

## The pain in Spain should be a carefully priced game

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As the recovery takes hold across Europe, confidence is growing among investors from around the world who see an opportunity to make strong profits by banking on improving returns and values for real estate in countries where property markets were hardest hit during the downturn.

In particular, US hedge funds are taking a growing interest in Europe – especially Ireland, Italy and Spain. Blackstone, Lonestar and Kennedy Wilson, for example, have shown interest in buying assets, including commercial property and loans, from the Irish government. With property prices in Dublin showing double-digit growth, these investors seem to be betting that the improvements in the Irish market will continue.

Certainly there are signs of growth across Europe but how significant these are, in real terms, is less clear. European Union forecasts put 2014 growth at 1.2%, led by Germany with 1.8%. In Greece, where the economy has contracted by a quarter, growth is predicted to be a meagre 0.6%. Even in the UK, research from Investment Property Databank shows that commercial property prices – which dropped 44% from June 2007 to July 2009 – have recovered by only 20%.

Is this a move back to steady, sustainable growth based on re-established fundamentals, or simply a tailwind of low inflation?

There are undeniably signs of positivity in some of the eurozone countries that were most affected by the recession, but these need to be put in context. There is, for example, evidence of some improvement in the Spanish economy but real estate there is still far from being prime, core or in any way a safe investment.

In recent months, we at Patron – like many others – have been looking at real estate investment opportunities in Spain. On a number of occasions, we have heard reports of US hedge funds offering up to 20% more than our offers. Of course, different investors have different outlooks and criteria, but such a significant disparity in pricing is unusual and potentially concerning.

There are two likely reasons behind this difference of opinion. The first is a variance in the expectation of how long the recovery in the hardest-hit European countries is likely to take, and therefore what returns will look like during that period. Whereas we have heard others talk of the sun shining on the Spanish economy in two years' time, our experience leads us to believe that four-plus years is a more realistic timeframe. Working to similar returns, these different forecasts give significantly different outcomes in terms of what constitutes an acceptable price.

The second possible reason is a variance in forecasts of asset values. Some investors are factoring a relatively rapid increase in asset values into the pricing of their bids. This has happened in other economies in the past: for example, when, as part of Lehman Brothers, we invested in France in 1994, the assets we purchased there did much better than expected, not necessarily because of our hard work to deliver the business plan, but primarily due to how dramatically the market recovered. But it is one thing to reap the benefits of this as an upside and another to rely upon it to make a reasonable return.

With growth forecasts for the UK recently upgraded from 2.4% to 2.7%, some investors are counting on the rest of Europe to follow suit. On the flipside, however, many opportunistic investors learned their lessons from investing in Germany, where even with much more solid fundamentals than countries such as Spain and Italy, things took a lot longer to turn around than everyone thought.

Every country in the eurozone has its own individual culture, characteristics and economy. It is impossible to say whether those bidding aggressively in markets such as Spain are right to be snapping up assets in a country where a rapid improvement in the economy cannot be predicted with any certainty.

What can, however, be said with some certainty is that the very real difference in opinions on sensible pricing for these assets highlights just how unprecedented the situation in Europe is and just how many funds are looking to take advantage of opportunities. How lucrative these opportunities will be at the prices at which some of them are being purchased, however, remains to be seen.

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