

**Cross-Border Expansion Strategy of U.S. Real Estate Development Firms:  
Entry and Operation Models in Brazil**

by

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Submitted to the Program in Real Estate Development in Conjunction with the Center for Real Estate in  
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**ABSTRACT**

Over the past several decades, technological advances, the spread of free-market ideology and the shifting of the economic center of the world have resulted in an incredible transformation of the world into a globalized, interdependent place. The term “globalization” has become an essential keyword associated with business in the modern world, creating great opportunities for U.S. firms to seek future growth potential in the global arena, especially in emerging markets that are undergoing rapid economic development.

Although the real estate industry has achieved some level of globalization in general, the *development* sector is one area of a broad real estate industry that has yet to show significant strides in global expansion activities. The purpose of this study is to examine the current business landscape of U.S. real estate developers’ globalization efforts and to create a qualitative analysis of why globalization works / does not work for real estate developers based in the U.S. The ultimate question the study asks and answers is **what are the key strategies that U.S.-based real estate developers should use to develop real estate property in emerging markets (Brazil, in particular)?**

Brazil was extensively investigated as the topic of this research. The research discovered some development risks in Brazil associated with the high levels of bureaucracy, tenants’ perception of the product and lack of market intermediaries. A number of American real estate development firms have successfully overcome these hurdles by forming strategic alliances with local partners and adequately responding to cultural and administrative distances between Brazil and the U.S.

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## INTRODUCTION

The term “globalization” has become a key word in the modern business world. Advances in communication and transportation, coupled with the advent of the internet in the 20<sup>th</sup> century, have blurred the physical boundaries between countries and cultures. These advances greatly increased the ease with which multinational firms can trade and operate in a vast, open market on the global stage and the aggregate level of global economic interdependence has increased exponentially in the past several decades. Currently, the trade of goods and services amongst countries account for 31 percent of the world’s total GDP, up from 23 percent in early 1999 and under 10 percent three decades ago. Foreign direct investment has also shown significant growth, from 1 percent of world GDP in 1990 to 2.2 percent in 2005.<sup>1</sup>

Such a rapid growth of economic connectedness is more pronounced in emerging markets, i.e., nations that are experiencing a rapid growth of industrialization toward becoming more affluent, and advanced economies. Many U. S. companies seeking growth either have a strong presence in or are considering these emerging markets because of the favorable economic conditions, rapid growth and tens of millions of untapped potential customers. Brazil, in particular, is an attractive market for its unique position as an economic power engine in South America, as well as its cultural proximity to more advanced Western countries relative to other emerging giants in the east like China and India.

While the trends of American firms’ rapid expansion into these emerging markets are certainly impressive, they do not imply that all industries in the U.S. are becoming globally integrated at the same rate. Real estate *development*, in particular, is one industry that remains relatively inactive in terms of

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<sup>1</sup> Vijay Govindarajan and Anil K. Gupta, *The Quest for Global Dominance* (Jossey-Bass, 2008), 5.

its global expansion efforts. The majority of American real estate development firms operate within the national borders of U.S.

A brief analysis of the terms *real estate development* and *globalization* may explain why there is a relatively low level of global presence of American real estate developers in international markets. Real estate, particularly real estate *development*, is a type of business that requires extensive knowledge and networks in a firm's specialized local area. On the other hand, the concept of *globalization* describes the very action of looking beyond the national borders, into foreign locations with little prior familiarity with the market. The apparent paradox present in these two concepts poses additional risks and challenges that other more "conventional" product or service industries may not experience.

The aim of this thesis is to understand the risks and challenges of particular relevance to real estate development practices in emerging markets, as part of a real estate developer's global expansion process. Brazil has been selected for investigation because of its strong long-term growth potential, status as a major regional power and relatively slight cultural difference from the U.S. The thesis will carefully analyze the opportunities and pitfalls of the globalization of real estate development, evaluate some of the development projects that have successfully been carried out in Brazil, and finally formulate realistic strategic guidelines for a business model of global expansion into the Brazilian market. Ultimately, this thesis will answer the question: **What are key strategies that U.S.-based real estate developers should use to develop a real estate property in emerging markets and in Brazil in particular?**

In order to guide the research process, the following three main methodological tools of investigation will be used:

- Literature Review

The thesis will first look at the globalization phenomenon in a generic sense and then attempt to understand its theoretical implications for the real estate development industry. The literature research will examine specifically the concept of *Institutional Voids* to understand challenges in emerging markets and develop a practical framework to overcome those challenges. The framework, designed to test the market conditions and absence of intermediaries of general industries in any emerging markets, will be adjusted accordingly to address the research topic of *real estate development* industry in *Brazil*.

- Case studies

The following two major office properties in Brazil built by American real estate developers will be closely examined:

Torre Almirante, Rio de Janeiro (Hines)

Torre Norte, Sao Paulo (Tishman Speyer)

The aim of the case studies is to analyze development risks that may occur in the development phases and to identify the actions that these firms took to resolve them. The way that these firms overcame the development risks in the case studies, as well as the lessons that they learned in each project phase will be the basis on which to build strategic guidelines for future real estate development projects in Brazil.

- Interviews

Qualitative analyses and assessments made by the actual managers of the development projects in the case studies will be integrated into the final recommendation part of the thesis. In-depth interviews with the following four managers have been conducted:

Daniel Cherman *Senior Managing Director, Tishman Speyer Brazil*: As Country Head of Tishman Speyer Brazil, Mr. Cherman oversees the firm's residential and commercial development activities in Brazil. For the thesis, Mr. Cherman has provided insights into Tishman Speyer's global expansion motives, its strategies for enhancing competitiveness in the Brazilian market and the development strategies taken from the Torre Norte project in Sao Paulo.

Daniel Citron: *CEO, Related Brasil*: Mr. Citron is currently in charge of Related Brasil's first development project in Brazil: a \$120 billion mixed-use complex in Sao Paulo. Mr. Citron's opinion of the opportunities of the real estate development industry in Brazil and potential risks associated with development practices in Brazil will be discussed in the Brazil overview section of Chapter III.

Steve Dolman: *Senior Managing Director, Hines Houston*: Before returning to his home office in Houston, Mr. Dolman served as Hines' Vice President and Project Officer for Brazil in early 2000s. He oversaw the full development spectrum of Hines' Torre Almirante project in Rio de Janeiro and provided detailed analysis of the tower's development phases and and of the important lessons that Hines had learned in the process.



*Bryan Koop Senior Vice President/Regional Director, Boston Properties:* Mr. Koop oversees the operation of Boston Properties' existing regional portfolio and develops new business opportunities in the Boston area. Mr. Koop provided a viewpoint of an American real estate developer's business model and an opinion of why local real estate developers like Boston Properties decided strictly to limit their development activities to U.S. markets only.

These interviews will be woven into the case study findings, allowing us to understand the cases in detail and to arrive at a practical overview of the development process in Brazil from the perspectives of industry experts.

## CHAPTER I: REAL ESTATE DEVELOPMENT IN AN AGE OF GLOBALIZATION

### GLOBALIZATION OVERVIEW

Expanding into global markets provides thousands of multinational enterprises with a broad scope of opportunities for growth and activities in different parts of the globe. By expanding their international presence, firms can increase their return through higher revenues or lower operating costs. McDonalds, for instance, considered by many an epitome of the multinational restaurant behemoth, has grown from a family burger-stand in 1940 to a global franchise with more than 30,000 stores in 118 countries around the world over the past several decades. Of its staggering \$27 billion revenues in 2011, international markets accounted for around 66% in sales.<sup>2</sup> In 2010, General Electric expected that emerging markets would account for 60 percent of its growth for the next decade, compared to 20 percent for the preceding decade. Of P&G's \$1.9 billion annual R&D expenditures, 30 percent is devoted to overseas emerging markets.<sup>3</sup> This kind of participation in international markets, especially in emerging economies, is expected to grow in the decades to come, since most of the increase in consumer demand over the next few decades will come from today's emerging markets.<sup>4</sup>

The reason for the acceleration of the globalization of multinational firms is that globalization is becoming increasingly desirable. There are a number of factors that explain this trend in globalization. First, an increasing number of countries are adopting a free market ideology and becoming part of integrated economic blocs. International trade is becoming easier and cheaper thanks to major trading blocs such as the EU (European Union), NAFTA (North American Free Trade Agreement) and ASEAN

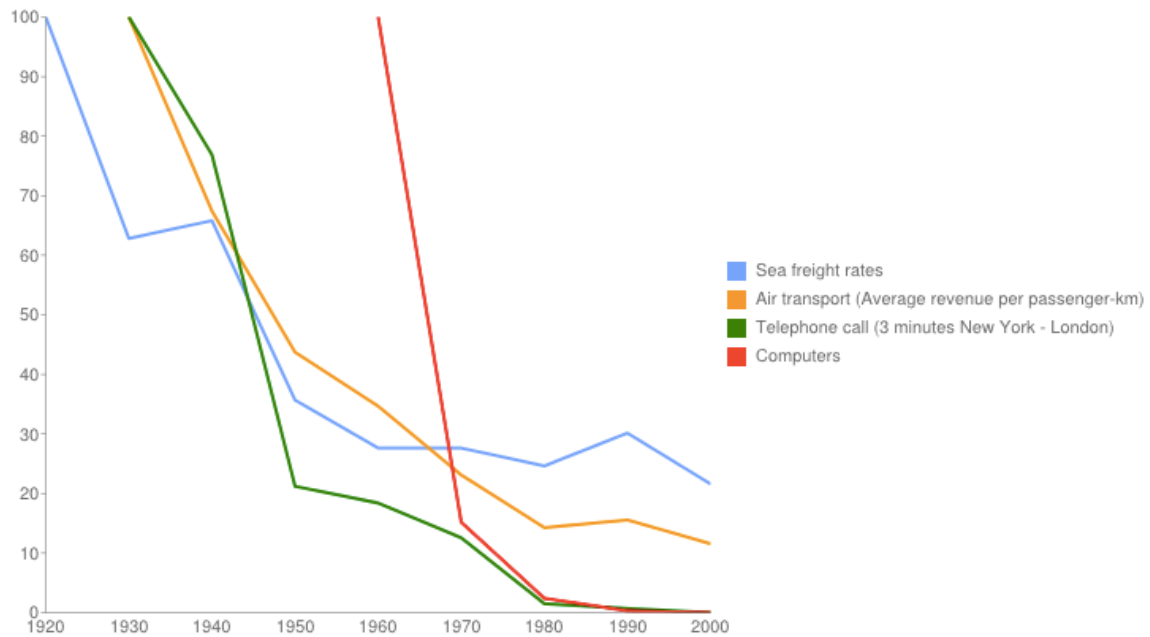
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<sup>2</sup> Eric Bleeker, "McDonald's: Looking at the International Opportunity," Updated Oct 24<sup>th</sup>, 2011, <http://www.dailyfinance.com/2011/10/24/mcdonalds-looking-at-the-international-opportunity>.

