About this report

This report was made possible by the contributions of more than 100 real estate experts from various areas of KPMG, who have analysed the factors they expect will determine the future of real estate in Spain.

To produce the report we surveyed more than 150 real estate experts from the six major segments in the industry: real estate companies, non-real estate companies with some involvement in the sector, investors, financial institutions, Sareb and the public sector.

The full report can be downloaded from kpmg.com/es/RealEstate

Ten workshops have been held to optimise the conclusions drawn from the survey and discuss the sector's present and future. At each event, coordinated by a KPMG partner with expertise in the subject matter, the key factors described in this report were discussed in detail. More than 50 members of senior management of some of the most important companies and entities from various real estate groups participated in the workshops, along with specialists from KPMG in Spain and sector experts.

This report covers the key points of the in-depth analysis. //

// ACKNOWLEDGEMENT



The Real Estate team at KPMG in Spain would like to thank the more than 200 executives from major public and

private companies and entities linked to the real estate industry, who shared their knowledge and vision of the present

and future of the sector at this key time, without whose contributions this report would not have been possible. //

Pedro Montoya Gómez-Comino, Director, Deal Advisory, Real Estate.
Report coordinator.



Keys to the real estate sector in Spain in 2015

// SCENARIO

01. Transformation of the business model

Towards a model based on generating value and on real demand, aligning capital + financing + management and establishing synergies between them, preventing them from working separately, to guarantee sustainable development in the coming years

02. Professionalization

A higher level of professionalization of the sector, through specialisation by type of product and location

03. New key players with diverse strategies and perspectives

Relationships that allow investments to match economic conditions and real demand should be encouraged

04. An attractive real estate market

Offering advantageous investment opportunities in comparison to other countries, in terms of capital values and country and timing variables

05. Value-added investors

Value-added investors are taking centre stage

06. Towards an indirect investment model

The real estate market will shift from a direct investment model to one of indirect investment

07. A moderate recovery in financing

Focused on bank lending, maintaining exhaustive controls of risks and processes and looking for new alternatives to diversify sources of financing

08. Direct lending

Financing that does not originate from banks will become a key alternative alongside bank financing, which will remain fundamental

09. SOCIMIs (Spanish REITs)

Will be an interesting vehicle for investment in stock exchanges by retail investors. They are in the process of specialising

10. Changes to tax and insolvency legislation

Changes are being made which should boost interest from international investors, with a positive impact on refinancing (making it easier to reach agreements), restructuring and insolvency proceedings (bolstering companies' feasibility)

11. Lack of prime assets

A lack of high quality assets means that transaction values start to exceed expectations and investor returns decline

12. Urban redevelopment

Greater positive impact on the quality of peoples' lives and the cost of maintaining housing

// KEY PLAYERS IN THE SECTOR

// Most companies with real estate businesses have completed their refinancing processes. The number and size of these companies have decreased.

// Non-real estate companies have segregated their real estate businesses, focusing on their core activity.

// A change of trend in measures adopted in response to feasibility problems: early solutions and restructuring (increase in agreements and bolstering of settlements) vs. insolvency.

// Opening up to alternative financing.

// Financial institutions will possibly choose one of two options for real estate assets:

- Financial operations (short-term)
- Real estate strategies (long-term)

Real estate companies

RC

Non-real estate companies

NR

Financial institutions

FI

IN

Investors

// Investors will remain prudent in their management of an economy that has yet to warm up and where there is still much pressure to invest capital.

// New key players who are prepared to invest, increasing competition and prices.

SA

SAREB

// Sareb will continue to play a key role due to the volume of assets to be divested over the next 13 years.

PS

Public sector

// The public sector is taking steps to put an end to complex legislation, which will facilitate private investment.

// To favour access for investors, especially foreign investors, the public sector's divestment of its real estate assets requires changes to increase flexibility and fluidity in practical terms.

// There is room for improvement in the use of publicly-owned real estate assets, moving towards a mixed rental and sale model.

GENERATING VALUE

THE AIM OF THE REAL ESTATE SECTOR IN 2015

// BY JAVIER LÓPEZ TORRES,
PARTNER, DEAL ADVISORY IN
CHARGE OF REAL ESTATE AT
KPMG IN SPAIN



The figures suggest that 2015 will be year zero for recovery in the real estate sector in Spain, which is now ready to be redefined following its collapse brought on by almost eight years of economic and financial crisis, to which this sector in particular succumbed.

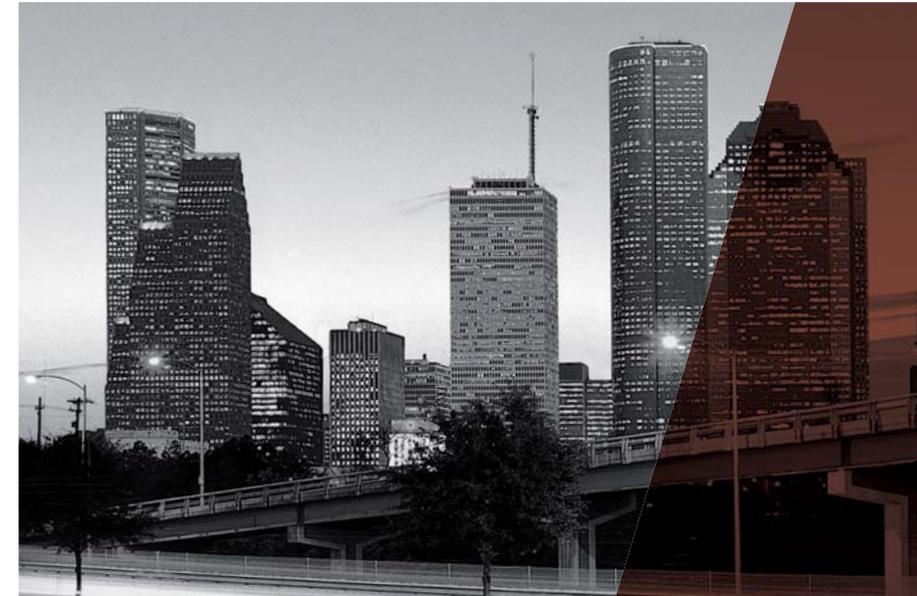
At the start of 2015 the economic situation is on the up. GDP grew in the last quarter of 2014 by 2% year-on-year, fuelled by a 2% rise in domestic demand in the closing months and a foreign sector that continued to hold its own after driving the economy for the duration of the crisis. The number of unemployed fell by 253,627 in 2014, the largest drop since 1998, while the consumer confidence index portrayed growing optimism. Figures for the real estate sector also reflect this trend: according to Ministry of Development

90%

In the eyes of almost 90% of respondents, the current real estate business model needs to change.

data, 253,000 real estate transactions involving residential properties were conducted in the first three quarters of 2014, which is 22% more than in the same period of 2013. Moreover, housing prices stabilised after a cumulative decline of 32% from the highs posted in 2007, according to the Spanish Association of Registrars.

The figures are promising, but forecasts are cautious. The construction and real estate sector's contribution to the Spanish economy will continue to grow, but will not return to the highs seen in the boom years. Four out of five people surveyed for this report predict that the sector will recover within two years, and although they foresee an increase in the construction sector's contribution to GDP over the next five years, they do not expect the figures recorded in 2007 to be revisited.



Recovery – in the form of a “return to normal” – will come, but at different speeds depending on the focal point. While the people surveyed expected a recovery in demand and a normalisation of lending in 12 to 24 months, they did not anticipate supply being absorbed in the short term. Nonetheless, the diversity of the real estate assets on the market makes it difficult to produce an overall forecast.

REAL ESTATE ASSETS

To analyse the situation in the real estate sector, the diverse products available must be considered as much more than a mass of finished real estate units, above all taking into account that one of the keys to the upturn is to enhance the level of professionalization through specialisation by product type and location, thereby generating added value for assets by meeting actual demand.

Dividing assets into broad segments, value generation is very limited for finished residential property, as ab-

sorption of this type of stock is entirely dependent on price, location and demand. New property developments should be based on conservative business plans with tight margins and, where applicable, financing conditions that are suited to prospective buyers' actual capacity to borrow and willingness to do so. The commercial property segment, where high-value stock varies greatly in terms of business types, has attracted the greatest investor appetite to date, for certain products and locations in particular. This segment has the scope to generate added value by adapting properties, changing their use and improving their profitability by reducing costs and increasing occupancy.

The land segment is potentially the real estate sector's main problem. There is much work to be done, a greater level of professionalization is required, and investor appetite remains limited. While there are opportunities on the market in specific locations with tight prices, there is also land, highly leveraged in

2015 BRINGS THE OPPORTUNITY TO LAY A SOLID FOUNDATION FOR A SUSTAINABLE MODEL, WHERE THE RELATIONSHIP BETWEEN CAPITAL, FINANCING AND PROFESSIONALISED MANAGEMENT CONTRIBUTES TO ECONOMIC AND SOCIAL DEVELOPMENT, THROUGH VALUE GENERATION.

many cases, which will not ultimately be developed for the purpose for which planning permission was requested, as the use was based on expected demand at that time. Therefore, applying selective criteria, creativity and imagination must be brought into play to adapt the land to future conditions so as to generate value, supported by the pertinent authorities, and create an end product that meets actual demand.

THE KEY PLAYERS

The economic recession also redefined the players involved in real estate market transactions in Spain. The two traditional key players in the Spanish market – real estate companies and non-real estate companies operating in the sector – have given way to a plethora of players that have entered the industry seemingly haphazardly for a variety of reasons; major refinancing and insolvency processes, high leverage, financial sector restructuring, a need to increase government revenues, or falling real estate prices.

As a result, the following key players have taken up their position in the real estate sector: on the one hand, financial institutions, Sareb, real estate companies, non-real estate companies and the public sector, each with their own characteristics, strategies and vision; and on the other hand, an array of investors ranging from end investors to opportunists and those seeking added value.

