
THE WALL STREET JOURNAL

The Property Report

Real-Estate Finance: A Big Bet on a Spanish Recovery --- Colonial Debt Revamp Hints at an Improving Market

By William Boston Special to the WSJ

716 palabras

9 de diciembre de 2009

The Wall Street Journal

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When shares in Inmobiliaria **Colonial** SA, one of Spain's largest property companies, tumbled 40% within days two years ago, the company's decline was seen as a sign that the Iberian property boom had run out of steam.

Colonial now appears close to refinancing 4.9 billion euros (\$7.3 billion) in debt. That is one of the first indications that Spain's property markets could be near bottom. But the path to health remains a steep one for **Colonial**, whose stock remains at distressed values.

Last week, **Colonial** said that real-estate private-equity groups — **Colony** Capital Partners and Orion Capital Managers — had acquired **Colonial** debt from **Goldman** Sachs Group Inc, assuming **Goldman's** position as lender. The deal is part of broader talks to restructure **Colonial's** debt.

According to participants in the talks, **Colonial** and its lenders are close to agreeing to convert 35%, or about 1.7 billion euros, of the company's debt to equity. An additional 45% of the debt would remain linked to income from **Colonial's** properties and the remaining 20% would be linked to its development business.

The Spanish news agency EFE reported that **Colony** and Orion will convert debt with a nominal value of 1 billion euros into **Colonial** shares.

Colony and Orion declined to comment. A **Goldman** official couldn't be reached.

A report in the trade magazine EuroProperty said **Goldman** had lent as much as 1.5 billion euros to **Colonial** and sold the debt to **Colony** and Orion for 950 million euros, a hefty discount.

"This is a strong recovery play," says Michael Haddock, director of European research at property services company CB Richard Ellis in London. "They are putting their faith in **Colonial** and recovery of the Spanish market."

Recovery could be a long time coming. **Colonial's** shares are trading at around 18 European cents, hardly a vote of investor confidence, and have traded in a 52-week range from 11 European cents to 24 cents.

Spanish property values peaked in the third quarter of 2007, when capitalization rates on office property stood at 4.25%. Cap rates express the relationship between income and the costs of the property. A higher cap rate indicates falling prices. For the past three quarters, Spanish prime office cap rates have been stable at 6.5%, suggesting that capital values for the best office space in Madrid and Barcelona have fallen 35% since the peak in 2007.

The decline of property values in Spain hasn't stopped, though. While cap rates have stabilized, rents are still falling, hitting overall valuations.

"Commercial real estate still has further to fall in Spain," Mr. Haddock says.

Colonial owns offices, warehouses and shopping centers in Madrid, Barcelona and Paris. The firm is still suffering from piling on debt for acquisitions made at the top of the market, especially the 2 billion euro takeover of shopping center developer Riofisa in early 2007.

London-based Orion was formed in 1999 by three former executives from LaSalle Partners and is targeting the U.K. and Spain. Earlier this year, Orion tapped Roberto Roca, a veteran of LaSalle Investment Management, to run its Madrid-based Iberian operations.

Mr. Roca, who declined to be interviewed, has said Orion is keen to pick up distressed loans and property assets. In May, Orion bought Plenilunio, one of Spain's biggest shopping malls, for 235 million euros from Grupo Santander.

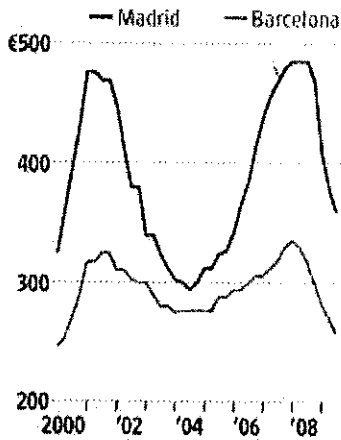
Colony, a Los Angeles real-estate private equity firm, is led by Tom Barrack, known during the boom for doing flashy deals. It helped lead the \$5.4 billion takeover in 2007 of Station Casinos Inc., which filed for bankruptcy this year. Last year, the firm bought the note backing Michael Jackson's Neverland Ranch.

Colony and Orion are not banking on a fast turnaround of the Spanish market. But they are betting that over the course of next year Spain's property market will begin to recover. With its debt made manageable, **Colonial** could be a good vehicle for them to ride a recovery of Spain's property market.

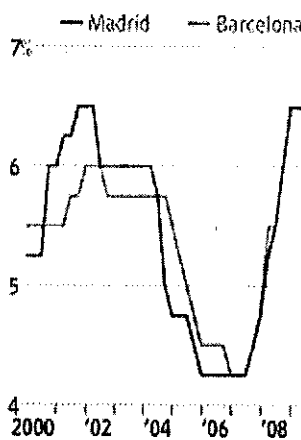
Hitting Bottom

Investors are betting the Spanish property market is nearing bottom.

Quarterly prime office rent, per square meter



Quarterly prime office yield^a



^a Net operating income relative to price
Note: €100=\$148

Source: CB Richard Ellis

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