<sup>3</sup> Edgar Blanco, "Winning in Emerging Markets: Five Key Supply Chain Capabilities" (Research from the Center for Transportation & Logistics, MIT, 2008) 3.

<sup>4</sup> United States National Intelligence Council, "*The Contradictions of Globalization*," (The Royal Institute of International Affairs and The National Intelligence Council, 2005), 20.

(Association of Southeast Asian Nations). Second, technological advancements have dramatically reduced the costs of communication and transportation. By the early 2000s, the costs of maritime freight, air transportation and telephone calls were about a 25%, 11% and less than 1% respectively of their 1920s levels, respectively (see Figure 1). Sustained developments in transportation



<Figure 1> Transportation and Communication Costs Index, 1920-2000<sup>5</sup>

and communications led to lower operational expenses and lower travel costs, making international expansion much more attractive. Lastly, the economic center of the world is shifting from the developed countries to emerging countries. Many developing countries, such as China, Brazil and India, have been experiencing massive economic growth and integration on the global stage throughout the 21<sup>st</sup> century.<sup>6</sup> They are essentially growth engines of the world's economy of today, providing further growth opportunities for the multinational firms described above. In 2007-2008, the growth rate of developing economies was 7.1%, compared with 2.7% in advanced economies (see Figure 2 below).

<sup>5</sup> UNDP 1999, *Human Development Report 1999*, UNDP, 30.

<sup>6</sup> Vijay Govindarajan and Anil K. Gupta, *The Quest for Global Dominance* (Jossey-Bass, 2001), 13.

	1989-1998	1999-2008	2006-2007	2007-2008
Advanced economies	2.7	2.6	2.5	2.7
Developing economies	3.8	6.4	7.5	7.1
World total	3.2	4.4	4.9	4.9

<Figure 2> Comparative Data on Economic Growth Rates of Different Groups of Countries<sup>7</sup>

## DEFINING GLOBALIZATION

Aside from the aforementioned multinational enterprises' efforts in expanding in international markets, the term *globalization* can generate diverse and sometimes emotional reactions because of its numerous implications to different people. So what does it really mean for a firm to *globalize*? In his book, *The Race to the Top: The Real Story of Globalization*, Thomas Larsson defines globalization as "the process of world shrinkage, of distances getting shorter, things moving closer. It pertains to the increasing ease with which somebody on one side of the world can interact, to mutual benefit, with somebody on the other side of the world."<sup>8</sup> Although the term is clearly defined here, in general, *globalization* is a very broad term. Perceptions of the impact of globalization vary widely, ranging from the convenience of purchasing foreign products in the local store to improvements of living standards to ill effects such as industrial pollution.<sup>9</sup>

In order to keep ourselves from getting lost in the broad spectrum of this concept, the very first step in applying the concept of *globalization* in any context is to limit the scope of investigation. In this thesis,

<sup>7</sup> International Monetary Fund 1999, *World Economic Outlook 2007*, International Monetary Fund, 169.

<sup>8</sup> Tomas Larsson, *The Race to the Top: The Real Story of Globalization* (Cato Institute, 2001), 9.

<sup>9</sup> Oded Shenkar and Yadong Luo, *International Business* (Sage Publications, 2008), 2.

we will adopt Larsson's definition to focus on the topic of research. We will frame the process of *globalization* as "the process of shortening the physical and psychological distances between the United States, an advanced economy, and Brazil, an emerging economy." This process "pertains to how real estate developers in the United States can increase the ease of interacting, to mutual benefit, with diverse entities in the Brazilian real estate development industry."

### **GLOBAL FOOTPRINT OF REAL ESTATE DEVELOPMENT INDUSTRY**

Contrary to the robust growth figures of the current globalization footprint of multinational enterprises described in the previous sections, most of American real estate developers opt to operate only in the domestic or, in many cases, regional market. Although numerous purchases of American landmark buildings like the Rockefeller Center in New York City and Arco Plaza in Los Angeles by foreign investors have made the headlines, globalization of real estate has been largely remained a local business,<sup>10</sup> or, at most, limited to investments activities. In other words, U.S. developers dominated the U.S. markets and foreign developers dominated the foreign markets. The scope of activity of the few developers that do operate internationally ranges widely, from fully-fledged activities spanning five continents, to a selected few English-speaking developed markets, to licensing their brand to other foreign partners. We will examine in detail the following three American real estate developers that either have developed a number of major properties overseas or have a solid planned project under way.

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<sup>10</sup> Ashok Bardhan and Cynthia Kroll, "Globalization and the Real Estate Industry: Issues, Implications, Opportunities" (Paper Prepared for the Sloan Industry Studies Annual Conference, 2007).

### *HINES INTERESTS LIMITED PARTNERSHIP*

Hines is a privately held real estate development, investment and management firm based in Houston, Texas. Founded in 1957 by Gerald Hines, the company has completed, acquired and managed more than 1,273 properties of diverse asset classes including office, mixed-use, industrial parks, resorts and residential communities (See Figure 3). The total value of the assets that the firm controls comes to approximately \$24.3 billion.<sup>11</sup> Since launching its first international office in Mexico City in 1992, Hines expanded its international presence in 18 different countries and developed 462 million square feet of properties in areas spanning Australia, Europe, North and South America, India and China.



<Figure 3> Hines Global Footprint. Red dots represent real estate properties currently under Hines management or ownership<sup>12</sup>

### *TISHMAN SPEYER*

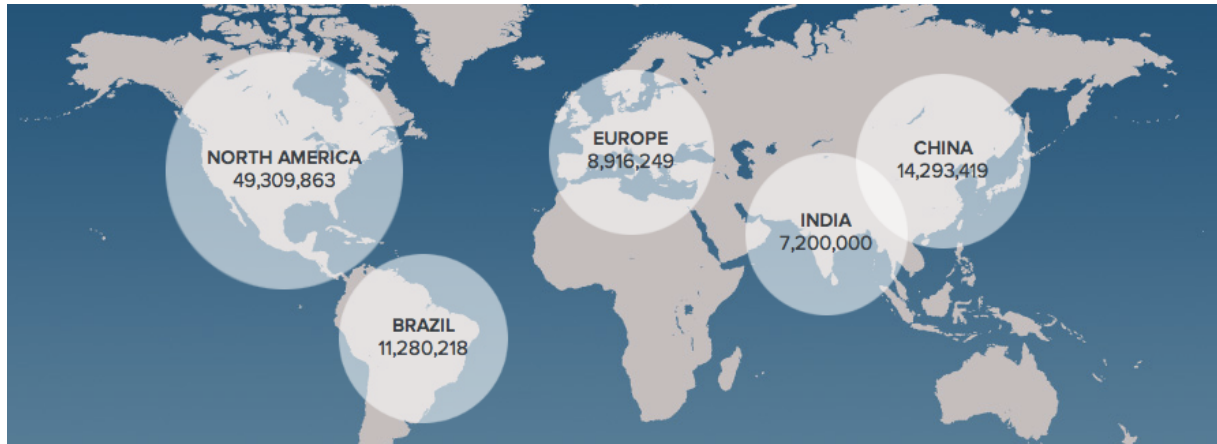
Tishman Speyer is a real estate development and operating company based in New York City. Founded in 1978 by Robert V. Tishman and Jerry I. Speyer, Tishman Speyer completed its first international property, MesseTurm, in Frankfurt, Germany in 1990. Since then, the firm has expanded its international presence into Europe, Brazil, India and China, having acquired, developed and operated over 355 projects in their global real estate portfolio valued at \$64.4 billion in total value. Of 92,750,000

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<sup>11</sup> "Overview: Setting the standard in real estate the world over," Hines, accessed July, 2013, <http://www.hines.com/about/>.

<sup>12</sup> "Property Search," Hines, accessed July, 2013, <http://www.hines.com/property/>.

square feet total assets, international properties account for about 42,000,000 square feet, 45% of the entire assets (see Figure 4).



<Figure 4> Tishman Speyer's global properties map. The numbers in each circle shows square footage of the firm's properties in each region.<sup>13</sup>

#### *RELATED COMPANIES*

Related Companies is a privately held real estate firm based in New York City, founded in 1972 by Stephen Ross. The company owns and operates a real estate portfolio valued at around \$15 billion, in diverse asset classes including luxury residential, mixed-use, office and retail.<sup>14</sup> Although the company is pursuing a number of international projects in Abu Dhabi and China in the form of JV partnership and as a development advisor, Related Companies' global expansion efforts have not yet been a major part of the company's development activities. However, the company, together with Related Group based in Miami, recently set up its Brazilian arm, Related Brasil, and decided to pursue a \$120 billion mixed-use project, thus becoming the biggest developer in the country.<sup>15</sup>

<sup>13</sup> "Our Global Properties," Tishman Speyer, accessed July, 2013, <http://www.tishmanspeyer.com/properties>.

<sup>14</sup> "Operating Portfolio," Related, accessed July, 2013, <http://www.related.com/our-company/businesses/19/Operating-Portfolio>.