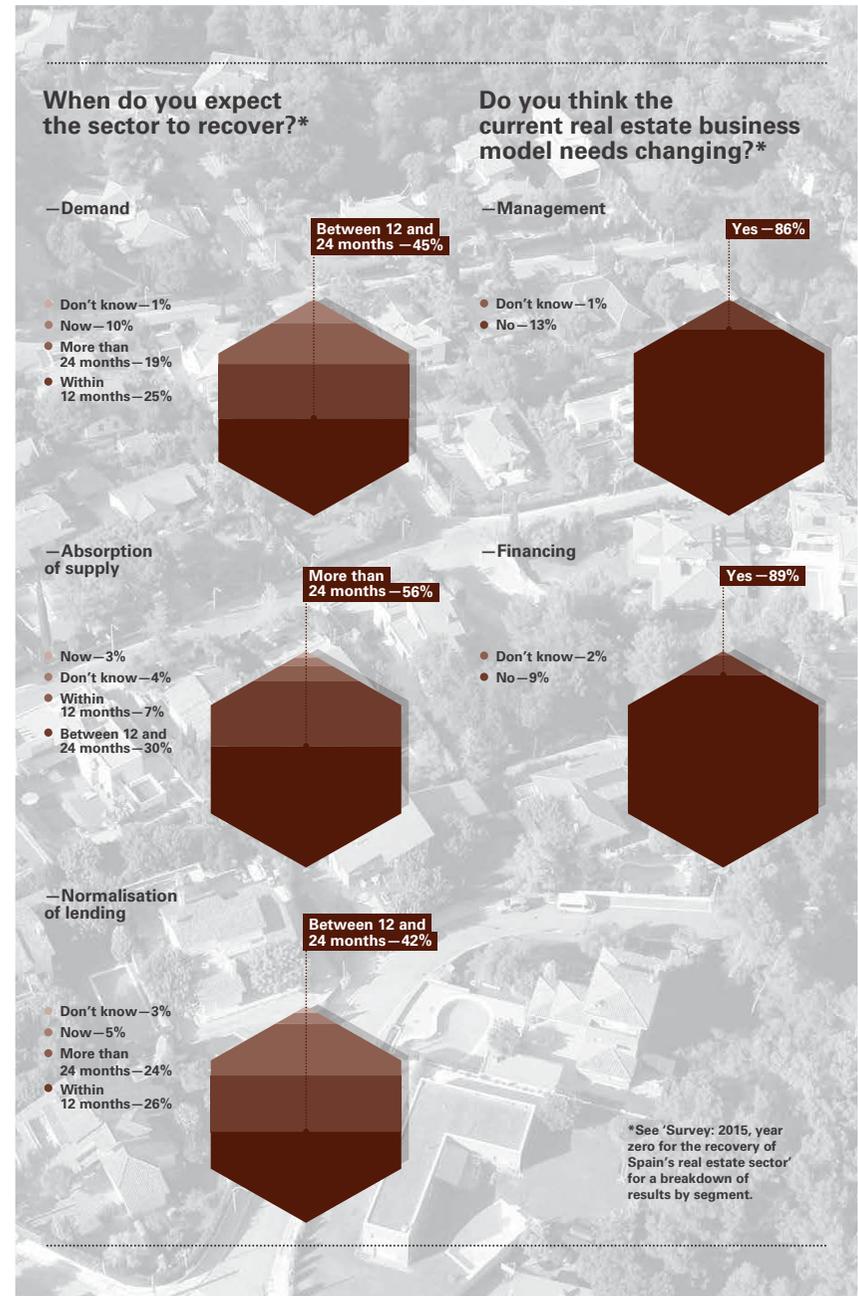
Even now, financial institutions are accumulating a considerable volume of

real estate assets on their balance sheets as a result of the high leverage that took hold of the construction and real estate sectors when the bubble burst. A number of different strategies are being employed to transfer these assets to the market, but to date they have focused on the short to medium term. As a result of banks' need to dispose of the worst quality real estate assets, in December 2012 the Management Company for Assets Arising from the Banking Sector Reorganisation (Sareb) was created.

At the same time, both foreign and domestic investors have turned their attention to Spain, and their activity levels are expected to be maintained. In view of this assortment of assets, investors now include opportunists, who were the first to arrive during the crisis; those seeking added value, who are expected to boost the recovery in the sector in the coming years; and in some cases more conservative long-term investors. The public sector has also joined the fray, to address its growing need for revenues. In recent months, moves have therefore been made to boost real estate divestment and resume the transactions that were put on hold by the crisis, with diverse criteria applied.

Traditional sector players have opted for a variety of strategies to sustain their businesses in response to the current complex outlook. Non-real estate companies have preferred to sell off their real estate divisions to focus on their core business. Meanwhile, real estate companies, most of which now have sustainable levels of debt on their balance sheets but limited liquidity, based on commercial property rentals, are resuming activity and even embarking on new developments from scratch in certain locations. Turnaround processes should and must be implemented in these major player segments – as is the case in nearby countries – to improve the profits of ongoing businesses. Of the people surveyed, 58% stated that they were aware of such turnaround processes and almost the same proportion considered such processes expedient and/or necessary.

In short, the relationship between these key players and investors is set to be



pivotal in the reactivation of the sector. Together with specialised management and a greater level of professionalization, the effects should flow through to the real economy, enabling work on core factors such as generation of value and bolstering actual demand, both of which are currently uncertain for some products and locations.

54%

Of respondents consider the level of professionalization in the Spanish real estate sector to be low.

/ THE NEED FOR A SUSTAINABLE BUSINESS MODEL

The arrival of year zero for the recovery in Spain's real estate sector should be seen as an opportunity for reflection, insofar as 90% of those surveyed considered that the business model, which is now being reinvented, needs to change. Three elements should be combined to establish a sustainable model based on value generation: capital + financing + management. This combination should be aligned, creating synergies between the elements and preventing them from acting independently.

Capital comprises new investments entering the Spanish market. The challenge now is to retain the type of capital that offers greater added value, bolstering the recovery in the sector. Financing, mainly bank lending, is already picking up. The next goal is to operate ongoing exhaustive control of risks and processes and to seek new alternatives to diversify sources of financing. Management should complete the equation, helping to proactively generate value from assets, with the aim of achieving a high degree of professionalization – an area that requires improvement in the eyes of more than 50% of those surveyed.

Although some key players already have the strength and capacity required to drive a recovery in the real estate sector, only a mix comprising investors who favour added value, professionalised management teams and renewed support from financial institutions offering conservative financing will help the real estate sector back onto the path of sustainability enabling it to resume its contribution to economic and social development. All of these elements should be combined in the quest for a reliable perspective on actual current and future demand for each type of property, so as to develop new projects or to bolster projects that are less likely to be absorbed by the market through value generation. This year, 2015, is therefore an opportunity to lay a solid foundation for a new real estate model that guarantees gradual development over the coming years. //

/ KEYS TO THE REAL ESTATE SECTOR

The Real Estate team at KPMG in Spain has analysed conditions in the real estate market, leveraging our knowledge and experience with a view to sharing the keys to the emergence of sector recovery. The following nine chapters describe and examine each of these key factors, referring to the survey and subsequent discussions at ten workshops with some senior managers from some of the most important companies and entities linked to the sector. //

// HIGHLIGHTS

REAL ESTATE TRANSACTIONS

MORTGAGES LOANS

PRICES OF LOCALISED RESIDENTIAL PROPERTIES

PRICES OF OTHER LOCALISED ASSETS

SECTOR CONTRIBUTION TO GDP

THIS POINT IN TIME OFFERS US AN OPPORTUNITY FOR REFLECTION, TO TRANSFORM THE BUSINESS MODEL INTO ONE BASED ON GENERATING VALUE AND ON REAL DEMAND, ALIGNING CAPITAL + FINANCING + MANAGEMENT AND ESTABLISHING SYNERGIES BETWEEN THEM, PREVENTING THEM FROM WORKING SEPARATELY, TO GUARANTEE SUSTAINABLE DEVELOPMENT IN THE COMING YEARS.

THE TWO TRADITIONAL KEY PLAYERS ON THE SPANISH MARKET – REAL ESTATE COMPANIES AND NON-REAL ESTATE COMPANIES OPERATING IN THE SECTOR – HAVE GIVEN WAY TO A PLETHORA OF PLAYERS THAT HAVE ENTERED THE INDUSTRY SEEMINGLY HAPHAZARDLY FOR A VARIETY OF REASONS.

A GREATER LEVEL OF PROFESSIONALIZATION OF THE SECTOR IS NEEDED, THROUGH SPECIALISATION BY PRODUCT TYPE AND LOCATION, ADDING VALUE TO ASSETS BY MEETING ACTUAL DEMAND.

ALTHOUGH SOME KEY PLAYERS ALREADY HAVE THE STRENGTH AND CAPACITY REQUIRED TO DRIVE A RECOVERY IN THE REAL ESTATE SECTOR, ONLY A MIX COMPRISING INVESTORS WHO FAVOUR ADDED VALUE, PROFESSIONALISED MANAGEMENT TEAMS AND FINANCIAL INSTITUTIONS OFFERING CONSERVATIVE FINANCING WILL HELP THE REAL ESTATE SECTOR BACK ONTO THE PATH OF SUSTAINABILITY, ENABLING IT TO RESUME ITS CONTRIBUTION TO ECONOMIC AND SOCIAL DEVELOPMENT.

1/ RESURGENCE AMONG SOME REAL ESTATE COMPANIES AND TRANSFORMATION OF CERTAIN BANKS

NEW SECTOR REALITY POST-REFINANCING POST-REFINANCING

57%

of financial sector players taking part in the survey believe that the sector restructuring initiatives have largely drawn to a close.

In 2007 the real estate sector in Spain finally peaked after a climb of approximately ten years. There, however, began a decline that dragged a great deal of the country's growth and employment down with it.

The number of companies engaged in the development, sale and purchase, rental or administration of properties had been on the rise since 1997, fuelled by Spain's favourable performance on the macroeconomic front, demographic growth and the availability of liquid funds and credit at low interest rates. According to the Banco de España, housing prices increased by around 150% up to 2007 in terms of nominal value. Sector firms posted turnover in excess of Euros 105,000 million that year.

A present-day cross section of the sector is quite different. Traditional real estate companies have seen their turnover almost halved, while banks are now key market players, carrying large stocks of assets on their balance sheets from companies struggling to repay their debts.

Over these last seven years, not only has the real estate sector borne the brunt of the financial crisis and felt the bubble burst. It has also been immersed in a complicated refinancing process that has completely reshaped the starting point. This complex sector restructuring could be summed up in three stages, starting

with the confident outlook that reigned at the outset of the crisis, and culminating in the adoption of an irrefutable reality (Fig. 1).

STRATEGY FOR THE FUTURE

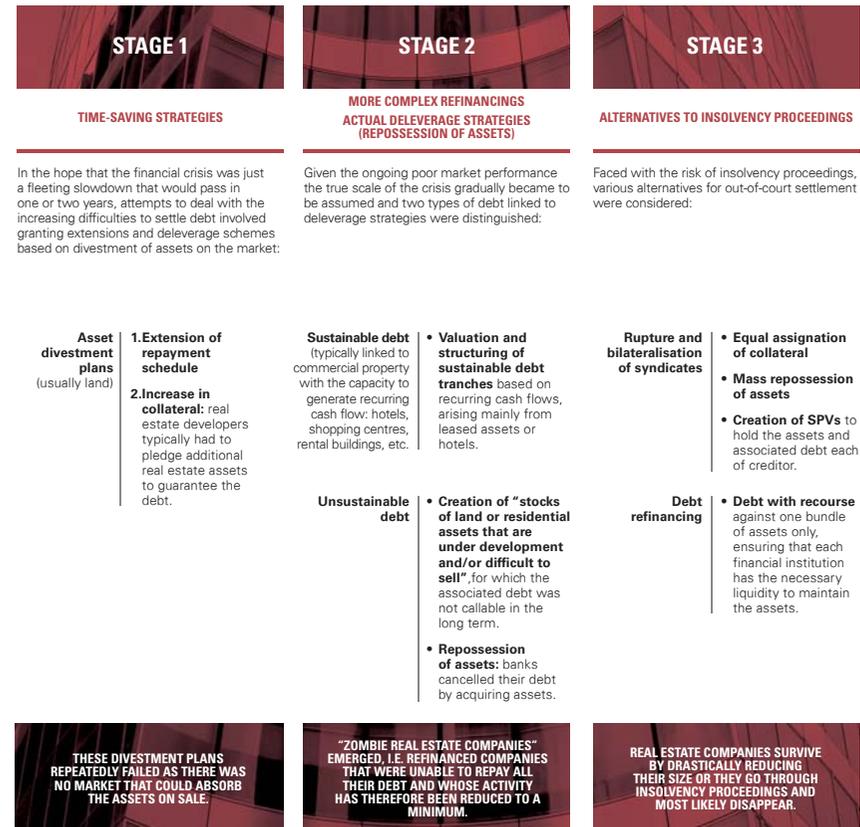
In 2015 the outlook for the real estate sector is brightening. Most companies have now survived together through the second and third stages of the sector restructuring – essentially the third – or are in the midst of insolvency proceedings that, statistics suggest, will probably result in their collapse (in 2013, 95% of companies involved in insolvency proceedings in Spain ultimately went into liquidation), or in their being hugely trimmed down following liquidations executed without filing for insolvency that have shrunk their balance sheets.

