

PROPERTY BOOM

Mexico's top transactional firms say real estate work can now bring in more money than any other practice area. Rosie Cresswell talks to the practice heads to find out how they are ensuring they get a slice of the action

Had you listened in to a group of young Mexican lawyers sizing up the most lucrative and exacting legal practices a decade ago, it is unlikely that real estate would have cropped up in the conversation. And rightly so – lacking in sophistication, and devoid of complex financing work, it was far too humdrum a field for the best and brightest to consider. But for today's budding equivalents, the story is very different.

For real estate practices in Mexico, business is booming, as is the market they serve. **LATINLAWYER** spoke to the practice heads at leading Mexican firms, all of whom have no end of work on their hands. More importantly, many say real estate transactions – some of which are profiled in this article – pulled in their firm's biggest fees of 2006.

They describe practices that have transformed alongside the property boom. Practitioners have adopted new skills to provide the assistance required for increasingly complex purchases and financing packages, and have watched lawyers flock to the practice as its image, and profitability, takes on an importance within the firm few could have imagined in the early 1990s.

It's no surprise the area is growing in popularity – the money in property in Mexico has ballooned spectacularly in the last ten years, so naturally lawyers are going to chase it. As Gonzalo Vargas of González Calvillo SC observes: "Firms and practitioners are realising just how much money is being devoted to real estate development. Having a real estate practice is trendy now, and important – it's where the big deals are taking place and there is a lot of potential for big professional fees."

Numerous factors have sparked Mexico's property explosion. A stable economy and more jobs in the early 1990s created a need for office and industrial space. Developers and construction companies duly responded, and today a drive from the centre of Mexico City up to Santa Fe reveals mile after mile of gleaming new office blocks, with more being built all the time to try and counter the dearth of office space. Rising wages and low inflation makes for a deep-pocketed middle

class with a penchant for spending their cash in huge new shopping malls. And favourable interest rates and better access to credit allowed more of that same group to buy houses – triggering a record housing surge.

With this much at stake, companies in the sector certainly think it is worth paying top dollar to hire Mexico's leading transactional law firms

During his presidency – between 2000 and 2006 – Vincent Fox made credit available to low-income households through Sofols – non-bank mortgage providers for the low- and middle-income population. Suddenly low earners were in the unprecedented position of being able to afford their own home – half a million more mortgages were provided in Mexico in 2006 than five years previously. Again, house builders leapt to the challenge. Cemex, which is providing a fair chunk of the raw materials for this boom, reported a 14 per cent jump in sales in Mexico last year, on top of a 9 per cent increase the year before. Tourism is another driver. The industry is worth US\$14 billion a year, despite problems caused by an increasing number of hurricanes. Baker & McKenzie's office in Cancún shows the client possibilities in the hospitality sector.

Before the 1990s, Mexico's property market belonged to local developers who relied quite happily on public notaries to oversee what were quite basic transactions. Times have changed. Foreign developers and investment funds have moved in, house builders such as Homex are breaking records with international offerings worth hundreds of millions of dollars, and home-grown mortgage providers like Hipotecaria Su Casita are tapping international markets with cutting edge security packages. Overseeing such transactions is not the work of a public notary, nor is masterminding the multibillion dollar purchases of prime real estate.

With this much at stake, companies in the sector certainly think it is worth paying top dollar to hire Mexico's leading transactional law firms. This is having a direct impact not only on the profitability of real estate practices, but on the bottom line of those law firms as a whole. Luis Moreno of Haynes & Boone says: "I would be very surprised if real estate was not one of the most profitable practices in all transactional firms in Mexico." And other lawyers' testaments back him up. Rodrigo Conesa of Ritch Mueller SC says: "Our largest billing clients were in real estate

Luis Moreno



AN ACQUISITION OF INDUSTRIAL PROPORTIONS

One of the weightier acquisitions to take place in Mexico's real estate sector last year was made by ProLogis.

The US distribution company snapped up a portfolio of industrial real estate, worth US\$238 million in cash and assumed debt last July – a high price tag by Mexican standards.

Seeing Mexico's economy take off, ProLogis recognised that there was a lucrative future to be had in providing distribution facilities to Mexican manufacturing outlets that sell to domestic markets, not just those that send their goods north of the border. So the company moved south from Monterrey, investing in land and buildings in six industrial parks in Mexico City and Guadalajara.

Guillermo Rivera Belden of Jauregui, Navarrete y Nader SC, counsel to the sellers, rates the deal as "the most important and interesting real estate transaction of 2006". Aside from the sheer value and size of the portfolio – 18 buildings comprising 3.5

million square feet, with room for a further 2.9 million square feet of development – the transaction deserves a mention because of the complexities of its structure.