<sup>15</sup> Georgiana Mihaila, "Related Aims to Become Brazil's Biggest Developer, Plans \$1B Investment," MHN Online, March 8, 2012, accessed July, 2012, <http://www.multihousingnews.com/news/related-aims-to-become-brazils-biggest-developer-plans-1b-investment/1004050427.html>.

The single most important motive for these firms to expand outside the U.S. national borders is to tap the growth potential of foreign markets. Daniel Cherman, Senior Managing Director at Tishman Speyer says that, since their first international project in Frankfurt Germany, Tishman Speyer continued to look for opportunities in overseas markets that have “potential for strong demands for long-term growth,” which has a “possibility to create the team that would be in the market for the long term.”<sup>16</sup> In other words, real estate development firms can gradually solidify their market presence over time, while geographically diversifying their portfolio.

Another strong motive for the American real estate developers’ global expansion is the demand from their existing tenants. Many of these real estate development firms have already established strong relationships with global companies headquartered in the U.S. through the provision of products or services. When these U.S.-based multinational companies go global and set up an international office overseas, they want their space to be developed with the “same standard of quality and service that they have in their home market.”<sup>17</sup> Expanding into the international markets is a way of responding to those demands from the tenants with which real estate developers have strong relationships.

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<sup>16</sup> Daniel Cherman, telephone interview with author, May 15, 2013.

<sup>17</sup> Stevel Dolman, telephone interview with author, July 18, 2013.



## CHAPTER II

### PITFALLS AND CHALLENGES IN INTERNATIONAL REAL ESTATE DEVELOPMENT

Despite the active globalization movements of the international real estate development activities into overseas markets, the majority of the American developers opt to stay in the domestic market. At one end of the globalization spectrum are global real estate developers such as Hines or Tishman Speyer and at the other are there are domestic business oriented real estate development firms that typically tend to focus on a specific target market within the U.S. Their business model focuses on extensive knowledge and networks in the specialized market. Boston Properties is an example of these developers that adhere only to the market they specialize in and has consciously decided that the global expansion model does not work for their domestic-only business model.

#### **BOSTON PROPERTIES FORMULA: “STICK TO WHAT YOU KNOW”**

Boston Properties, Inc., headquartered in Boston, Massachusetts, is a self-administered and managed REIT that acquires, develops and manages mostly Class-A office buildings in the U.S. The company’s property portfolio is comprised mainly of Class-A office properties and specializes in developing premium Central Business District (CBD) office buildings, suburban office centers and projects for the U.S. government.<sup>18</sup> Boston Properties has a business model that is clearly defined as follows:

- *Concentrate on a Few Carefully Selected Geographic Markets*

Boston Properties focuses their development and investment activities exclusively on five major markets in the U.S.: Boston, New York City, Princeton (New Jersey), San Francisco and

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<sup>18</sup> “Boston Properties Overview,” Boston Properties, accessed July, 2013, <http://www.bostonproperties.com/pages/about>.

Washington D.C. (see Figure 5). They have strictly adhered to a selected few markets since the founding of the firm and this focus is thus rooted in the company's DNA and culture.



<Figure 5> Boston Properties Office Products: Prudential Tower in Boston, Citigroup Center in New York City, Democracy Tower in Washington D.C. and Embarcadero Center in San Francisco (clockwise)<sup>19</sup>

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<sup>19</sup> "Boston Properties Overview," Boston Properties, accessed July, 2013, <http://www.bostonproperties.com/pages/about>.

- *Concentrate Activities Where High Barriers to Entry Exist*

Boston Properties deliberately seeks markets that, with a lack of available sites and a difficulty in receiving permits, require extensive skills and financial strengths in building an office property. In this way, they eliminate major competition from other developers, while establishing a strong foothold in their chosen market.

- *Leverage the Skills of Management Team*<sup>20</sup>

Boston Properties pursues highly complex and technically challenging projects, leveraging the extensive development knowledge and resources in the firm successfully to acquire and develop properties.

These clearly defined strategies, the mantra of “stick to what you know,”<sup>21</sup> have allowed them to develop skills and resources and services that are hard to compete with and have made them a successful industry leader for decades. Their core strategies entail focusing on a selected few, high-barrier markets and resourcing extensive local knowledge and the firm is highly risk averse when pursuing a new development project outside of their specialized markets.

The attributes that made Boston Properties so successful in the U.S. market are the very reason that the firm deliberately stays away from any development opportunities overseas, especially in emerging markets like Brazil. Bryan Koop, Senior Vice President and Regional Manager of Boston Properties, sees the two most critical risks involved in building in a developing/emerging country to be valuation and

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<sup>20</sup> “Boston Properties Strategy,” Boston Properties, accessed July, 2013, <http://www.bostonproperties.com/pages/about/our-strategy>.

<sup>21</sup> Terry Pristin, “Boston Properties Sticks to Its Formula,” June 26, 2012, accessed July, 2012, <http://www.nytimes.com/2012/06/27/realestate/commercial/boston-properties-stays-with-a-winning-formula.html?pagewanted=all&r=0>.

permitting.<sup>22</sup> In a foreign market, Boston Properties clearly lacks market knowledge to evaluate whether or not certain project site is priced fairly. Nor do they have access to reliable market data to address this issue. Concerning permitting, Koop explains that the intricate local regulations may hinder Boston Properties' competitive advantage because they do not know the nuts and bolts of the specific market's regulations, an attribute that makes Boston Properties excel in its home markets. They consider any unforeseeable regulatory issues or changes in the development process a critical risk. Furthermore, the fact that Boston Properties must send out the best manpower to these foreign markets may create negative reactions from investors and Wall Street.<sup>23</sup>

Boston Properties' case clearly shows that, no matter how lucrative foreign operations may be, it is not a desirable choice unless the firm's inherent business model is predisposed to them. Boston Properties' founding principle and business model –pursuing a selected few high-barrier markets that they know best—are simply not designed to extend beyond their target markets. Boston Properties is, in fact, well aware of the tremendous opportunities present in emerging markets such as Brazil and China. However, their best strategy to achieve sustained success as a real estate developer is to “stick to what they know.”

## **PITFALLS IN INTERNATIONAL REAL ESTATE DEVELOPMENT**

As illustrated in the Boston Properties case, many real estate developers in the U.S. shy away from expanding into international markets, especially emerging markets, because of their unfamiliarity with the local regulations and market value of properties. If we examine the nature of the real estate development industry, it is clear why this is so. Unlike many of the “conventional” consumer products

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<sup>22</sup> Bryan Koop, telephone interview with author, July 18, 2013.

<sup>23</sup> Ibid.

or service industries described earlier, real estate property is an asset that is physically and permanently fixed in one specific location, and cannot be shipped, delivered or moved to another location. Much of the development activities must therefore happen at a specific location, or at least in a particular country, where the actual asset sits. Thus, while exchange of ideas and communications is still relatively easy, the question of location creates other complications in collecting good market data or analysis at the level of detail achieved in the United States.<sup>24</sup> A lack of local knowledge and inefficiency in local tradability of real estate asset are precisely the reasons that, as Bradahn and Kroll say, “discussions of globalization in the 1990s and earlier, overlooked the real estate industry as a possible participant in the ongoing phenomenon of increasing global economic integration.”<sup>25</sup> These factors that make real estate development overseas more challenging pertain to the specific nature of the development practice. In a more general sense, a number of international business scholars talk about “voids” that exist in the emerging markets that hinders the effective functioning of multinational companies. The following section describes these *Institutional Voids* in detail.

## **INSTITUTIONAL VOIDS**

Increasing global integration does not necessarily generate the productively functioning markets that one can expect in developed countries. When observing the business landscape in emerging markets like Brazil, managers must recognize the level of institutional development and the extent to which it helps the market to function properly in a particular industry.<sup>26</sup> Diverse arrays of intermediaries must exist in the country in order to support a business’s functions (or transactions) in the market, and most emerging markets, as well as developing countries, fall short of such a system, leaving a “void” in the

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<sup>24</sup> Dean Schwanke, *Mixed-Use Development Handbook* (Urban Land Institute, 2003), 34.

<sup>25</sup> Ashok Bardhan and Cynthia Kroll, “Globalization and the Real Estate Industry: Issues, Implications, Opportunities” (Paper Prepared for the Sloan Industry Studies Annual Conference, 2007), 1.

<sup>26</sup> Tarun Khanna and Krishna G. Palepu, *Winning in Emerging Markets: A Road Map for Strategy and Execution* (Harvard Business Press, 2010), 16.

functioning of the market. In their book, *Winning in Emerging Markets*, Tarun Khanna and Krishna Palepu use the term *Institutional Voids* to describe this condition in the emerging markets.<sup>27</sup> For example, in emerging markets, it may be difficult for buyers and sellers to access objective and reliable information regarding products and services, or there may be a lack of adequate contractual means or arbitration to mediate any disputes that may arise. Anticipating the institutional voids helps managers to spot any lacunae created by the lack of such intermediaries in these markets.<sup>28</sup> The *Institutional Voids* can be found in the following broad categories in a market:

*Product Markets:* Do businesses and consumers have access to reliable third-party information providers to conduct proper market/product research?

*Capital Markets:* Does the market have adequate financial intermediaries such as commercial banks, insurance companies and mutual funds to help investors facilitate capital for investment and operation activities?

*Labor Markets:* Does the market have adequate educational institutions and headhunters to help employers find talent, develop human capital and ensure the quality of the professionals?

The voids in these categories can happen in any industry, including real estate development. For instance, Boston Properties' lack of knowledge in the market price of real estate properties or land to acquire in a foreign market is due in large part to the absence of fully functioning intermediaries that could provide solid and reliable data. Applying and spotting such institutional voids, therefore, should

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<sup>27</sup> Tarun Khanna and Krishna G. Palepu, *Winning in Emerging Markets: A Road Map for Strategy and Execution* (Harvard Business Press, 2010), 14.

<sup>28</sup> *Ibid.*

be a crucial part of the strategic process for firms in U.S. that wish to reach customers in emerging markets. To help tackle the issues related to the real estate development process, Khanna and Palepu provide a toolkit to identify these institutional voids which any enterprises that wish to expand overseas can use.