Banks, meanwhile, are linking up new strategies with programmes devised during previous crises and are focusing their efforts on bolstering or selling their asset sales and debt recovery platforms, and their portfolios of real estate-backed debt and developer loans (secured debt).

Such is the current state of affairs. Looking to 2015, most of those surveyed for this report (77%) consider that the refinancing programme still has a long way to go. However, the specific responses of those surveyed in the financial sector – who are key witnesses to these proces-

FIGURE 1. STAGES IN THE RESTRUCTURING OF SPAIN'S REAL ESTATE SECTOR

From the confident outlook that reigned at the outset of the crisis to the adoption of an irrefutable reality.



// HIGHLIGHTS:

The refinancing processes in which most real estate companies were immersed have largely been completed.

The financial sector will have to choose between two strategies:

- Financial transactions aimed at maximising cash and profits in the short term
- Real estate strategies: recovering value in the long term

ses – indicate that they do not share this standpoint: almost six out of every ten individuals taking part in the survey believe that the initiatives being undertaken in this sector are largely drawing to a close. Some real estate companies are now reviving and certain banks are undergoing a transformation, and both must decide on the strategies that will mark the way forward for the market in the coming years. //

TRADITIONAL REAL ESTATE COMPANIES SAW THEIR TURNOVER ALMOST HALVED FROM 2007 TO 2012

Spanish National Statistics Institute (INE)

// THE KEYS according to the expert



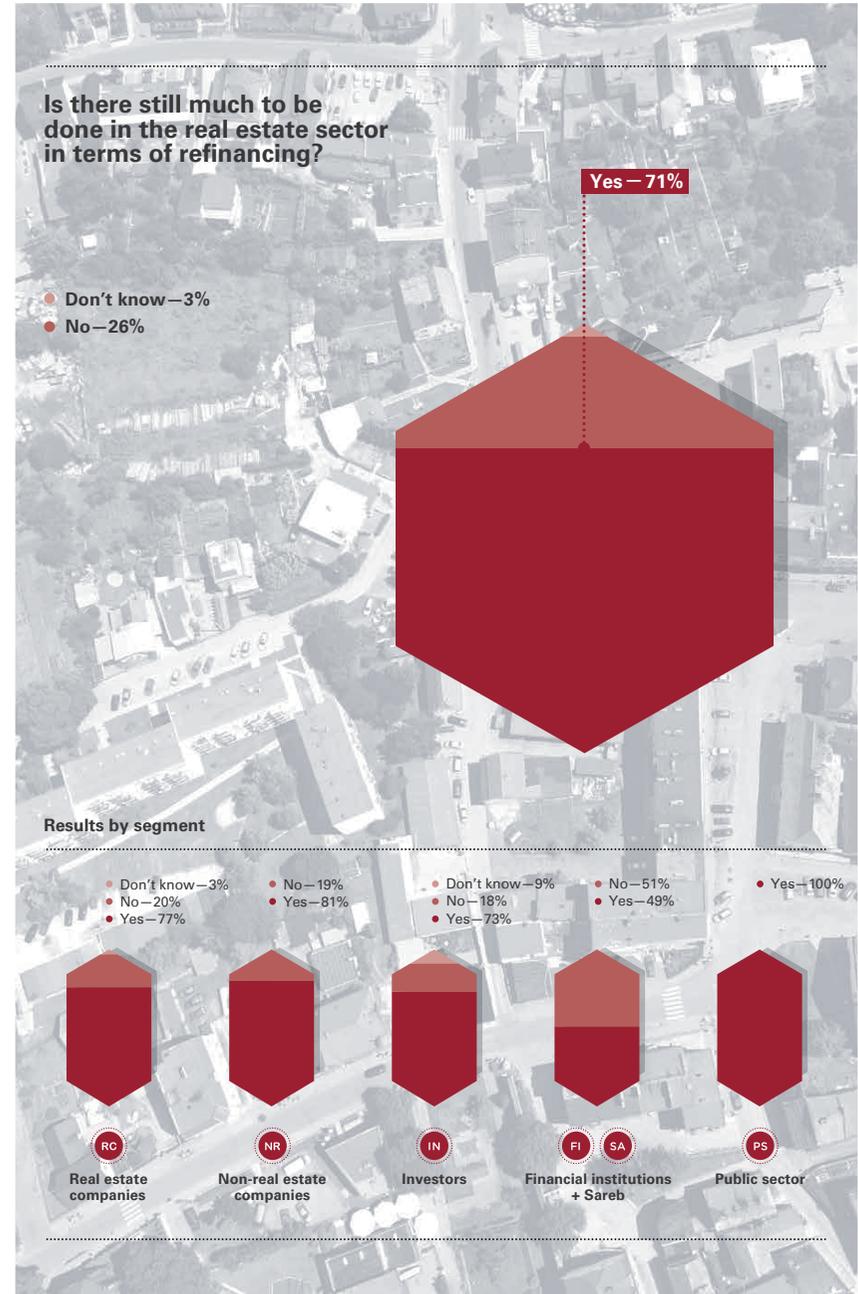
The new real estate sector landscape will be defined in the coming years on the basis of the strategies selected by two of the market's current major players. On the one hand, we have the surviving real estate companies, which are faced with the challenge of becoming the robust real estate firms of the future. Their new strategic plans will need to adapt to a changed market where the prices of certain assets and locations are struggling to rally. Meanwhile, the financial sector, inadvertently converted into a real estate giant, has yet to decide on its strategy to generate a return on the assets on its balance sheets.

Essentially, there are two options, and the market is now getting its first glimpse:

- Some entities are opting in the short term to cash in the large volume of real estate assets weighing on their balance sheets. The aim in this case is to generate liquidity and/or a profit in the short term through financial transactions entailing sales of debt or asset bundles, particularly to investment funds.
- Others are more inclined to hold the assets on their balance sheets for as long as it takes to maximise their value, and are beginning to develop purely real

estate strategies with sights set on the long term. The teams in charge of these projects are to be composed of real estate professionals. They will have the task of analysing in depth the portfolio of available assets and seeking out the best strategy for each one, which could also include new developments or leases. Entities choosing this second option could join forces with local property developers, placing their trust in the financial solvency and proven management capacity of these players, so as to increase the value of land assets and execute new real estate developments. //

By Luis García Laynez, Partner, Deal Advisory, Restructuring at KPMG in Spain.





2/ REFINANCING VS. INSOLVENCY PROCEEDINGS

WHICH HAS RETAINED VALUE?

The real estate sector has been practically the sole recipient of the measures adopted by the government in the last two years – not before – to alleviate companies' financial burdens and revive the flow of credit. In 2012 the first legislative initiatives introduced reforms for mortgage debt, housing and social housing, and debt restructuring, in response to exponential growth in the number of mortgage guarantee enforcements since the onset of the crisis.

The reforms that followed sought to support entrepreneurs and sole proprietorships, establishing mechanisms for out-of-court debt negotiations ("fresh start"), which were the precursor to the pre-insolvency and insolvency reforms of 2014.

A record number of insolvency proceedings was declared in 2013, almost 10,000 to be precise, of which 25% pertained to real estate sector companies. During that year, 95% of insolvency proceedings culminated in liquidation, highlighting the inefficiency of insolvency legislation as a means to enable the continuity of crisis-stricken companies. The third major group of legislative measures was aimed at restructuring business debt so as to

62%

Of those surveyed consider that the Insolvency Act has not been a useful mechanism towards business viability.

contribute to redressing companies that were highly "leveraged", but nonetheless deemed "productive." It is true to say that the reality of the real estate sector has little to do with productivity; rather, it is geared towards the possibilities of increasing the value of assets for the purpose of their sale, through buyers and access to the financing needed for the purchases. The absence of buyers, of visibility as to the duration of the crisis, of liquidity and of financing, coupled with the different perceptions of asset prices from the buyer and seller standpoints, has led to a situation where more than 80% of real estate sector companies filing for insolvency in 2013 were ultimately liquidated.

Despite the huge number of insolvency proceedings declared in recent years, according to data issued by the Banco de España the insolvency rate in Spain continues to be low compared to neighbouring countries. This is in part because creditors have traditionally opted for alternative solutions, such as creditor arrangements, enforcement of (essentially mortgage) guarantees, and debt restructuring. This desire to reach a consensus has nonetheless been met with inflexibility in legislation and an absence of legal provisions in certain cases.

THE ABSENCE OF BUYERS, LIQUIDITY AND VISIBILITY AS TO THE DURATION OF THE CRISIS, AMONGST OTHER FACTORS, LED TO A SITUATION WHERE MORE THAN 80% OF REAL ESTATE SECTOR COMPANIES FILING FOR INSOLVENCY IN 2013 WERE ULTIMATELY LIQUIDATED.

LEGAL CERTAINTY AND THE INSOLVENCY REFORM

To give legal certainty and comprehensive legal backing to business restructuring procedures, Royal Decree-Law 4/2014 introduced mechanisms such as ironclad refinancing agreements, the possibility of binding dissenting creditors and the legal standardisation of any agreements reached, as well as reinforcement of the benefits associated with "fresh money". These measures were replicated within insolvency proceedings through the reform introduced by Royal Decree 11/2014. In terms of bolstering solutions to avoid

insolvency through the sale of production units of insolvent companies, the Insolvency Act once again provides for judicial practices and incorporates legal solutions to bridge the existing legislative gap. The new legal regime seeks to confer legal certainty on sales of production units and to allow for flexibility in successfully executing such transactions, so as not to discourage them. Investors have recently expressed their interest in proceedings such as those of the Blanco Group or the Neoelectra Group, wherein KPMG served as the Insolvency Administrator. //

// HIGHLIGHTS:

Increase in agreements between debtor companies and financial institutions to find solutions other than insolvency.

The different legislative reforms introduced in 2014 bring greater legal certainty and eradicate the inflexibility characterising the legislation that had hindered the adoption of refinancing agreements until that time.

Insolvency proceedings promote the attainment of agreements and avoidance solutions that foster the viability of insolvent companies, building up scenarios of great economic interest to new players (e.g. investment funds). However, these processes are hard to apply, in view of the specific characteristics of the real estate sector.