ProLogis is a US public real estate investment trust and so has specific tax status in the US. ProLogis's legal team – from Ritch Mueller SC – needed to come up with a suitable structure to give it an efficient tax position in Mexico as well. "We established non-Mexican resident vehicles to buy the properties, which gave rise to legal and tax challenges such as having to obtain pre-qualifications for the newly formed entities before we could proceed with the transaction," remembers Rodrigo Conesa, who led the Ritch Mueller team.

On top of that, all of the properties had term financings on them that could not be altered. ProLogis had to take the financings on, but it meant the legal team had to accommodate the fact that they were granted in Mexico and that the purchasers

were the non-Mexican vehicles.

The acquisition increased ProLogis's Mexican portfolio by over 40 per cent. Five of the industrial parks that the new portfolio brings to ProLogis are in Mexico City, where the industrial market covers 31 million square feet, and demand for industrial real estate still far outstrips supply. Guadalajara is smaller, with a total industrial supply of about 20 million square feet, but demand is growing there too.

All of the buildings were constructed within the last six years and already, over a quarter of the space is leased to ProLogis's target group of manufacturers, retailers, transportation companies, logistics service providers and other companies with large-scale distribution needs in multiple markets.

Counsel to ProLogis

- Ritch Mueller SC

Counsel to Grupo GIM Desarrollos – the sellers

- Jauregui Navarrete y Nader SC

last year, and the practice was our largest income generator." At Santamarina y Steta, it sits only behind the corporate practice. Of course this is not a universal opinion – some say cross-fertilisation of practices makes it difficult to measure, while others, such as Jose Visoso of Galicia y Robles SC, say that although the profitability of the practice has grown considerably, it is still not the firm's biggest cash cow.

With such money flowing in, all the firms we spoke to for this article are investing heavily too, moving more and more manpower to their practices. All now have between one and three partners dedicating 60 per cent of their time or more to real estate, with anything up to ten associates helping them. A decade ago, a tiny handful of lawyers in Mexico would have described themselves as real estate specialists.

The big bang

The evolution of today's real estate practices began with M&A and finance lawyers drifting into early real estate transactions – like Haynes & Boone's Moreno, who, after working on two or three deals, realised quickly there was a great future in it, and went in search of similar deals, building his real estate experience along the way. He now leads the IBA's group for real estate lawyers. Similarly, González Calvillo's Gonzalo Vargas represented a golf course developer 13 years ago, saw there was money to be made, and has strived to bring in real estate deals

ever since. At Mijares Angoitia Cortés y Fuentes SC, M&A and financial lawyers have migrated to real estate as the deals got bigger and bigger.

Others were lucky to be approached by key international players. In 1993, General Electric saw the opportunities to provide real estate funding in Mexico. It asked Jáuregui Navarrete y Nader SC to come up with a legal structure to make the plan possible. The structure quickly became the market standard. "For a while, the vast majority of real estate funding in Mexico came from GE, so naturally our real estate practice grew," remembers Michell Nader. Reports that GE announced plans just last June to invest a further US\$400 million into Mexico's industrial and retail space suggest it will continue to keep the firm busy.

The average age of real estate practices in Mexico is between 10 and 13 years. Over those life times, lawyers have taken on new skills to bring in different types of deals. At Mijares Angoitia, for example, what began with banking lawyers working on financing deals soon morphed into a real estate practice that now works on fund creation, financing and M&A deals. Ritch Mueller also started out representing clients that were financing real estate, unsurprising considering the firm's core strengths and business, but has now moved the practice on from that. "As we gained experience in the industry we started taking on clients from the developing side. Now it is half and half," says Conesa.

Jáuregui Navarrete's Nader says that in his firm today, the real estate practice is one of the most sophisticated. "We cover three segments of real estate financing – lending, fund creation and acquisitions. We also represent some developers on a selected basis," he says.

The skill-sets drawn on by a real estate department are numerous. Banking lawyers will always have their place, particularly as local developers and financiers expand their use of capital markets to raise cash, and as foreign investment funds, disheartened by diminishing activity in the US real estate

Rodrigo Conesa





Jose Visoso

market, continue to find Mexico one of the more profitable alternatives.

But aside from core finance capacity, successful real estate practices also require unique skills, particularly since Mexico has made great efforts to modernise its real estate legislation so it stands up in the international arena. Now, rules governing land and property ownership are far more intricate, as Michael Fitzgerald of US firm Milbank Tweed Hadley & McCloy LLP illustrates: “Over the years, Mexico has come up the real estate learning curve. Title insurance that wasn’t in place five years ago is now, and land records are better kept.”