The following tables are organized to provide a clear and detailed idea of the institutional voids. The first set of tables helps the reader spot what kind of institutional voids exists in U.S. markets and in other major emerging markets, namely Brazil. The second table provides a set of strategic choices for a firm to take when faced with these voids. Both tables describe the voids in generic industries like consumer products or technology firms. Therefore, the tables have been modified and framed to reflect the real estate development industry and the real estate market in Brazil, in order to stay within the scope of this research.

*SPOTTING INSTITUTIONAL VOIDS IN REAL ESTATE DEVELOPMENT INDUSTRY*<sup>29</sup>

<Product Markets>

	Institutional Voids in General Consumer Product Industry	Institutional Voids in Real Estate Development Industry
United States	Well-developed, highly competitive retail sector with strong and varied retail chains and wide range of Internet-based vendors.	Extensive and developed networks of brokerage and real estate market data. Firms can rely on these sources before acquiring or repositioning a property or piece of land.
Brazil	Supermarkets, hypermarkets, department stores, including foreign retailers such as Carrefour and Walmart, have growing presence, though focused in urban centers. Shopping center sales account for almost one-fifth of retail sales.	Sporadic and inconsistent brokerage practice and market data. In order to get access to standardized and reliable market and leasing transaction data, firms may create their own exclusive team of agents.

<Capital Markets>

	Institutional Voids
United States	Companies can easily get bank loans. The corporate bond market is well developed. The integration of stock exchanges gives companies access to a deep pool of investors.
Brazil	A good banking system exists, and there is a healthy market for initial public offerings. Wealthy individuals can invest in offshore accounts.

<Labor Markets>

	Institutional Voids
United States	A large and varied pool of well-trained management talent exists.
Brazil	The large pool of management talent has varying degrees of proficiency in English. Local and expatriate managers hold senior management jobs.

<sup>29</sup> Tarun Khanna and Krishna G. Palepu, *Winning in Emerging Markets: A Road Map for Strategy and Execution* (Harvard Business Press, 2010), 30.



*RESPONDING TO INSTITUTIONAL VOIDS*

<b>Strategic Choice</b>	<b>Options</b>	<b>Options for Real Estate Developers in Brazil</b>
Replicate or Adapt?	Replicate business model, exploiting relative advantage of global brand, credibility, know-how, talent, finance, and other factor inputs.	Replicate the business model (brand, know-how, financing, etc.) and product (design, finishes, services, etc.) in Brazil real estate market.
	Adapt business models, products, or organizations to institutional voids.	Modify the business model and product to reflect the demands and needs of tenants in Brazil.
Compete Alone or Collaborate?	Compete alone.	Compete alone.
	Acquire capabilities to navigate institutional voids through local partnerships or JVs.	Acquire capabilities of local real estate developers, investors or general contractors by forming a JV.
Accept or Attempt to Change Market Context	Take market context as given.	Take market context as given.
	Fill institutional voids in service of own business.	Fill institutional voids in Brazil real estate industry by providing various real estate services like market research, brokerage or project management.
Enter, wait, or exit?	Enter or stay in market in spite of institutional voids.	Enter or stay in Brazil in spite of institutional voids.
	Emphasize opportunities elsewhere.	Focus on U.S. markets, other developed markets or emerging markets other than Brazil.

Using these institutional voids tables, development managers can look beyond the simple administrative and cultural challenges in the development process, and formulate strategies to tackle issues related to the gathering of reliable real estate market data and to access to appropriate tenant brokerage and human resources in Brazil. Additionally, the tables can help development managers build the essential frameworks to tackle these institutional voids in advance, which would minimize any risks in the development process.

## **CHAPTER III**

### **REAL ESTATE DEVELOPMENT CASE STUDIES IN BRAZIL**

#### **INTRODUCTION**

This chapter will examine the details of two of the successful real estate development projects in Brazil. Each project has been completed by one of the previously discussed prominent real estate developers in the U.S.: Torre Almirante by Hines and Torre Norte by Tishman Speyer. The case studies have been selected on the grounds that 1) they are both one of the firms' earliest projects in Brazil and 2) they have achieved great success both in financial returns and in their status as a major landmark building in the region.

These developers chose Brazil as a strategic international location for their projects shares with common rationale: Brazil is an attractive market that has a tremendous amount of long-term growth potential. Moreover, compared with those of other emerging economies in Asia and the former-Communist East European nations, Brazil's cultural and political landscape is closer to that of Western countries like the United States. Thus, Brazil seems to be an attractive and accessible market in which these global development firms can effectively diversify their global portfolio.

#### **BRAZIL: OVERVIEW**

The Federative Republic of Brazil is the largest country in South American continent and the fifth largest country in the world, both by geographical area and population. It is considered a major political and economic power in Latin America. Brazil's population, 201 million in 2013, accounts for almost half of that of South America; its land area of 3.28 million square miles occupies 47% of the South American

continent; and it is the only Portuguese-speaking nation on the continent (see Figure 6).<sup>30</sup> The capital city of Brazil is Brasilia, but the cities of Sao Paulo and Rio de Janeiro function as economic, cultural and business centers of the country.



<Figure 6> Flag and map of Brazil (Images source: CIA The World Factbook: Brazil<sup>31</sup>)

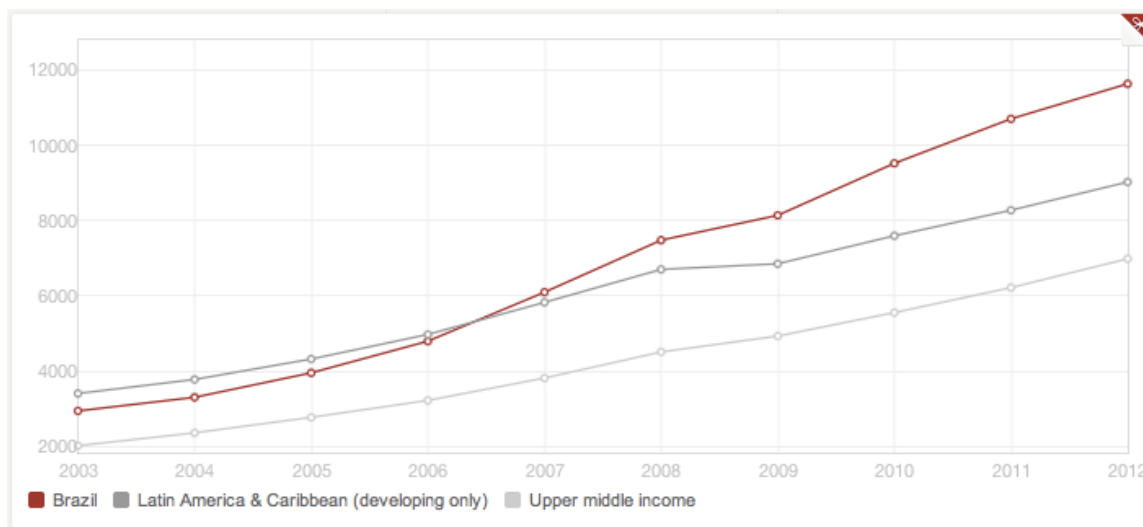
## ECONOMY

Decades of modernization transformed the country from a rural and single-product country (for example, wood, coal, sugar and coffee) into one of the fastest growing economies in the world. Along with Russia, India and China, Brazil is one of the BRIC economies (a term coined by Goldman Sachs that refers to the countries that will eventually become the global economic powerhouses in the 21<sup>st</sup>

<sup>30</sup> "The World Factbook: Brazil," CIA, accessed July, 2013, <https://www.cia.gov/library/publications/the-world-factbook/geos/br.html>.

<sup>31</sup> Ibid.

century).<sup>32</sup> It will become the world's fourth-largest economy by 2030, behind China, the U.S. and India. More important, in the past eight years over 40 million Brazilians—almost the size of Spain's population—have been lifted out of poverty and into the middle classes, with access to health, education, credit and formal employment.<sup>33</sup> Brazil's GNI (Gross National Income) per capita has been growing at a steady rate, outpacing other Latin American and Caribbean countries to reach almost \$12,000 in the year 2012 (see Figure 7).



<Figure 7> GNI per capita: Brazil vs. other Latin American countries<sup>34</sup>

Brazil has enjoyed very strong and sustained economic growth for decades, despite a short recession in the global financial crisis in 2008. Such expansion of economic power has largely been powered by a growing middle class in the country, which increased domestic purchasing power and demand.<sup>35</sup> Higher interest rates made the country an attractive destination for FDI, which accounts for about 2.2% of national GDP. In 2008, rating agencies classified the country as a “safe investment,”<sup>36</sup> helping to attract even more foreign investments into the country. In 2011, FDI in Brazil rose to \$69.1 billion, raising the

<sup>32</sup> S. George Philander, *Encyclopedia of Global Warming and Climate Change, Second Edition* (SAGE Publications, 2012), 148.

<sup>33</sup> “The Brazilian Model.” *The Economist The World in 2012* (2012), 30.

<sup>34</sup> CIA. “The World Factbook: Brazil,” accessed July, 2013, <https://www.cia.gov/library/publications/the-world-factbook/geos/br.html>.

<sup>35</sup> Luciana Lopez, “Factbox: Key Facts About Brazil’s Economy,” *Reuter*, November 19, 2010, accessed July, 2013, <http://uk.mobile.reuters.com/article/summitNews/idUKTRE6AI3ZZ20101119?ca=rdt>.

<sup>36</sup> Brasil Literature. “Brazil- A Growing Economy,” accessed July, 2013, [http://www.buchmesse.de/pdf/buchmesse/facts\\_and\\_figures\\_brazil\\_2013.pdf](http://www.buchmesse.de/pdf/buchmesse/facts_and_figures_brazil_2013.pdf).