// THE KEYS according to the expert



When talking of the real estate sector, we have to distinguish between commercial property, residential assets and land. The financing associated with those assets may be bilateral per asset and/or, in the case of real estate companies that have acquired other real estate companies, syndicated corporate financing with assets as collateral.

Commercial property (offices, shopping centres, etc.) generates income, and variables such as occupancy and rental price are therefore decisive factors when it comes to cash flow generation and, consequently, the ability to repay the associated debt. Time and the positive performance of macro variables (consumer spending, employment, etc.) have an impact as regards cash flow enhancement and, by extension, asset value. Such assets are therefore able to be refinanced and are of great interest to investors. The liquidity of residential assets, from the standpoint of the developer or owner, has been linked to the price of the end product and the buyers' need for financing.

The upturn in the economy, the revival of mortgage loans, buyers' equity and the market suitability of the price and the amount of the subrogated mortgage have gradually enabled their sale over the last few years. These sales have in many cases been made through the branch network of the lender

bank that had previously acquired the properties from the developer or foreclosed on them vis-à-vis the borrowers. Commercial property and residential assets alike could have by-passed insolvency proceedings and indeed, in the early years of the crisis, many of these assets wound up on the balance sheets of the lender banks as a result of debtor-creditor negotiations, which were faster and less detrimental for both parties. Conversely, from the house-buyer's perspective, the legislation has been pivotal as regards mortgage debt, housing and social housing, and debt restructuring, albeit somewhat late in coming.

The main issue for the sector arises from land that was financed at incremental rates in the years prior to the crisis. The surplus supply of housing with respect to demand, the need to invest in land to continue developing it coupled with the lack of financing, the delay in developing such land, when development should meet actual demand, and the final price of housing have all had an impact on land prices and the associated debt. Investors are few and far between and insolvency proceedings involving land owner companies are leading headlong into liquidation. Insofar as possible, this should be an orderly affair since, given the lack of an actual price for these assets, liquidations

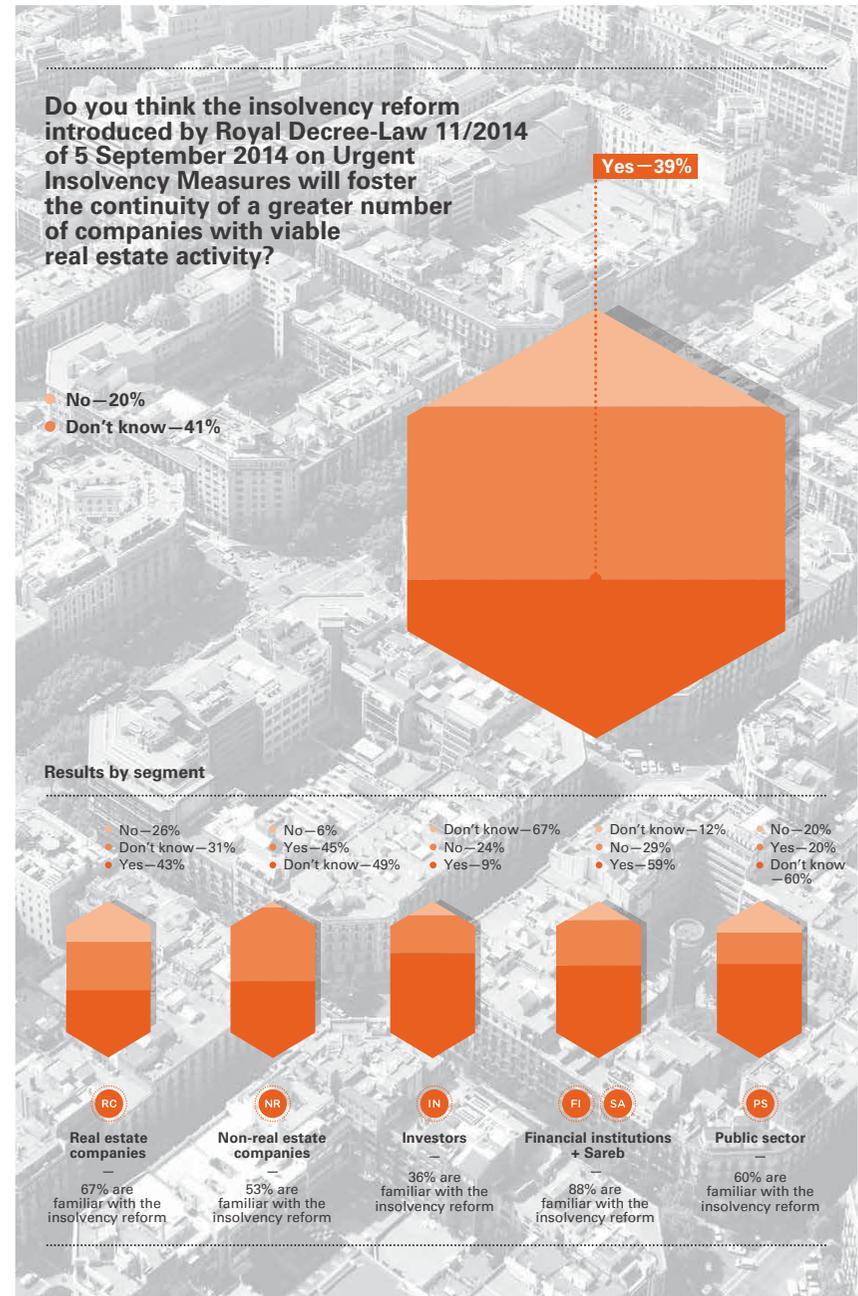
by auction are adverse for both debtor and creditor, the latter especially recovering only the bare minimum.

I conclude that insolvency proceedings in the sector, from a business perspective, have not been effective in putting the sector back on its feet. However, where companies have filed for insolvency in good time in view of the assets' failure to generate cash and the inability to settle the fixed costs of their activity (property taxes, payroll, security, etc.), this has in many cases prevented directors having to put up personal collateral and has favoured a certain order for the foreclosure and purchase of assets while providing guarantees to creditors.

Agreements reached outside of insolvency proceedings, the incorporation of real estate holding companies to take on assets foreclosed by financial institutions, the gradual increase in the value of residential assets through rentals with a purchase option, the creation of the Sareb (Spain's "bad bank") and SOCIMIs (Spanish REITs) are driving a sector revival fuelled by recovery and the ECB's liquidity policies.

In any case, our experience in relevant insolvency and refinancing proceedings in the sector has shown us that specialist professional advisory services, which offer an independent and objective view of the value of assets and their capacity to generate

By Ángel Martín, Partner, Deal Advisory in charge of Restructuring at KPMG in Spain, Europe, Middle East and Africa (EMA).



3/ THE RETURN OF BANKS AND THE ARRIVAL OF DIRECT LENDING

TOWARDS A MORE DIVERSIFIED FINANCING MODEL

+27%

Sources of financing other than banks represent 27% of the total in Spain, whereas in markets such as France 55% of financing comes from alternative sources

Bank financing has traditionally been the source of credit for business in Spain. Prior to the crisis, when interest rates were very low and liquidity was easily accessible, all sectors, especially the real estate and construction sectors, fuelled their growth through this type of financing: According to information from a recent report by BBVA Research¹, loans related to these activities (home purchase loans, loans for construction and loans to real estate developers) accounted for up to 60% of loans to other resident sectors (private sector) in Spain in 2008.

However, following the collapse of Lehman Brothers in September 2008, the principles that had traditionally been applied to granting credit broke down and the Spanish financial system underwent a significant restructuring process which, coupled with high levels of bad debts and new capital requirements, forced banks

to review their policies and develop more restrictive and selective credit mechanisms. Bank loans to non-financial entities declined by 56% from over 900,000 in 2008 to less than 400,000 in 2013-14.

In view of the reduced availability of bank financing, real estate companies were forced to diversify their sources of financing and seek alternatives, a process which is still ongoing in the case of small companies. This transformation is part of a natural de-banking process that is being spurred on by the widespread financial crisis and could, in the short-term, lead to a notable rise in alternative sources of financing from 27% of the current total to levels closer to markets such as the French, where they account for 55% of financing.

Although throughout this process bank financing will continue to be fundamen-



tal to the development of the real estate sector in Spain, certain other options are gaining traction as alternatives, e.g. funds showing an interest in companies in either a distressed or normal situation (both in terms of equity and debt) or direct lending funds.

Since April 2013, following the improvement in Spain's image and the foreign

100% OF THOSE SURVEYED FOR THIS REPORT CONSIDER THAT DIRECT LENDING, AN INJECTION OF FUNDS AND BANK FINANCING ARE THE KEYS TO REVIVING ACTIVITY IN THE SECTOR.

// HIGHLIGHTS:

Bank financing will continue to be important to reviving activity in real estate sector in Spain. The challenge is to find financing for viable projects while restricting risk.

Real estate companies have the adaptability to take on new sources of financing. Direct lending will become an interesting alternative in the future.

¹Zurita, Jaime; La reforma del sector bancario español hasta la recuperación de los flujos de crédito (The reform of the Spanish banking sector to recover the flow of

market's renewed confidence, international funds have begun to take on operations in Spain, joining the main national players, indicating their desire to position themselves in a market that they consider attractive.

The advantages of direct lending lie in its flexibility, as the credit is tailored to the specific circumstances of the company and the sector; in its availability to be applied to projects with higher LTVs (the portion that

secures the loan); and a single payment when the operation matures. Conversely, they are costlier than bank financing and have more restrictive legal clauses in the event of non-compliance with the payment schedule. Furthermore, public entities are joining forces to promote these alternative sources of financing through legislation such as the recently approved Venture Capital Companies Act, which focuses particularly on regulating collective investment and venture capital. //

// THE KEYS according to the expert



In 2015 the banking sector will gradually pick up the pace in real estate transactions, focusing, as already seen in 2014, on rental assets, particularly shopping centres and offices and, to a lesser extent, on development. In any case, banks should approach the future without forgetting their past.

Following years in which it was standard practice to grant financing with very high LTVs and even to provide funding for the acquisition of land, the challenge is to return to a system in which sufficient capital is available for viable and solvent projects while limiting risk. It would be desirable for this new phase to implement former practices in which the land was contributed by the developer

and the credit was granted solely for construction. This would need to go hand-in-hand with an exhaustive analysis of the project, a certain level of prior commercialisation and the backing of a professional business owner with a certain degree of experience.

Besides traditional bank financing, which is now becoming available, business owners should be aware of other alternatives for carrying out projects which, due to their structure, risks, leverage or flexibility, are more suited to alternative investor profiles. Before choosing one option over another, companies should assess its advantages and disadvantages, together with its flexibility or room for negotiation if payment difficulties arise.

Direct lending funds also need to do their homework if they want to become a strong and viable alternative and need to develop products that offer advantages that justify paying higher returns.