And as Mexico signs up to more international treaties, and as different types

of buyers and sellers enter the market, local companies have had to shape up too. “A decade ago, Mexican companies did not have to worry about their contracts complying with international standards in financing and environmental matters, now they have to take this into consideration,” says Baker & McKenzie’s Gaspar Gutierrez-Centeno.

Real estate clients expecting to benefit from the boom have had to keep pace with this increasing sophistication – Homex, for example, improved its corporate governance programme considerably for its international IPO in 2004 and it was nominated as the best Latin American company listed outside LATIBEX on the strength of its corporate governance by Spanish law firm Garrigues last year.

As companies need to be more sophisticated, so do their service providers. Law firms are noticing clients are singling out lawyers with real estate knowledge that is only learnt in the field. “Clients expect industry knowledge – experience and specialisation goes a long way now,” says Jáuregui Navarrete’s Nader.

After all, this is a multi-disciplinary patch – encompassing agricultural, condominium, environmental, permit, construction, hospitality, home ownership and leasing matters for a start. Lawyers need to be able to prove their skill-sets cover such issues. “Our real estate lawyers have gained experience in title insurance, entitlement, development and survey requirements,” says Jose Pozas of Santamarina y Steta, and at Ritch Mueller they must know “how to read maps and site plans and be able to calculate payments and work out agreements with developers,” according to Conesa.



Gonzalo Vargas

With such knowledge, lawyers can assure clients that they are signing up to a secure exchange – be it development, leasing or purchase. In spite of modernised legislation, lawyers suggest too that paperwork surrounding land ownership and property rights can still be questioned. Unversed lawyers might take a deed as given – relying on what a notary or an engineer has contributed to it in the past without understanding the language themselves.

As González Calvillo’s Vargas explains, there are areas in which an experienced real estate lawyer might be able to spot potential issues where others might not. “You cannot rely on a public registry report’s overview of potential encumbrances. Real estate lawyers

HOMEX – A HOUSEHOLD NAME ON INTERNATIONAL MARKETS

Desarrolladora Homex is one of the heavyweights of Mexico’s property sector. Not only is it one of the country’s biggest housing developers, it is also known for its appearances on local and international capital markets.

Last year, it made the headlines when its stock offering was tipped as Latin America’s largest equity offering of 2006 to date. Homex raised US\$255 million with a secondary stock offering in February on Mexican and US stock markets.

Secondary offerings are rare in Mexico, but that did not deter investors – the offering was oversubscribed more than 11 times, signalling the far-reaching appeal of Mexico’s real estate, according to Patricio Trad-Cepeda of Mijares Angoitia Cortés y Fuentes SC, who advised Homex and

the selling shareholders. “There is an all-time high interest in the Mexican housing industry, which has been on a boom for the past few years,” he notes.

The selling shareholders included a venture capital fund controlled by Chicago real estate investor Sam Zell, Equity International Properties, which sold one-third of its interest in Homex, and the former owners of Casa Beta, a housing company acquired by Homex in 2005.

The offering was underwritten by Citigroup and co-managed by Merrill Lynch and Morgan Stanley.

Homex broke records previously when it went public in 2005 – its US\$160 million IPO was the first Securities and Exchange Commission-registered and New York Stock

Exchange-traded offering to come out of Mexico for five years.

Counsel to Homex and selling shareholders

Mexico

- Mijares Angoitia Cortés y Fuentes SC

Counsel to Homex

US

- Milbank Tweed Hadley & McCloy LLP

Counsel to Citigroup

Mexico

- Ritch Mueller SC

US

- Cleary Gottlieb Steen & Hamilton LLP

need to personally review public records entries and do a title review up to the earliest background deed available.”

Like all practices, the real estate department draws on other departments, namely tax – most importantly for fund creation – and environment law. For Visoso’s team at Galicia y Robles SC, “the environment practice is crucial.” And Mijares Angoitia’s Patricio Trad believes that firms with an established environment practice have the edge on others for real estate deals, although the exact work depends on the deal. “If the project is commercial, in a city, then zoning will be an issue. If it is a hospitality development then health facilities and arable

Business for Mexican real estate lawyers is set to continue, and the market is far from exhausted

land are the matters in hand. Environment comes most into play with industrial spaces,” he says.