FDI-GDP ratio to 2.78%.<sup>37</sup> Businesses have also been able to increase their profits in recent years. The profits of 260 of the companies listed on the Brazilian stock exchange – the second largest stock exchange on the American continent and the third largest in the world – have doubled. Although the GDP growth rate has been stagnant in recent years due to rising inflation and the sluggish international economic situation, Brazil’s overall macroeconomic framework is considered sound and sustainable for the near future.<sup>38</sup> The World Cup of 2014 and the Olympic Games of 2016 are expected to generate massive investments in urban area and the transport infrastructure in Brazil.<sup>39</sup>

#### *REAL ESTATE MARKET IN BRAZIL*

Sustained periods of economic growth and a surge in the middle class over the past decades in Brazil have given many Brazilians, and foreign investors alike, confidence to invest in real estate properties in many urban areas including Rio de Janeiro and Sao Paulo. Real estate prices have been surging in these markets for the last decade, more recently buoyed by positive externalities such as the discovery of oil in Libra field, the forthcoming FIFA World Cup in 2014 and the summer Olympic games in 2014. For example, house price growth over the last five years has averaged 23% annually in Rio, and 17% in Sao Paulo.<sup>40</sup> And the hot property market in Rio is likely to continue beyond the one-time event of the Olympics, because of the country’s rising incomes.<sup>41</sup> The mortgage market was almost nonexistent until the 1990s, but has been growing rapidly since late 2000s. Mortgages have become much more affordable to the newly created middle class after the central bank lowered interest rates.<sup>42</sup> Many developers based in the United States are making a sizable bet on Brazil’s real estate investment

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<sup>37</sup> “Brazil Overview,” The World Bank, accessed July 2013, <http://www.worldbank.org/en/country/brazil/overview>.

<sup>38</sup> Ibid.

<sup>39</sup> Ibid.

<sup>40</sup> Les Calvert, “Brazils Booming Housing Market Attracts Home And Overseas Investors,” June 25, 2013, accessed July, 2013, <http://www.property-abroad.com/brazil/news-story/brazils-booming-housing-market-attracts-home-and-overseas-investors-19317731>.

<sup>41</sup> Alexei Barrionuevo, “Staking a Claim in South America,” March 21, 2013, accessed July, 2013, <http://www.nytimes.com/2013/03/24/realestate/americans-invest-in-south-american-real-estate.html>.

<sup>42</sup> “Booming Brazil,” *Global Perspectives To Local, International & Lifestyle Real Estate* (April 2013): 2

opportunity; Related Group, based in Miami, predicts that Brazil will be in need of new upscale housing over the next decade, and has established a Brazilian subsidiary to invest in a \$100 million mixed-use complex.<sup>43</sup> The Trump Organization, based in New York City, is licensing the Trump brand for a 4.5-million-square-foot office complex in Rio.<sup>44</sup>

#### *OPPORTUNITIES FOR FOREIGN REAL ESTATE DEVELOPERS IN BRAZIL*

Many experts in the real estate field have favorable opinions of Brazil's future prospects and investment opportunities. Daniel Citron, CEO of Related Brasil, also finds Brazil an attractive market that has tremendous amounts of growth potential for real estate developers. Citron attributes Brazil's strength to its position among the BRICs, and to its being the most similar to the Western culture.<sup>45</sup> It is in the second wave of development – urbanization and industrialization happened in the 1960s in Brazil, as opposed to other countries that are in the first stage. Economic stability, over twenty years of solid democracy, improving institutions, lower interest rates and the high availability of credit are the main reasons for real estate developers to expand into the country.

Citron argues that the main risks in Brazil are the permit timing and increase in construction costs. Although the real estate market expanded rapidly in the last 10 years, municipal bureaucracies did not follow. Problems like new environmental and traffic concerns arose, as well as neighborhood associations finding a voice to fight against municipal rulings in certain case (i.e., loss of views, deterioration of traffic conditions, etc.). As for the increase in construction costs, there has been a steady increase in labor costs resulting from the robust real estate market and construction activities. In order to address these risk factors, says Citron, Related has been intently including risk factors to its

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<sup>43</sup> Alexei Barrionuevo, "Staking a Claim in South America," *New York Times*, March 21, 2013, accessed July, 2013, <http://www.nytimes.com/2013/03/24/realestate/americans-invest-in-south-american-real-estate.html>.

<sup>44</sup> Ibid.

<sup>45</sup> Daniel Citron, telephone interview with author, July, 22, 2013.

performance model and trying to build a team with technical strengths to follow up on any deviations from the original plan as early as possible.<sup>46</sup>

Citron suggests that the most successful organizational model for international real estate companies in Brazil should be a team comprised of 90%+ local professionals. The international aspect of the organization should execute essential tasks such as risk control, financial structuring and reporting, and fund raising, whereas the local aspect of the organization should take care of the more hands-on development functions such as design, construction and permitting. Some international developers have a matrix of 2 levels of command on design and construction, which adds an extra level of cost and energy expenditures, but allows for new technologies and foreign networks of service providers and designers to be appropriately added to process.<sup>47</sup>

Despite these positive outlooks in the real estate market, Brazil certainly is not without problems in doing business, especially for foreign entrepreneurs. Brazil ranked 126<sup>th</sup> this year out of 183 countries in 2012 annual global report "Doing Business", which evaluates the ease of starting a business, dealing with construction permits, registering property, and paying taxes.<sup>48</sup> Data show that starting a business in Brazil takes 13 procedures and 119 days of work, and construction permits need an average of 17 procedures and 469 days for authorization. According to IBGE, Brazil's main government research institute, the excess of laws, regulations, taxes, paperwork and time required to meet the requirements when opening or running a business is one of the reasons that, 40% of Brazilian start-ups do not survive for more than two years after opening.<sup>49</sup>

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<sup>46</sup> Daniel Citron, telephone interview with author, July, 22, 2013.

<sup>47</sup> Ibid.

<sup>48</sup> "Annual Global Report: Doing Business," The World Bank Group, accessed July 2013, <http://www.doingbusiness.org/rankings>.

<sup>49</sup> "Annual Survey of Industry," The World Bank Group, accessed July, 2013, <http://www.ibge.gov.br/english/estatistica/economia/industria/pia/empresas/2011/defaultempresa.shtm>.

These are clear examples of Mr. Citron's point regarding municipal bureaucracy not keeping pace with economic development. It is crucial that any real estate developers become aware of these negative externalities in the development phases and establish a clear set of strategic guidelines to effectively address these issues. The following case studies paint a picture of how some American real estate developers faced and resolved these difficulties in the development phases of their properties, and what lessons they have learned from the process.



## CASE STUDY 1: TORRE ALMIRANTE, RIO DE JANEIRO<sup>50</sup>

### PROJECT OVERVIEW

Torre Almirante is a 36-story, 550,000 gross square feet Class-AA office tower located at the Centro area in Rio de Janeiro, Brazil. The tower was developed in 2002 by Houston based Hines, one of the largest privately held real estate development, investment and management firms in the world. The architectural design was led by a U.S. based architecture firm, Robert A.M. Stern Architects (RAMSA), with Pontual Arquitetura in Brazil as associate architects. The project had initially been promoted by the Rio de Janeiro's municipality office that aimed to revitalize the downtown area,



which had been suffering from the lack of high-quality office space in the market. When Hines first performed a real estate market analysis in Rio, they found that there was demand for 200,000 square meters of office space in the city. Also, numerous multinational companies in the city were occupying Class C office space, and were eager to move to a higher quality working space at the time. Clearly, Rio lacked the office space in absolute terms and Class-A office products to meet the market demands (see Figure 8).

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<sup>50</sup> Arthur Segel And Ricardo Reisen De Pinho *Hines Goes to Rio* (Harvard Business School Press, 2004), 4-10.

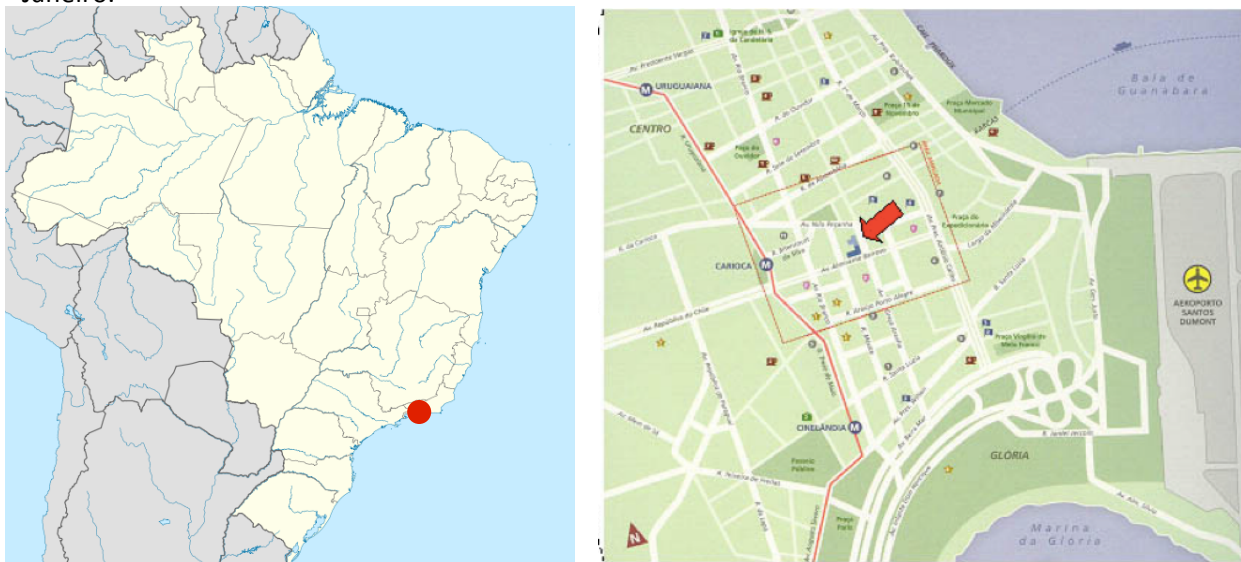
**Rio de Janeiro Market<sup>51</sup>**

Total Stock (m <sup>2</sup> )	2000	2001E	2002E	2003E
Downtown <sup>a</sup>	126,372	122,872	133,504	133,984
Downtown (Others)	198,384	198,384	208,223	219,832
Orla	229,091	229,091	230,527	232,298
Barra da Tijuca	30,920	62,220	69,185	111,997
<b>Total</b>	<b>584,767</b>	<b>612,567</b>	<b>641,439</b>	<b>698,111</b>

Vacancy Rates (%)	2000	2001E	2002E	2003E
Downtown <sup>a</sup>	1	0	16	14
Downtown (Others)	11	5	8	9
Orla	1	3	7	13
Barra da Tijuca	10	11	11	28
<b>Total</b>	<b>5</b>	<b>4</b>	<b>9</b>	<b>15</b>

<Figure 8>Market Data: Rio de Janeiro- Class AA + A – Total Stock and Vacancy Rate<sup>51</sup>

Well aware that the city of Rio de Janeiro was suffering from subpar office space that was far below the standards required for the multinational firms present in the city, Hines set the goal of making the project the best office building in Rio. In December of 2001, Hines acquired the site for Torre Almirante from the local bank called Banco Interatlântico (see Figure 9). This was a strategic move on Hines’s part; not only had the site already been approved by the local municipality, but it had also been awarded more height and density than would be normally required under the regulations in the city of Rio de Janeiro.