Although the recovery has already benefited the most consolidated real estate assets, the challenge is now for it to reach the whole sector through projects that offer added value. To this end, agreements between different market players will need to be encouraged: the banks, which have returned to financing projects; the funds, whose role is to provide capital and management companies, which offer the added value needed to meet demand. //

By Gonzalo Montes, Partner, Deal Advisory, Restructuring at KPMG in Spain.

Could a highly-leveraged financing model, similar to that seen in the pre-crisis years, be used again in the real estate business?



Results by segment





4/ ADDED-VALUE, OPPORTUNISTIC AND CONSERVATIVE INVESTORS

THE NEW TRANSACTIONS MARKET MIX

Real estate was the sector chosen by two of the largest international investment funds in the summer of 2013 to start a new era in the Spanish transactions market. A year earlier Spain had been on the verge of a bail-out, its risk premium at an all-time high. As the risk of having to leave the Euro ebbed and the possibility of an intervention disappeared, an increasingly stable macroeconomic scenario, a legal and tax framework that provided certain security and the sensation that prices were close to their all-time minimums and therefore bottoming out all served to fuel renewed international trust in the country's potential. Since then, Spain has consolidated its appeal for investors worldwide. High yields on investment products, compared with some of Europe's main markets such as London, Paris or Berlin, together with

8.500

Returns on investments in real estate assets doubled from 2013 (Euros 3,756 million) to 2014 (Euros 8,500 million).

low returns in the fixed-income markets, sparked a "beacon effect" that set off a whirlwind of investment activity in the region that is still going strong.

Spain has thus become the land of opportunity (through its location and through timing): 94% of survey respondents for this report agree that Spain is an attractive country for real estate investment and the data bear this out conclusively. Whereas in 2012 the Spanish real estate transactions market slipped 20% from its peak, this trend has now reversed. What is more: international investors continue to place their trust in Spain. In 2015 the market is expected to be a somewhat haphazard one in which multiple agents operating under different investment profiles will carry out substantial transactions to gain a foothold in their chosen assets.

A GROWING NUMBER OF COMPETITORS ARE BEING FORCED TO SEEK NEW ANGLES FOR THEIR REAL ESTATE BUSINESS, FOCUSING ON VALUE CREATION STRATEGIES

DIVERSE INVESTORS FOLLOWING DIVERSE STRATEGIES

With country risk under control and an apparently excellent risk-return profile compared with that of other European countries, Spain may continue to provide a market place of opportunities that "nobody wants to miss out on".

Vulture funds were the first to put in an appearance on the premise that prices might be bottoming out, although after almost two years of activity they are beginning to gravitate towards other countries such as Italy. Value-added funds are the latest arrivals, and they are here for good. 71% of survey respondents are of the opinion that this type of investment capital currently holds centre stage on the market and 83% state that now is

the best time to come to Spain. Value added funds are known as such because they are willing to make changes in the use of the properties and because they invest for the purpose of adding value to the assets, their strategies, which are more long term in nature, may contribute decisively to bringing about the recovery of the sector over the next seven or eight years.

At the same time, traditional core investors –essentially domestic and foreign private equity, particularly from Latin America and Asia, mutual funds and insurance companies– who took part in stock-picking transactions during the years of the crisis when the foreign funds followed a "wait and see" strategy, continue to plumb the market searching for products with a conservative

// HIGHLIGHTS:

The Spanish market will continue to attract domestic and foreign investors thanks to its appealing capital values, and its country and timing variables. Given the size of the market and the scarcity of prime assets, international investment funds must seek out new value strategies. New capital will have a value-added investing profile.

Investment vehicles – primarily SOCIMIs (Spanish REITs) – will become more specialised.

Transactions will be complex and high volume, with a considerable debt component.

Prudent management of an economy that is still "cold" and where there is still much pressure to invest capital.

profile, sacrificing profitability in transactions in return for greater security.

The outlook has turned around: with new actors willing to invest, the race to make off with higher-quality assets is guaranteed and growing in intensity, as are prices. According to survey respondents, finished housing for first homes in good locations within areas where demand is visible, offices in prime locations and retail space on commercial streets will be the seg-

ments registering the largest increases in terms of both number of transactions and capital value thereof over the next five years.

Interest therefore focuses on prime assets; but in view of the evidence that Spain is a mid-sized market and that truly premium assets are few and far between, transaction values are beginning to exceed expectations. Conversely, yields are declining. How will these new agents react? //

// THE KEYS according to the expert



Despite a strong outlook for a consolidated recovery in real estate transactions, the risks that persist in Spain still need to be addressed. Among the main worries voiced by investors are political and regulatory uncertainty, in addition to a real economy that is taking off very slowly and continues to hold back growth of sustainable effective demand. Only a coordinated country strategy that addresses this lack of confidence can overcome the risk that investors may fail to meet their expected returns and turn their sights towards new horizons.

An entirely different matter is the change in strategy that the main investors must assume if they wish to consolidate and expand their investments in Spain. The continued appeal of the market is unquestionable, but we are looking at what is a small market; consequently, many investors are

forced to follow multi-product strategies where the number of higher-quality assets is limited in order to adapt to this new reality. A growing number of competitors are being forced to seek new angles in the real estate business to obtain attractive returns, focusing on value-creation strategies and creating their own central product in which assets, based on their planned exit strategy, can then be sold to yield buyers or core investors.

Some five to eight years are thought to be needed for capital values to resume their former levels. This is the primary source of appeal of purely real estate funds that are moving into Spain and implementing value-added strategies in which one of the main investment cases is the search for locations with current and potential demand, with capital values that are at all-time market

lows. The margin for error, assuming that these two variables are handled properly, is very limited and there is a case for the upside.

The market recovery is still in a volatile stage and we must be prudent. High transaction volumes are real, but the yield compression being seen is due more to a lack of investment alternatives (products) than to an improvement in demand and economic fundamentals.

The Spanish market is small and capital flows are clearly betting on two variables: the country and the timing, with a recovery in actual demand that is still not matching expectations. How should these three variables be managed more effectively? Probably the key lies in adopting a prudent attitude. This should be our challenge in the short and medium term. //

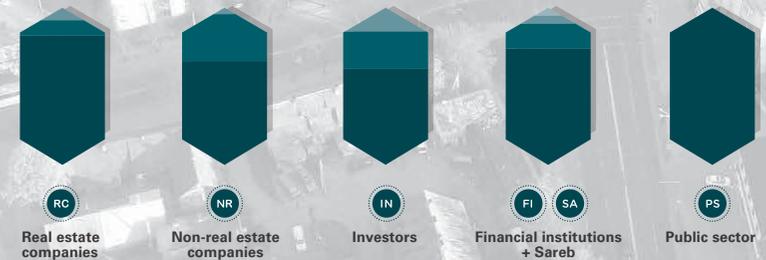
By Ignacio Faus, Partner, in charge of Deal Advisory at KPMG in Spain.

What investor profile will become more prominent in Spain's real estate investment market?



Results by segment

- Conservative -8%
- Opportunistic -10%
- Added-value -82%
- Don't know -4%
- Opportunistic -30%
- Added-value -66%
- Conservative -15%
- Opportunistic -24%
- Added-value -61%
- Don't know -5%
- Conservative -5%
- Opportunistic -16%
- Added-value -74%
- Added-value -100%





5/ THE GOLDEN AGE OF SOCIMIs (SPANISH REITs) TOWARDS AN INDIRECT INVESTMENT MODEL

9

Out of 10 respondents are sure that new equity will continue to be channelled into real estate trusts in 2015.

Traditionally, direct investment has “placed” most of the capital circulating around the real estate sector in Spain. However, five years ago, the system acquired a new legal figure that is revolutionising the real estate scene and beginning to attract funds towards a form of indirect investment that is becoming increasingly attractive for certain investor profiles. Structures such as residential rental companies or real estate funds and firms have been left behind, losing ground to the currently fashionable alternative.

In 2009 Spain saw the birth of the new SOCIMI regime (Spanish REITs) aimed at promoting the property rental market in Spain, increasing the level of professionalism, making it easier for ordinary citizens to buy property, rendering the

Spanish securities markets more competitive and creating a more dynamic real estate market. In theory, the idea was undoubtedly attractive; in practice, acceptance was lukewarm. Although a government amendment was three years in coming, the regulatory review in 2012 did manage to bring in more flexible requirements for setting up these companies, enabling them to be listed not only on the continuous CATS market but also on the MAB (alternative stock market), which offers more accommodating access conditions. That was the start of what can be considered the golden age of SOCIMIs.

The advantages of SOCIMIs are varied, including a favourable tax regime that provides for exemption from corporate income tax. In return, they must fulfil

certain legal requirements aimed at ensuring the function they are intended for: to promote real estate rentals and encourage long-term property investment. Thus, 80% of income must come from rental of the assets under management, which must be kept in the portfolio for a minimum of three years, and at least 80% of profits must be distributed as dividends.

Ten SOCIMIs are expected to be listed in Spain in the short term. The forecasts indicate that these vehicles will continue to grow in importance: most of those surveyed for this report are convinced that SOCIMIs will be one of the two main market agents in the next five years; while nine out of ten respondents are sure that new equity will continue to be channelled into real estate trusts in 2015. During the last year, a variety of agents ranging from large financial institutions to investment funds and families holding real assets have expressed their desire to group their assets under the umbrella of a SOCIMI, which combines asset portfolios that show attractive purchase prospects and the possibility

of raising funds to undertake real estate development with the tax advantages both options provide.

The unstoppable advance of Real Estate Investment Trusts (REITs) – the international equivalent of a SOCIMI – over the last decade bears out the theory that in Spain these vehicles still offer considerable scope for growth. First set up in the USA in the 1960s, they have since spread worldwide. According to the European Public Real Estate Association (EPRA), today 37 countries contemplate in their respective legislations vehicles

TRANSACTIONS CONTAIN AN INCREASINGLY FINANCIAL COMPONENT AND ARE GROWING IN COMPLEXITY, WHICH IS SPARKING THE ARRIVAL OF NEW PLAYERS

// HIGHLIGHTS:

Spain will shift from a market model focusing on direct investment to one based on indirect investment.

The unstoppable advance of REITs – the international equivalent of a SOCIMIs – over the last decade bears out the theory that in Spain these vehicles still offer considerable scope for growth.

that are similar to REITs. Moreover, even in markets such as France where, as in Spain, they only came under regulation in the 2000s, there are already more than 30 such listed companies. In its November bulletin, the EPRA already acknowledged the significant surge in the Spanish REIT market.

The international experience also suggests that retail investors will be the next to benefit from their advantages: returns on these vehicles are quite predictable as the assets under management are known ahead of time, and the Spanish rental market has, until now, been known for its stability. //

// THE KEYS according to the expert



The Spanish real estate market is progressing from a model based on direct investment to one in which indirect investment is gaining importance. Spain's growing economic stability and the change in legislation in 2012 have fuelled the creation of SOCIMIs and now, in view of the volume of funds raised in recent months, it is hoped that their role will expand over the coming years.

Furthermore, unlike in the previous crisis, in recent months we have witnessed the appearance of a more complex and innovative market in which the increasingly financial component that normally derives from the weight of debt is attracting new players. This is translating into practices that are almost unprecedented in our market: acquisition of controlling interests and divestment of the former real estate investment funds (FIs), mass sales of their management platforms for both assets and debt, sales of debt secured by

both real estate developments and assets in the tertiary sector (hotels, shopping centres, etc.), insurers lending money through the banks, etc.