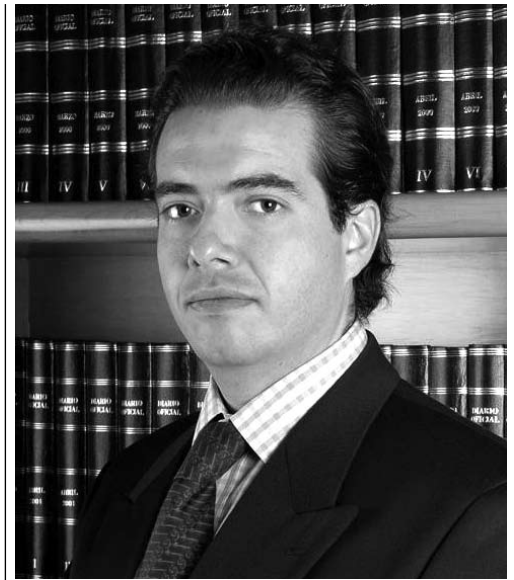
Clearly, Mexico’s real estate market is worthy of specialised legal practices. To a small extent these practices are splintering off further, with some lawyers increasing their specialisation in one area. A practitioner might choose to concentrate on retail or hospitality deals, as Baker & McKenzie is seeing. “Particular skills are required to organise hospitality projects, requiring knowledge of time shares, recreational clubs, and residential developments with a hospitality component,” explains Gutierrez-Centeno.

But so far, such specialisation is not the norm. Haynes & Boone’s Moreno believes “a good real estate practitioner should know all the industry branches.” At Santamarina y Steta, there are lawyers who focus more on retail or industrial work, “but there is not complete specialisation in Mexico yet, like the US,” says Pozas. “Specialisation is developing as the market requires. We are seeing real

estate legal areas develop to accommodate clients’ needs.”

But equally, it is simply not the done thing in Mexico to specialise – at least not for the first three or four years of a career. While young lawyers are increasingly drawn to a real estate practice, very few will focus on the field exclusively because they don’t like to close doors. And for firms, separating real estate lawyers from others can make little business sense. “We don’t really have real estate lawyers – rather transactional lawyers that know how to deal with real estate projects and matters,” says Haynes & Boone’s Moreno.

Business for Mexican real estate lawyers is set to continue, and the market is far from exhausted, as not all Mexican companies are fully aware of the money that could be made, or the requirements that must be fulfilled. Mexican bank Bancomer, for example, is in the middle of selling the largest office unit in Mexico City. Last week, a leading real estate lawyer had breakfast with a member of Bancomer’s senior management and discovered that, so far, outside counsel had not been retained.



Patricio Trad

Naturally, the lawyer pointed out how hiring real estate counsel would help and the listener “reacted favourably.” Should Bancomer act on the advice, whoever wins the instruction will have yet another very lucrative deal on their books.

NON-BANK MORTGAGE PROVIDER SETS THE TREND

Another star performer in Mexico’s housing sector that likes to make use of international capital markets is Hipotecaria Su Casita, Mexico’s leading non-bank mortgage lender for low and middle-income house buyers.

Su Casita led the way in its field last September, when it became the first non-bank mortgage provider in Mexico to offer high-yield bonds internationally, raising US\$150 million on markets in the US and Luxembourg.

The 10-year bonds, which have an 8.5 per cent coupon and are callable after five years, were over-subscribed three times. One reason for such international interest in bonds placed by Mexican real estate companies is the recent decline of US housing stocks. Investment funds have been forced to turn to more profitable markets, and over the last four years, there have been few as favourable as Mexico’s. As Michael Fitzgerald of Milbank, Tweed, Hadley & McCloy LLP, international advisors to Su Casita, said at the time of the offering: “Mexico’s housing sector is the place to be.”

But the issuance’s success is also thanks to Su Casita’s own financial might, as Patricio Trad of Su Casita’s local counsel, Mijares, Angoitia, Cortés y Fuentes SC, points out: “Casita was able to close the high yield back in 2006 due to its financial

strength and in light of its track record in the local markets. Investors were also very excited about buying debt from a strong player in the mortgage market that is independent from big banks.”

Su Casita is Mexico’s largest SOFOL – Sociedades Financieras de Objeto Limitado. SOFOLs were introduced by the Mexican government in 2000 as a means of promoting affordable housing. Today, Su Casita provides housing credit to 23 per cent of that market. It continues to pave the way for Mexico’s mortgage providers, making the first ever cross-border securitisation of Mexican residential mortgage loans in April this year, worth US\$253 million.

Counsel to Hipotecaria Su Casita Mexico

- Mijares Angoitia Cortés y Fuentes SC

US

- Milbank Tweed Hadley & McCloy LLP

Counsel to Credit Suisse, the underwriter Mexico

- Ritch Mueller SC

US

- Cleary Gottlieb Steen & Hamilton LLP