<Figure 9>Location of Rio de Janeiro (left) and Torre Almirante Site location (right)<sup>52</sup>

<sup>51</sup> Arthur Segel And Ricardo Reisen De Pinho *Hines Goes to Rio* (Harvard Business School Press, 2004), 15.

<sup>52</sup> Arthur Segel And Ricardo Reisen De Pinho *Hines Goes to Rio* (Harvard Business School Press, 2004), 16.

## *SITE ACQUISITION*

The most challenging aspect of the site acquisition was the entitlement. Torre Almirante site was a site of a tragic history, where the original building was destroyed by fire in 1986, killing 30 workers. At the time of the acquisition, the site still had ongoing lawsuits and liability issues. Furthermore, the ownership of the site was fragmented between private and public institutions, which further complicated the entitlement process. Hines again turned to Banco Interatlântico to resolve these complicated matters, requiring them to secure individual interests on the site under unified ownership prior to the final agreements between the two entities.

## *ARCHITECTURAL DESIGN*

Many of the cultural clashes and technical differences between the two countries, U.S. and Brazil, occurred in the design process of the development. Hines had to make numerous crucial decisions about many factors affecting the successful delivery of the project, including the building materials, mechanical systems, structural systems in compliance with the local regulations, etc. Such an intricate process of reconciling the differences between the two cultures was well articulated by Archie Searby, Hine's Brazil's design director:

*"Although moving fast toward more international standards, Brazil was still culturally and technically complex for us. Processes, systems and designs that looked and worked well in the U.S., sometimes weren't as appropriate for or available in Brazil. From the very beginning we have had innumerable debates to which level [of quality] we would like to go yet keeping an acceptable payback rate. With this project we found out that each building has its own personality. Torre Almirante raised the bar, forcing us to review preconceived models, to add new procedures, and more important, to be more adaptive to local peculiarities."*

Hiring Searby was another strategic decision that Hines made in order to coordinate the local and international teams for the project. Searby had developed extensive planning and project management skills in the South American market and was very familiar with local construction methods and regulations, which mitigated the risks associated during the development period of Torre Almirante. Together with RAMSA and Pontual Arquitetura, Hines Construction department and Searby were able to efficiently navigate through the complex building permit process by retaining the existing building elements including foundations, columns and elevator shaft. These preexisting conditions left little space for electrical and mechanical systems in between the floors, making it difficult to achieve the minimum ceiling height required for a Class AA office space. To address this issue, the Hines team implemented a raised floor system that they pioneered themselves in their home market in the U.S.

Further design coordination continued throughout the development process. The RAMSA team in the U.S. had initially proposed that the tower be clad in entirely low-emissivity glass. However, the local architecture partner, Pontual, made major modifications to the façade design by applying granite on every floor for the following reasons: 1) the climate of Rio de Janeiro was characterized by relatively high temperatures throughout the year and strong sun incidence, 2) Brazilian firms lacked the knowledge and expertise in delivering the required specification, causing delays and 3) the initial costs for the low-emissivity glass had been based on the estimate from the Brazil-based supplier.



The actual costs incurred from importing the materials from the U.S. supplier were 20%, or R\$4.0 million higher than the initial costs.

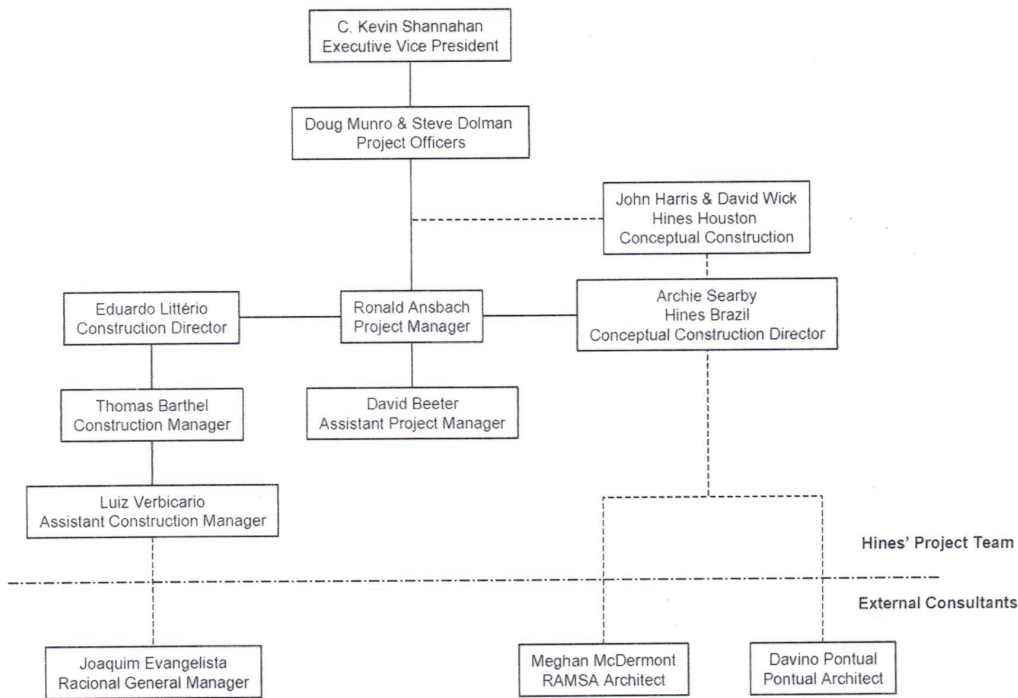
## *LEASING AND MARKETING*

Hines also wanted to ensure that their pursuit of the highest-quality office space in Rio was promoted and reached potential tenants, the municipality and the general public who may not be familiar with the Hines brand and its prowess in creating superb office products. Hines tackled this issue by constructing a state-of-the-art information center to successfully introduce the brand to the market and showcase the quality of the space that they would finally create. Knowing that the marketing and public relations efforts had to extend beyond the potential tenants, Hines also established a healthy relationship with the city officials and engaged in community involvements such as donating recycled rubble blocks, cleaning the street and planting trees. With these efforts, Hines was able to avoid being wrongly perceived as an American firm that was only after the money. The positive image of the company ultimately helped the approval and leasing process later in the development process.

The biggest challenge in the leasing phase of Torre Almirante was the tenants' perception of "preleasing." While it was common in most mature markets, tenants in Brazil were not used to signing a lease contract before the project's successful completion of the construction. The tenants in Brazil also wanted to adhere to the Brazilian leasing practice of registering their leases with the municipality, rather than the landlord, in order to avoid a possible eviction caused by change of ownership of the building. Not only was this idea undesirable for Hines, it also created a huge problem with the permit process, because such practice was only possible when the occupancy permit was granted after the completion of the construction. This kind of leasing practice had been caused by the fact that the Brazilian office market had an ownership structure that was fragmented among many different owners, which is different from the structure in most of the developed countries, where only a single entity generally owns the entire asset. In the end, Torre Almirante had the entire building leased out to a single tenant, Petrobras, a prominent Brazilian energy corporation. Although having at least two or three tenants

would have been ideal, according to Dolman, Hines knew at the time that Rio’s office market was tight and it would be hard for Petrobras to relocate to a different property that offered the same amount and quality of space that Torre Almirante provided. Therefore, the probability of the leasing renewal was expected to be very high.<sup>53</sup>

**ORGANIZATIONAL STRUCTURE**



<Figure 10> Hines’ Torre Almirante Organizational Flow Chart<sup>54</sup>

Hines Brazil office had a good mix of the U.S. expats who were familiar with Hines’ way of doing business and seasoned local professionals who had extensive knowledge of Brazil real estate industry. For example, Archie Searby’s coordinated the local construction methods and design with RAMSA (American) and Pontual Architect (Brazilian), while seeking approval from Hines U.S. Conceptual Construction department in Houston (see Figure 10). As indicated in many of the development phases in earlier sections, this organizational structure allowed Hines to mitigate risks associated with its lack of

<sup>53</sup> Stevel Dolman, telephone interview with author, July 18, 2013.

<sup>54</sup> Arthur Segel And Ricardo Reisen De Pinho *Hines Goes to Rio* (Harvard Business School Press, 2004), 23.

local knowledge and connections, while implementing the innovative, high-quality product developed in the home market. As the business in Brazil grew, Hines was able to bring in more local talents into the company and was able to retain active development practices in the city. As time went on, Hines Rio de Janeiro office became heavily dominated by local professionals, while most U.S. expats went back to their home country.<sup>55</sup>

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<sup>55</sup> Stevel Dolman, telephone interview with author, July 18, 2013.