In this new market we find large global funds or private equity firms operating directly and the new SOCIMIs, which in some cases contain the same type of structure and in others harbour institutional investors. Together with the increase in the number of SOCIMIs we are beginning to see a move towards growing specialisation and professionalisation in the sector, much like what happened previously in other countries and also what occurred in the investment fund sector. In the future, SOCIMIs will undergo a transformation, becoming larger and specialising in certain types of assets such as residential properties, offices or shopping centres.

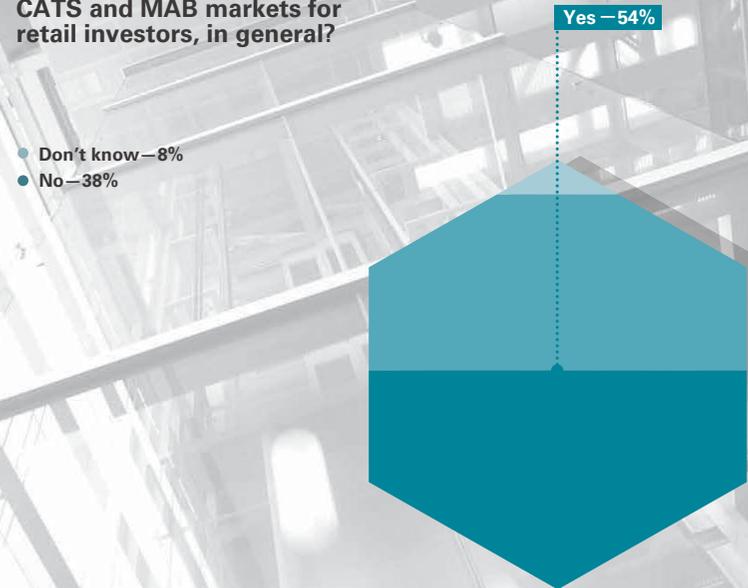
In Spain SOCIMIs are already playing a key role in the real estate investment market, where in 2014

they accounted for more than 25% of all purchases. These figures, however, contrast with the volume of tertiary assets on their respective balance sheets which at this time may be in the region of 2.5% of total assets. To put this into perspective, our British and French colleagues hold close to 20% and 9.8%, respectively, of total available real estate through these listed vehicles. These figures are very high compared with those for Italy and Germany, where they are approximately 0.63% and 1.59%, respectively.

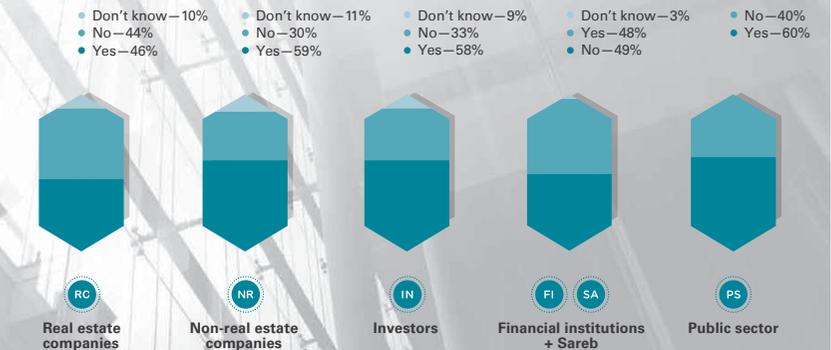
International experience also suggests that retail investors will be the next to benefit from the advantages of their profitability. The arrival en masse, or otherwise, of retail buyers will determine the growth of these vehicles in Spain. Having said this, it is likely that investments by small companies will reduce their contribution to the Spanish market in the face of such strong indirect investment vehicles. //

By Emilio Miravet, Partner, Deal Advisory, Corporate Finance, Real Estate at KPMG in Spain.

Do you think socimis will be an attractive investment vehicle on CATS and MAB markets for retail investors, in general?



Results by segment





6/ AUDITOR ROTATION AND CHANGES TO REVENUE RECOGNITION

NEW ISSUES AFFECTING THE SECTOR

Society in general, regulators and stakeholders are increasingly demanding greater transparency and responsibility from companies. The European authorities have therefore taken advantage of the period of reflection in the aftermath of the crisis to approve a reform of the audit market in the European Union which, in the words of Michel Barnier, former European Commissioner for the Internal Market, is aimed at "re-establishing investor

2016

Effective application of the new regulatory framework must occur before 17 June 2016.

confidence in financial information, an essential ingredient for investment and economic growth in Europe'.

The new regulatory framework approved in April 2014 consists of a Directive that all member states must transpose, and a Regulation that has to be applied before 17 June 2016. The legislation will affect Public Interest Entities (PIEs), which include companies listed on regulated markets.

In Spain on 26 December the Council of Ministers approved the draft Audit Law, which apart from transposing the Directive, regulates the various options permitted under EU law. This draft legislation is expected to pass through the Spanish Parliament in the first quarter of 2015. One of the new developments introduced is the mandatory rotation

every ten years of the auditors of accounts of PIEs, with a transition period depending on the present auditor's length of service. It also increases the current restrictions on non-audit services that can be provided by the audit firm and limits the fees for non-audit services to a maximum of 70% of those obtained for the statutory audit.

// HIGHLIGHTS :

With the introduction of the new Audit Law, companies will have to reconsider the services they hire from professional services firms.

IFRS 15 represents a major change in how and when revenue is recognised, having a significant impact on the real estate and construction sectors.

IFRS 15 REGULATING HOW AND WHEN REVENUE IS RECOGNISED WILL ENTER INTO FORCE IN JANUARY 2017.

The audit committees of PIEs are also given a more important role. All PIEs must have an audit committee or a similar body that assumes the functions set forth by law in the Spanish Companies Act.

NEW IFRS 15

In addition, in the financial reporting area, a new standard on the recognition of contract revenue – IFRS 15 – will enter into force in January 2017. The majority of those surveyed (54%) claimed to have no knowledge of this standard or the impact it will have on the real estate sector. However, it will bring changes to the recognition and disclosure of contractual obligations,

requiring their appropriate identification in the contracts signed by third parties for the delivery of goods and services, and the recognition of costs to obtain contracts and comply therewith.

IFRS 15, published in mid-2014 by the International Accounting Standards Board (IASB) and the US Financial Accounting Standards Board (FASB), regulates, in a general manner, how and when revenue should be recognised and provides criteria for its practical application in different situations, e.g. the recognition of construction contract revenue based on the stage of completion, which is relevant to the real estate sector. //

// THE KEYS
according to the expert



The new audit regulatory framework in the EU will have a wide scope in Europe and its implementation in Spain will affect public interest entities and firms rendering professional services. The changes, aimed at increasing audit quality, reinforcing corporate governance and enhancing the transparency and content of the financial information used by the markets, are positive. However, the new framework approved provides considerable options and

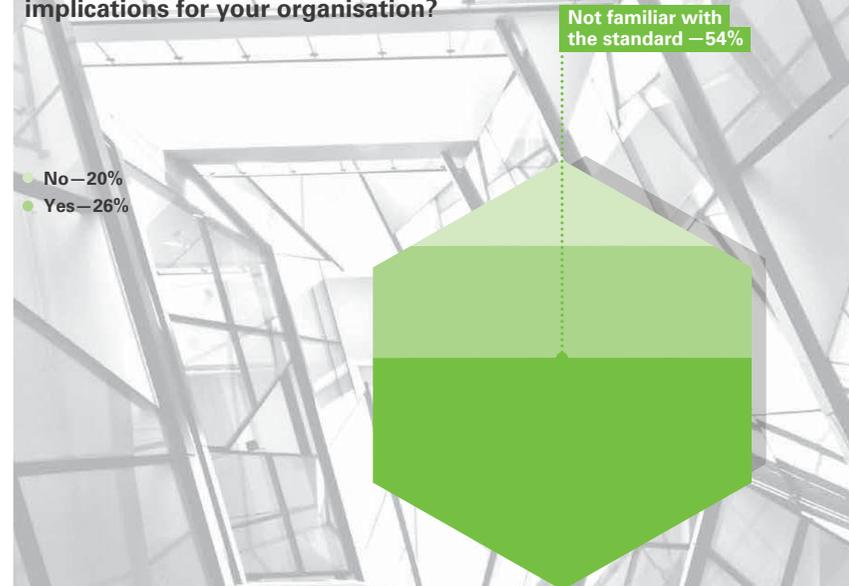
leeway for application to each member state. There is therefore a risk that it will lead to a complicated legislative mosaic in Europe, meaning that real estate companies will have to take care to avoid non-compliance.

In the area of financial reporting, all companies will be affected by the new IFRS 15 on the recognition of contract revenue. It will be particularly important in the real estate and construction sectors

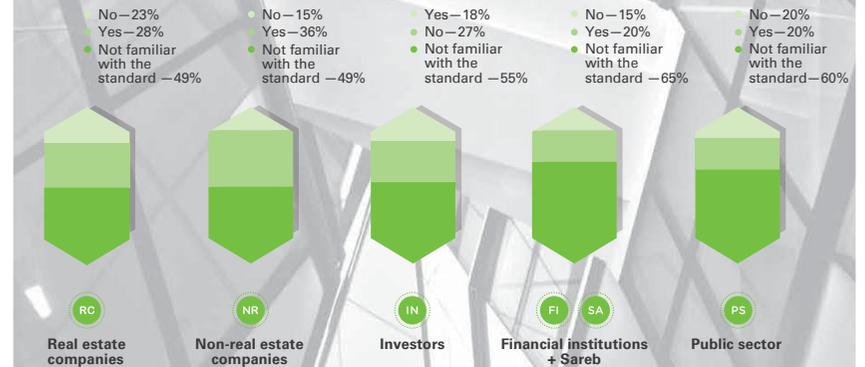
because sales of products and services are frequently carried out jointly or companies take part in long-term projects. Its impact is not merely limited to the accounting area but is much more widespread, affecting different levels of the organisation: from the tax area to internal control or project management, and including communications with financial markets. It is therefore important for real estate companies to correctly assess its impact. //

By Tomás López de la Torre, Partner in charge of Real Estate, Audit Area at KPMG in Spain.

The new standard on revenue recognition will soon come into force; are you aware of the implications for your organisation?



Results by segment



71 BEYOND THE RATES

MAJOR CHANGES TO THE INDUSTRY AS A RESULT OF THE TAX REFORM

43%

of those interviewed considers that the tax pressure is greater in Spain than in other European countries

One of the major reforms introduced by the Spanish government as part of the raft of structural measures designed to boost economic recovery is the tax reform that entered into force on 1 January 2015. The new legislation brings with it changes to four of the main Spanish taxes: value added tax (VAT), the changes to which are mainly technical, albeit with certain other more significant modifications (the possibility of waiving exemption in the event of pro rata); personal income tax (PIT), with respect to which rates and taxation of certain income from former assets have changed (taper relief is eliminated), although its basic structure remains unchanged; non-resident income tax (NRIT), which has seen few changes, although some of them are noteworthy; and corporate income tax (CIT), the only tax that has been completely revamped, with the promulgation of a new law.