## CASE STUDY 2: TORRE NORTE, SAO PAULO<sup>56</sup>

### PROJECT OVERVIEW

Torre Norte is a 36-story office tower in Centro Empresarial Nações Unidas (CENU) in Sao Paulo. The tower, designed by a Brazilian architecture firm, Botti Rubin Arquitetos, was completed in November of 1999 and has 665,210ft<sup>2</sup> of office space (see Figure 11). The developer, Tishman Speyer, intended this property to be one of the first Class A office buildings with high-quality design and finishes, a variety of retail and restaurant components and easy access to transportation. At the time of completion, the sheer size, quality and visibility of the tower allowed it to become the new landmark in the city of Sao



<Figure 11> Torre Norte<sup>57</sup>

<sup>56</sup> Napon Cholvanich, Dan Kang, Mayu Sasabe, "Tishman Speyer's Global Expansion Comparative Analysis of Strategies in Sao Paulo and Thailand" (Paper Prepared for Global Strategy and Organization, 2013).

<sup>57</sup> "Torre Norte," Tishman Speyer, accessed July, 2013, <http://www.tishmanspeyer.com/properties/torre-norte>.



Paulo. Through this project, Jerry Speyer, Tishman Speyer's president, achieved the goal of "leveraging [Tishman Speyer's] presence in Sao Paulo to build real estate business, not only in Brazil, but in select markets throughout Latin America."<sup>58</sup>

In the late 1990s, the real estate sector in Sao Paulo was going through a rapid transformation. With decades of economic instability and hyperinflation, the real estate market in Sao Paulo was suffering from slow demand and a lack of project financing. These macroeconomic factors resulted in tens of thousands of subpar office spaces or mom-and-pop type of stores that filled much of Sao Paulo's colossal urban sprawl. The sluggish real estate market conditions started to transform dramatically with the growth of the overall Brazilian economy. Rising incomes and sustained periods of economic stability gave both local and foreign investors confidence to invest in this lucrative market. Additionally, because there was such a great lack of Class-A office buildings, the demand for these buildings grew exponentially.

#### *ARCHITECTURAL DESIGN / LEASING AND MARKETING*

Tishman Speyer found tremendous long-term growth opportunities in the Brazilian real estate development business and started expanding into the market in the late 1990s. They had confidence in the market because of the strong demand for office properties described above, coupled with optimism for sustained growth potential over the years to come. Well aware that Sao Paulo suffers from a severe lack of class-A office buildings, Tishman Speyer decided that their products, i.e., real estate property, should incorporate the same quality of design, function and services that they have developed in their home market. Tishman Speyer's Torre Norte sits on a prime site along the river in Sao Paulo and carefully integrates high-quality design to ensure the leasability, profitability and efficiency of the space.

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<sup>58</sup> "Tishman in Brazil Venture," *New York Times*, June 28, 1996, accessed July, 2013, <http://www.nytimes.com/1996/06/28/business/tishman-in-brazil-venture.html>.

Torre Norte was one of the first international quality office products ever developed in Brazil at the time of its completion. Because of its unique status as a major Class A office tower, Torre Norte was able to attract some of the most prestigious global tenants in Sao Paulo. By the time the project's official grand opening ceremony in November 1999, 80 percent of the building was committed to premier multinational tenants, including Microsoft Brasil, Direct TV, Ford South America and Volvo. Other high-profile tenants like Monsanto of Brasil, Brazil's major agriculture company, and the Canadian Consulate also signed leases.<sup>59</sup> On the marketing front, Tishman Speyer brought a rotating art exhibit from San Paulo's Museum of Modern Art into the tower's lobby, which would further strengthen Torre Norte's reputation as the premium office space in Sao Paulo.<sup>60</sup>

#### *ORGANIZATIONAL STRUCTURE*

Tishman Speyer was well aware that their expertise in development alone was far from sufficient to ensure a sustained success in this new market. Real estate development is, after all, a location specific business. Since a real estate property cannot be manufactured in a factory and shipped to diverse locations, virtually every stage of the development process requires comprehensive knowledge of the regional market and regulations, connections with public officials, access to capital and knowledge of local consumer tastes. To address this critical issue, Tishman Speyer's Sao Paulo team was composed mainly of professionals from Brazil. Also, in order to secure additional funding sources and locate a prime property for development in the local area, Tishman Speyer formed a strategic alliance (TSM) with Método Engenharia S.A., one of Brazil's most traditional construction companies.<sup>61</sup> TSM was able to

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<sup>59</sup> "Tishman Speyer-Metodo & Funcef Open Largest Class-A Office Building in Latin America," *Business Wire*, November 22, 1999, accessed July, 2013, <http://www.thefreelibrary.com/Tishman+Speyer-Metodo+%26+Funcef+Open+Largest+Class-A+Office+Building...-a057758417>.

<sup>60</sup> Ibid.

<sup>61</sup> "A Deeper Look at Torre Norte," Tishman Speyer, accessed July, 2013, <http://www.tishmanspeyer.com/properties/torre-norte#!/properties/torre-norte?cs=true>.

integrate Tishman Speyer's core strategies, while effectively overseeing the technical and legal due diligence of the Torre Norte project.

Furthermore, TSM managed the design process of the project, in order to conform to the Brazilian regulations that strongly favor local architects for the design of buildings. The entire development process of the Torre Norte was effectively executed in large part due to Tishman Speyer's strategic integration of their core competencies and local expertise. The Torre Norte was completed in 1999 and was considered a tremendous success in Sao Paulo's real estate market; the property was fully leased six months after its delivery with some of the most prestigious international firms as its major tenants, including Microsoft, HP, Booz Allen and Mastercard.<sup>62</sup> Moreover, Tishman Speyer's properties introduced an innovative approach in executing the project, as well as a superior design and efficiency of the space, setting the new standard for office properties in Sao Paulo.<sup>63</sup>

#### *ENHANCING CORE COMPETENCIES*

Tishman Speyer's efforts in global integration continue to be a major part of their strategy. The Sao Paulo office has assigned VPs by projects and functions, and "set a communication channel for a global interaction."<sup>64</sup> This type of structure allows Tishman Speyer Sao Paulo to interact not only with the U.S. headquarters, but also with international offices in other emerging markets such as China and India. From this process, Tisham Speyer Sao Paulo is able to engage in the learning of various international real estate market conditions. For instance, they can predict Brazilian real estate cycles by understanding the past U.S. real estate market cycle and development activities. Or, they can come up with a comparative analysis of a development cycle and process by communicating with the office in China, thereby understanding the dynamics of development strategies that should or should not be applied in

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<sup>62</sup> Ibid.

<sup>63</sup> Daniel Cherman, telephone interview with author, May 15, 2013.

<sup>64</sup> Ibid.

Brazil.<sup>65</sup> This type of cross-cultural process strengthens the competencies from one global office to another and ultimately reinforces the firm as a whole.

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<sup>65</sup> Daniel Cherman, telephone interview with author, May 15, 2013.

## CHAPTER IV

### CASE STUDIES EVALUATIONS

#### TORRE ALMIRANTE

##### *SITE ACQUISITION*

Hines was able to bypass most of the complicated permit process for Torre Almirante site acquisition phase by partnering up with Banco Interatlântico, who had already secured municipal approvals on the project site. Furthermore, requiring Banco Interatlântico to bring the fragmented ownership on site allowed Hines management in Brazil to deal with the entitlement process much more effectively than had Hines delivered the process themselves. However, the greatest shortcoming in acquiring the Torre Almirante site was the fact that the site had been involved in complicated legal and ownership issues to begin with, as described in the case study above. Because of this complicated history and lawsuit, Banco Interatlântico was not able to resolve the entitlement issues until February of 2002, some seven years after initial agreements between the two parties.

Dolman suggests watching for any legal or entitlement risks during the site acquisition phase of the development project in Brazil. Any site that has a history of ownership problems, especially if they are entangled with legal issues would result in months, if not years, of delay in delivering the projects. Also, these “title risks” may affect a developer’s ability to sell or lease the property to the potential investor or tenants in the future.

##### Lessons:

- Given Brazil’s complicated regulations and longstanding bureaucracy, zoning and permit process pose great risks in the development process. Find a Brazilian partner that has

experience, resources and networks in the local municipality to navigate this process, and make sure of choosing a site where zoning and permit can be achieved. Never choose a site that has any potential title risks.<sup>66</sup>

### *ARCHITECTURAL DESIGN*

As Conceptual Construction and Design manager of Torre Almirante, Searby faced a number of cross-cultural challenges that affected the design development process of the tower. First, the final design of Torre Almirante had to adapt to the local conditions, while adhering to Hines' credo of delivering buildings of superior quality and architectural merit. The façade responded to Rio's tropical climate; the raised floor systems were adapted effectively to handle the permit process; the spectacular architectural details in the lobby reflected Hines' pursuit of superior quality. As a result, Hines ended up producing a "product" that not only delivered its core qualities and innovations, but also appropriately responded to the Rio de Janeiro market conditions.

Second, design conflicts between the architects from the United States and Brazil were greatly reduced, thanks to Searby's ability to understand both Hines model and development practice in Brazil. His background in project planning and construction in Brazil helped Hines' design team effectively navigate the design and approval process. However, issues with local architects arose when they attempted to get involved in the actual design stage of the building. Consequently, this caused some friction between the RAMSA team and Pontual Arquitetura, related to taking credit for some of the design efforts made by RAMSA.

Lessons:

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<sup>66</sup> Stevel Dolman, telephone interview with author, July 18, 2013.

- Know how to coordinate the design of the building so that it both incorporates the core product value of the firm and adapts to the local regulation and regional climate in Brazil.
- Make sure the product is designed appropriately to the Brazilian market conditions. Do not overdesign unless the market is ready for the quality of the product.
- Choose Brazilian architects that are willing to develop good working relationships with the corporate architecture team without challenging or attempting to overtake their design efforts and credit.

### *LEASING AND MARKETING*

As the case described, Hines' efforts to establish brand recognition in Brazil involved 1) extensively advertising the superior quality of their product in the Rio de Janeiro leasing market and 2) forming a healthy relationship with local city officials. These two strategies allowed them to successfully showcase the quality of Hines' products to potential tenants, as well as facilitating a favorable permit process for Torre Almirante development.