When asked about the taxation of the Spanish real estate industry, 43% of those surveyed said that the tax pressure is greater in Spain than in other European countries. As regards the potential impact of the CIT reform, it is mostly seen in a positive light, with 35% expecting it to be beneficial, and just 21% foreseeing a negative impact; the same cannot be said for the chan-

ges to other taxes, which one third of interviewees expect to be detrimental to their interests.

One of the main developments in the new Corporate Income Tax Law is the reduction in the tax rate, which will be implemented in two phases: from 30% in 2014 to 28% in 2015 and to 25% in 2016. Like all other Spanish companies, those in the real estate sector will have to adjust to this new tax, as the former rate of 30% will now only apply to credit institutions (the rate for some companies in the hydrocarbons sector will be reduced from 35% to 30%).

The reform will also bring with it other significant changes. On the one hand, the tax consolidation rules have changed, so that Spanish companies forming part of a single group that are owned by foreign companies and Spanish subsidiaries of Spanish groups owned via other foreign companies will now form part of consolidation groups for corporate income tax purposes.

On the other hand, the law introduces restrictions for the offset of tax losses over and above the caps established in recent years. This limit is now set at 70% for 2017 onwards (and at 60% for 2016, with a variable percentage in 2015, depending

on the circumstances of each company). Thus for example, if a company makes a profit of 100 in 2017, it will only be able to offset tax losses for 70% thereof or one million euros, whichever is greater. The reform has also eliminated the tax credit for reinvestment of extraordinary profits: whereas until now a company that sold a fixed asset and obtained a capital gain that it reinvested would have paid tax at an effective rate of 18%, from now on, it will be taxed at the general rate (28% in 2015).

The sale of a real estate company, however, could be tax exempt.

CALCULATION OF THE TAX BASE USING CADASTRAL VALUES THAT CURRENTLY EXCEED SALE VALUES MEANS, IN PRACTICE, THAT THE AMOUNT PAYABLE SOMETIMES EXCEEDS EXPECTED GAINS

// HIGHLIGHTS:

Each company must analyse the impact of the new Corporate Income Tax Law in view of its specific characteristics and conditions.

Certain modifications to the tax system will require international investors to consider a new strategic approach.



Another change that will affect the real estate sector is that impairment of fixed assets will no longer be tax deductible on recognition, irrespective of whether it might later be deductible either through amortisation and depreciation or through losses incurred outside the group.

As regards NRIT developments, cases in which a vehicle may be set up to avoid having to pay tax in Spain, when

a company distributes a dividend to a company with an establishment in the European Union, have been restricted.

Finally, besides the taxes already mentioned, the tax reform has not sought to amend the autonomous region and municipal tax system which, in practice, imposes different taxes for similar real estate developments, depending on the Spanish territory in which the activity is carried out. //

// THE KEYS according to the expert



The tax reform is a step forward with respect to the transitional laws in force over recent years. While it is true that the reduction in corporate income tax rates will be beneficial for the real estate sector, other measures such as the broadening of the tax base (impairment is no longer deductible) and the elimination of the tax credit for reinvestment of extraordinary profits will also affect construction and real estate companies and call for a careful analysis. Moreover, a number of international investors will have to reconsider their investments and how they are financed.

The changes to the tax consolidation rules could affect national and international groups that, for a number of reasons (e.g. the inclusion in their shareholding structure of minority investors or a desire not to mix distinct businesses such as rentals and sale-purchase),

have until now only sought to consolidate some of their companies in Spain. Another practical problem is also foreseen: international groups will have to clearly identify all of the companies that would form part of a potential tax consolidation group.

On the other hand, the restrictions on the use of tax losses could give rise to situations in which companies with significant losses from prior years are taxed if they fail to use them. Companies in the market are also calling for the government to give priority to the long-awaited reform in regional and local taxation, with a view to unifying the various models and limiting subjective interpretation. Yet perhaps more urgent in the face of a shift in the economy is the need to deal with the undesired consequences of certain real estate transactions of

the current interpretation of the municipal tax on the increase in urban land value.

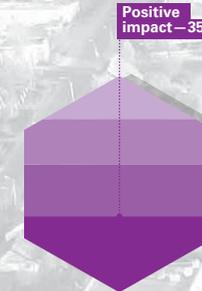
The taxable event for the purposes of this tax (the event that triggers it) is the increase in the value of urban land as from its purchase date. However, certain transactions are seeing no such increase at present. Added to this is the fact that the tax base is calculated on the basis of cadastral values that now exceed the sale value, which, in practice, means that the amount payable exceeds the amount of any expected gains. The consequences of these deviations are already noticeable, with transactions being thwarted as a result of such expectations and the high courts of justice ruling that taxpayers are exonerated from payment in the absence of a taxable event due to the lack of increase in value. //

By Alberto Estrelles, Partner of the KPMG Abogados Tax Department in charge of Real Estate.

How do you think the tax reform will affect the following matters?

— The income tax reform

- Positive impact—35%
- Don't know—19%
- Negative impact—21%
- No significant impact—25%



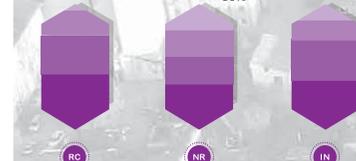
— The reform of other taxes

- Negative impact—33%
- Positive impact—18%
- No significant impact—24%
- Don't know—25%



Results by segment

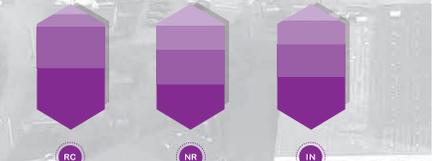
- Don't know—5%
- Negative impact—20%
- Positive impact—31%
- No significant impact—44%
- Don't know—21%
- Negative impact—21%
- No significant impact—22%
- Positive impact—36%
- No significant impact—15%
- Don't know—12%
- Negative impact—30%
- Positive impact—43%



Real estate companies Non-real estate companies Investors

Results by segment

- Don't know—8%
- Positive impact—10%
- Negative impact—33%
- No significant impact—49%
- No significant impact—17%
- Positive impact—19%
- Don't know—28%
- Negative impact—36%
- Positive impact—18%
- No significant impact—18%
- Don't know—21%
- Negative impact—43%



Real estate companies Non-real estate companies Investors

- No significant impact—17%
- Negative impact—17%
- Positive impact—26%
- Don't know—40%
- Don't know—20%
- No significant impact—20%
- Positive impact—60%



Financial institutions + Sareb Public sector

- No significant impact—11%
- Negative impact—20%
- Positive impact—20%
- Don't know—49%
- No significant impact—20%
- Negative impact—20%
- Positive impact—60%



Financial institutions + Sareb Public sector



LEGISLATIVE AMENDMENTS TO STREAMLINE AND EXPEDITE PROCESSES AND ALLOW CHANGES TO BE MADE TO LAND USE AT THE REQUEST OF THE INVESTOR SET TO PERFORM THE DEVELOPMENT ARE AMONG THE KEY DEMANDS

8/ CHALLENGES FACING THE PUBLIC SECTOR

FLEXIBILITY AND EMPATHY TO SUCCESSFULLY MANAGE ITS ASSETS

6.500

In 2013 the government analysed 6,500 legislative provisions, of which 2,700 were deemed to be affecting market unity by hindering free access and/or the pursuit of economic activities

Between 2013 and 2015, over 15,000 publicly-owned properties will have been placed on the market, going by the forecast in the plan to raise the value of publicly-owned real estate assets, rubber-stamped by the government back in June 2013. Income during this period is expected to hit the Euros 150 million mark, to the tune of Euros 50 million a year, although on first inspection the programme has already fallen short of its 2013 targets: of the 2,922 properties on sale, only 1,381 found a buyer, fetching just over Euros 41 million in total, 82% of the earnings estimated, according to figures from the Directorate-General of State Property. While this initiative bears witness to the efforts made by the government to improve management of

publicly-owned assets, those surveyed for this report called on the authorities to step up their efforts in view of the exceptional current circumstances of the Spanish property market. Three quarters of those consulted recognised that there is considerable room for improvement in optimising the use of public assets, while 94% take the view that the public authorities need to overhaul procedures if state-owned assets are to be successfully sold off.

The overhaul required calls for focusing on the demands of investing in the sector, the characteristics of which have changed over the course of the crisis, as well as on a new type of investor that has been gaining ground in Spain

in recent years and will continue to do so in the future: the foreign investor. According to figures from the Banco de España, 2013 saw foreign investment in real estate at its highest point in nine years (Euros 6,453 million), while the latest forecasts from DBK, a subsidiary of Informa D&B, suggest that the 2014 figures will break the Euros 7,000 million barrier, a twofold increase on 2009. The main stumbling blocks to selling off publicly-owned property indicated by those surveyed for this report were regulatory

barriers and/or red tape (40%) and starting prices that are out of touch with the going market rate (33%). The real estate industry was also unanimous in its call on the public authorities to cut down on the piecemeal nature of Spanish legislation, which hinders the process and slows it down, impacting on property development in the shape of the various central government, autonomous region and local regulations in terms not only of urban planning, but also further afield in areas such as the environment.

// HIGHLIGHTS:

It would be well worth introducing changes aimed at making the process to sell off Spain's publicly-owned real estate assets more flexible, in order to facilitate access by investors, above all international ones.

Steps are being taken to put an end to the legislative complexity prevalent in Spain, which will make private investment more straightforward. It will also be essential, from a practical standpoint, for the public sector to set processes in motion quickly.

To this end, the authorities have also rolled up their sleeves: alongside the approval of a Law to Guarantee Market Unity, which aims precisely to recover a single Spanish market integrated within the European market and prevent the breakup of the domestic market, November 2013 saw the government launch a plan to streamline legislation. In all, 6,500 legislative provisions were analysed, 2,700 of which were deemed to be affecting market unity by hindering free access and/or the pursuit of economic activities, of which around 30% were central government laws, with autonomous region legislation making up the remaining 70%. Nevertheless, there is still room to bridge

the gap between the stances taken by the public authorities and the private sector. Furthermore, administrative procedures will have to evolve towards greater speed and flexibility.

As is only to be expected, the economic crisis has also been felt in the manner in which administrative action and regulatory matters impact on the industry. Thus, legislative amendments to streamline and expedite processes and, more specifically, allow changes to be made to land use at the request of the investor set to perform the development, are among the demands most frequently aired in recent times. //

// THE KEYS according to the expert



In the real estate market, there has been an increasingly widespread feeling in recent years, accentuated by the need for fiscal consolidation, that there is a great deal yet to be done in terms of optimising the management and sell-off of publicly-owned assets. There are no doubt some properties that are highly attractive to a market that awaits with baited breath. However, there is at times a certain lack of flexibility or readiness to cut through red tape in a bid to make investments more appealing. This may have led to certain divestment processes falling by the wayside or falling short of expectations. The new investment profile, the upshot of the financial crisis, and the international background of many

of the investors now looking into the Spanish property market no doubt have a key role to play in all of this. Spain's public sector cannot allow the opportunity represented by the initial appeal of real estate assets in Spain, above all for major international investors, to pass it by.

However, this calls for a change of mind-set and a shift in administrative action towards a greater understanding of investors' needs, without overlooking the need to safeguard the public interest and free competition. Quite the contrary. The demands of such investors take in everything from the traditional calls for greater legal certainty and security to others of a more educational bent. The aim is for

the public sector to approach investors with a view to clearing up any doubts and cutting down on the perceived risks, in order to ensure a successful asset sell-off.

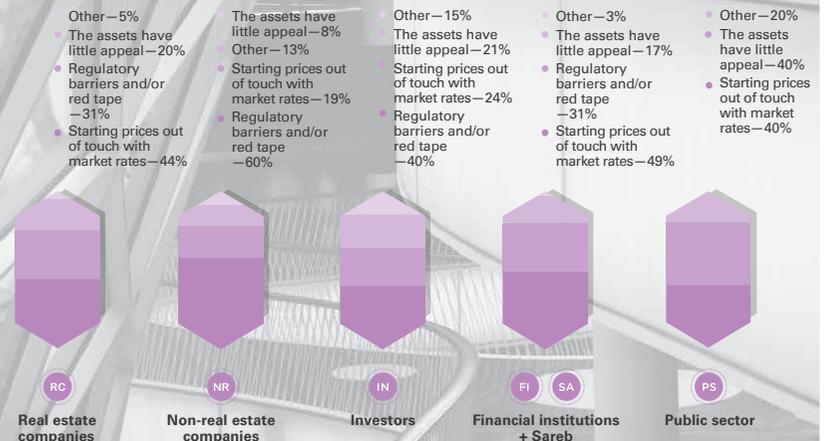
There is no doubt that Spain has in place suitable legislative instruments to ensure the public sector plays its part in setting the real estate industry back on the road to recovery. It now simply remains for the authorities to set in motion such processes with speed, flexibility, the utmost rigour in terms of meeting requirements and deadlines and, in short, a keener awareness of the needs common to all investors, safe in the knowledge that such investors will continue to play their part in the recovery of the industry and the economy as a whole. //

By Jorge Aguirregomezcorta, Partner of the KPMG Abogados Legal Area in charge of Construction Law.

What do you think is the main reason for the difficulty in selling off excess state-owned properties?



Results by segment



9/ RENT AND REFORMS

PUBLIC AUTHORITIES' SOLUTIONS TO ENSURE ACCESS TO HOUSING

The right to decent, suitable housing is enshrined in Article 47 of the Spanish Constitution. One of the so-called economic rights, it is strictly speaking more of a principle than a right, and its enforceability by the public authorities depends on the legislative provisions. The Magna Carta establishes that "the public authorities shall seek to ensure the necessary conditions and set in place the relevant provisions to make this right effective".

Thus, the authorities competent in the area of public housing, mainly municipal councils and autonomous regions, have gradually rolled out a range of systems in order to put into practice this goal set by the Constitution. In the shape of the Autonomous Region or Municipal Housing Institutes, various types of subsidised housing have been built, on a range of different types of land, albeit always available at below market rates. Initially, the beneficiaries of subsidised housing policies were people or families with little financial means. However, in the wake of the exponential rise in housing prices during the years of economic expansion, middle-income earners also found themselves shut out of the open housing market, and such policies began to make room for these earners in

2013

Since the 2013 reforms to their housing-related competences, municipal councils have found their initiatives in the area of public housing development restricted to those meeting criteria of financial sustainability.

the form of different types of housing with varying degrees of subsidisation.

The onset of the financial crisis brought with it the need to reassess public housing policies. There was a steep decline in the number of new builds started during this period: according to figures from the Ministry of Development, the number of subsidised dwellings initiated fell from 97,617 in 2006 to 6,489 in 2013. Throughout this period, the public revenues of the competent authorities, as well as those linked to the land development cycle, dropped off sharply, thus making financing for public housing policies harder to come by. Nonetheless, the market price of housing has fallen off in recent years, narrowing the gap with subsidised housing price (the Ministry of Development estimates that while subsidised housing prices in 2006 were half those on the open market, this figure had risen to 75% by 2013), casting doubt on its ability to sell certain housing developments with a lower level of subsidisation.

Moreover, since the 2013 reforms to their housing-related competences, municipal councils have found their initiatives in the area of public housing development restricted to those meeting criteria of financial sustainability.



From a demand point of view, wide swathes of the middle classes have seen their purchasing power fall across the board, a state of affairs that, in practice, by making access to bank financing more difficult, would have led to an increase in the numbers of people applying for subsidised housing, although many lack the capacity to raise finance even on favourable terms. Consequently, while conditions on the open market have undergone

an adjustment, 85% of those surveyed consider that the time has come to design new public housing policies in line with the current reality. The defining features of the general economic backdrop described above, in tandem with trends in the housing and finance markets, mean that the profile of those seeking subsidised housing is approaching that in the years leading up to the property bubble. For this segment of the population, the difficulties

// HIGHLIGHTS:

The public sector will take a two-pronged approach to promoting access to housing:

- Encouraging rentals: both in terms of promoting an efficient private rental market and developing public policies
- Urban redevelopment: positive repercussions in both economic and social terms.

when it comes to making a purchase call for a reassessment of the rental model as an approach offering greater advantages to developers and those seeking housing, as well as a greater chance of efficiency and equality on the part of the authorities. Meanwhile, the general public's view of this issue has been strongly influenced by the constant newsfeed, not free of a certain ideological baggage, of the evictions suffered by many citizens year on year. //

THE GENERAL ECONOMIC BACKDROP, IN TANDEM WITH TRENDS IN THE HOUSING MARKETS, MEAN THAT THE PROFILE OF THOSE SEEKING SUBSIDISED HOUSING IS APPROACHING THAT IN THE YEARS LEADING UP TO THE PROPERTY BUBBLE

// THE KEYS according to the expert



Faced with the collapse of both the property market and the public authorities' spending capacity, the latter have a legal obligation to resolve any situations of inequality that may arise. Their actions in 2015 must revolve around two core principles: rentals and the refurbishment of properties. However, before setting in place standard policies applicable to the public at large, attempts must be made to order the real problems and pressing needs of the different sectors of society into some sort of priority.

incentivising long-term rentals and promoting subsidised housing and the development of a free and competitive open rental market. As far as the former is concerned, the ideal high-impact, short-term model would consist of agreements with the major property developers in order to put the current residential developments pending commercialisation up for sale, thereby benefiting both parties. The latter would call for economic and tax measures to encourage individual investment in the refurbishment of properties for rent.

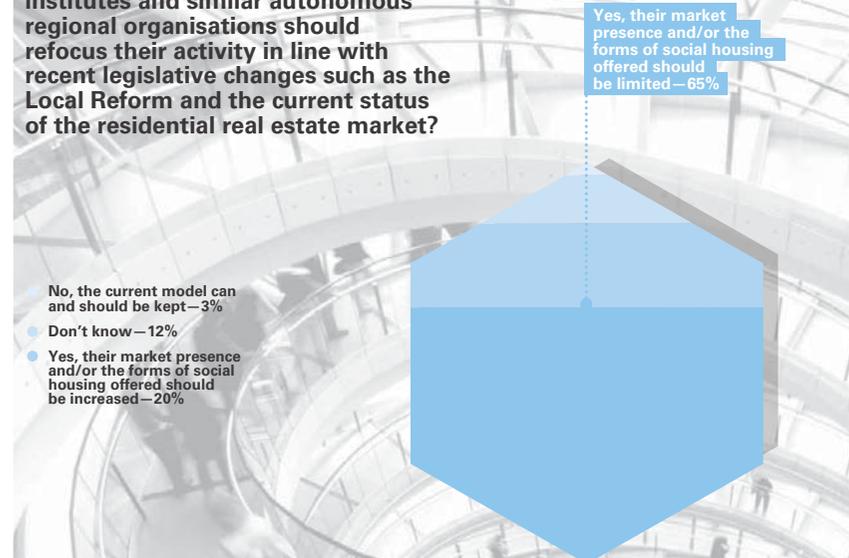
ment policies, the costs of which must be offset, in whole or in part, with major cuts to other items such as health or welfare. City centres are currently undergoing a process of gradual deterioration in parallel with the ageing of their residents. In order to minimise the effects of this degeneration, transformations are required to improve accessibility to buildings and energy efficiency, aspects that will have a positive knock-on effect on the quality of life of their citizens, as well as on the cost of building upkeep. Future housing policies must play their part in efficiently promoting this process to overhaul our cities. //

This calls for policies with a real capacity to transform the landscape,

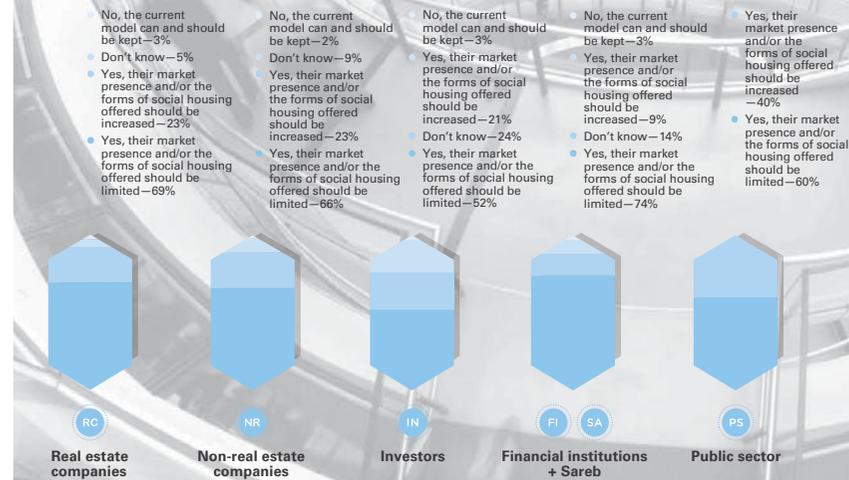
Lastly, it is vital to set in place urban regeneration and refurbish-

By Cándido Pérez, Partner in charge of Infrastructure, Transport, Governance and Health at KPMG in Spain.

Do you think that municipal housing institutes and similar autonomous regional organisations should refocus their activity in line with recent legislative changes such as the Local Reform and the current status of the residential real estate market?



Results by segment



SURVEY

The full results of the survey conducted to compile this report are available through this QR and at kpmg.com/es/RealEstate

The survey collates the answers of more than 150 real estate experts in the six major segments in the sector: real estate companies, non-real estate companies with some involvement in the sector, financial institutions, the Sareb, investors and the public sector.



/ CONTACT

Javier López Torres

Partner, Deal Advisory, in charge of
Real Estate at KPMG in Spain

91 451 30 20

flopez1@kpmg.es

Pedro Montoya Gómez-Comino

Director, Deal Advisory, Real Estate
at KPMG in Spain

91 456 82 67

pmontoya@kpmg.es



kpmg.es

© 2015 KPMG, S.A., a Spanish corporation and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved.

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

The KPMG name, logo and "cutting through complexity" are registered trademarks or trademarks of KPMG International.