Hines did face an institutional void in this market when, according to Dolman, they found that there was no reliable market data or standardized transaction deal information.<sup>67</sup> Hines' approach of allowing a small number of exclusive brokers to have access to the consistent data on rent figures proved to be effective. U.S. developers should also bear in mind that in Brazil moving in and out of an office building is much more difficult because, unlike in western countries, landlords in Brazil typically do not pay for any of the moving or tenant improvements costs. Therefore, as was the case with Torre Almirante and its tenant (Petrobras), having a single tenant structure may not be as risky as if it were in the U.S.

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<sup>67</sup> Stevel Dolman, telephone interview with author, July 18, 2013.

However, sustained supply of Class A office buildings in the market means that it is becoming easier for tenants to find and move into a new office space.

Lessons:

- The Brazilian real estate market is not familiar with the names and products of real estate developers' in the U.S. Extensively advertise the firm's brand, while establishing a healthy relationship with local officials.
- Overcome Institutional Voids in market analysis and brokerage activities in Brazil by hiring a small number of exclusive brokers.
- A single tenant structure is not as risky as it is in the U.S. However, it is still ideal to have several tenants, especially when the property will be sold to a potential buyer.

#### *ORGANIZATIONAL STRUCTURE*

The complicated entitlement and lawsuit issues could have been worse if Hines had not collaborated with Banco Interatlântico. As for the office team structure, Torre Almirante's success can largely be attributed to the fact that it had the right mix of Brazilian professionals and consultants like Archie Searby. Also, Steve Dolman stayed in the area throughout the development phases, responding to the development challenges and providing solutions.

Lessons:

- Always have a mix of U.S. expats and Brazilian experts. This structure will allow implementation of the firm's core strategies in the market, while significantly reducing development risks.



- Make sure that managers from the U.S. stays in the Brazilian office in the long-term, rather than having them travel back and forth during a project.

## **TORRE NORTE**

### *SITE ACQUISITION*

Tishman Speyer's strategy in site acquisition was to look for a location that could add extra values to the project. This meant that, on top of the superb quality Class A office product itself, the project site had to take advantage of other strong site context that would generate synergy between the



product and the existing site context. To do so, Tishman Speyer strategically selected the prime commercial location in Itaim Bibi, one of the most important business districts in Sao Paulo. Also, the very location that Torre Norte sits on took advantage of the iconic cable bridge, which gives added value to the iconic image of the project. Also, vibrancy and activities in and out of the project have been enhanced by the nearby restaurants and shopping malls, which surround the project site.

Another important advantage of the site was the fact that it has already been approved for construction prior to Tishman Speyer's acquiring of the site. This eliminated many of the complicated permitting and approval processes, allowing Tishman to focus on transferring their core strengths in financing and building a property throughout the development process.

#### Lessons:

- In order to avoid dealing with complex permit process in Brazil, form a strategic alliance with Brazilian firma to either spot a site that has already been approved for construction or have them process the permitting of the site.
- Understand the various business clusters in Brazil, or Sao Paulo, and the unique characteristics of those submarkets. For example, while Itaim Bibi, Torre Norte's project site, has modern and vehicle-oriented site conditions, other submarkets like downtown or traditional business districts may be accessed mainly by public transportation or walking.
- The potential Brazilian JV partner will be likely to have much of the market information described above, which would significantly reduce institutional voids in accessing reliable macroeconomic data in Brazil.

#### *ARCHITECTURAL DESIGN*

Tishman Speyer's decision to choose a Brazilian architect for the design process of Torre Norte had two advantages: first, it complied with the local regulations that strongly favored the local architect as the main design manager. Second, Tishman Speyer was able to implement their expertise in building a Class A office in Brazil while effectively making appropriate design adjustments to ensure the leasability, profitability and efficiency of the product.<sup>68</sup> For example, converting two and half floors of mechanical floors to leasable space or redesigning the building core to improve the building systems performance was made possible thanks to the Botti Rubin Arquitetos' understanding of building codes and system requirements in Brazil. Upon completion, Torre Norte had a cogeneration plant in it and was the first commercial multi-tenant building in Brazil to be capable of producing electricity. Tishman Speyer's

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<sup>68</sup> "A Deeper Look at Torre Norte," Tishman Speyer, accessed July, 2013, <http://www.tishmanspeyer.com/properties/torre-norte#!/properties/torre-norte?cs=true>.

strategy in choosing a Brazilian architect for its project continued after Torre Norte project and most of the properties in Brazil are designed by local architects.

Lessons:

- Always hire a Brazilian architect who is familiar with the local codes and building systems. If the main design has to be managed by another international architect, bring a Brazilian architect as a partner to guide the local design and permitting process.

#### *LEASING AND MARKETING*

Tishman Speyer's main strength in their leasing efforts was the fact that they were able to spot and respond to the strong demand for the type of office that did not exist in Brazil. By integrating their key strengths of executing the Class A office products developed in the home market, which precisely met the needs of these tenants, Tishman Speyer was able to achieve a healthy mix of multinational tenants by the time of the project's completion. However, it is important to note that, since the completion of Torre Norte in 1999, there has been a steady supply of Class A office properties in major Brazilian cities like Sao Paulo and Rio de Janeiro. These cities are considered "peaking markets" (see Figure 12 chart) in terms of office supplies, so they do not have the type of needs that existed in the market nearly fifteen years ago.



<Figure 12> Real estate Market Clock of major cities in Brazil<sup>69</sup>

Lessons:

- Target appropriate customer base in Brazil and build a property that responds to it. Brazil is an emerging market, so tenants' demand for the quality and type of real estate products can change rapidly.

### ORGANIZATIONAL STRUCTURE

Daniel Cherman, Senior Managing Director of Tishman Speyer Sao Paulo office, acknowledges the importance of the understanding the local market when developing a real estate project in Brazil. He says that the key factor to success in Brazil depends on the right “combination of local knowledge and

<sup>69</sup> “Latin America Prime Office Market Overview, Q4 2012” (Jones Lang LaSalle ,2013), 2.

global expertise<sup>70</sup>.” This combination can be achieved, according to Cherman, by developing local teams while maintaining the firm’s ability to create opportunities and deploy core competencies in Brazil. Tishman Speyer’s joint venture structure with Método Engenharia was part of this strategic choice. The joint venture between the two firms, TSM, was able to identify and acquire a prime site that had already been approved for construction, a process which would not have been possible had Tishman Speyer gone into Sao Paulo by themselves. On the other hand, TSM was able to leverage local expertise in the market to transfer Tishman Speyer’s core competencies in developing a high-quality office building in Sao Paulo. Furthermore, TSM’s strategic alliance with a Brazilian pension Fund, Funcef, greatly helped facilitate the project financials to provide funding to purchase and develop Torre Norte.

Lessons:

- Seek a Brazilian partner to form a joint venture structure. The JV structure will facilitate the process of acquiring a desirable project site.

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<sup>70</sup> Daniel Cherman, telephone interview with author, May 15, 2013.

## CHAPTER V

### GUIDELINES: WHAT TO EXPECT AND HOW TO PREPARE FOR A DEVELOPMENT PROJECT IN BRAZIL

So far, we have investigated a broad range of American real estate development firms' globalization opportunities in emerging markets, pitfalls and institutional voids present in the globalization process, Brazilian real estate market trends and case studies that helped us to evaluate the risks and lessons from the development phases. In this chapter, we will attempt to integrate all of these aspects of the globalization of real estate development in Brazilian markets and formulate qualitative strategic guidelines for a real estate developer that wishes to establish his presence in Brazil. The following recommendation chart has been created for the firm that is considering overseas expansion. Recommendations have been developed based on the findings from the literature review, case studies and interviews from the preceding chapters above.

#### REAL ESTATE DEVELOPMENT PROJECT IN BRAZIL: RECOMMENDATIONS CHART

Development Stage	Recommendations
Evaluating Development Potential	Understand the firm's core strengths. Make sure that its real estate development strategies align with international expansion ideology. If the firm's fundamental business model relies on its resources, knowledge and authorities at the local level, then it is advisable that the firm stay within the area it specializes in. If the firm's business model relies on assessing opportunities for long-term growth and acting before the competitors, then expanding into an emerging market would be a viable option for the firm.

<p style="text-align: center;">Site Acquisition</p>	<p>Entitlements and permit process related to acquiring the project site can be some of the most complicated processes in operating in Brazil. Find an experienced and reliable Brazilian development partner that can navigate through the entitlement and permit phases for the site. If possible, search initially for a site that has all the entitlements and construction permit approved. Do not pursue a project that has any title risks to avoid being caught in complicated zoning regulations and bureaucracy in Brazil.</p>
	<p><b>Institutional Voids:</b> Lack of market data on property values or development approval information. Overcome Institutional Voids by acquiring capabilities of local real estate developers, investors or general contractors by forming a JV.</p>
<p style="text-align: center;">Design</p>	<p>The design of the product must have a good balance of the firm’s distinctive quality and product adjustments to local conditions. While it is important to construct buildings of superior quality and architectural merits, the product should respond appropriately to the Brazilian market condition. Investigate how much the market is ready for the quality of the design and services that the product can provide. Always have Brazilian architects in the team to tackle these issues. They are the ones most familiar with local design tastes, climate and building codes. Make sure the local architects and international architects have good working relationships.</p>
	<p><b>Institutional Voids:</b> Different culture, climate and how quality of space is perceived in Brazil. These voids can be easily overcome by hiring local consultants.</p>
<p style="text-align: center;">Leasing and Marketing</p>	<p>Keep in mind that there is a lack of support industry for brokerage and adequate data for tenant movements in the Brazilian real estate market. Before setting up an office in Brazil, understand what types of tenants will be the target for the project and consider hiring one or a small number of brokerage professionals to handle the project’s leasing transactions. The market is not familiar with the firm’s brand and the type of products it delivers, so create extensive marketing materials and presentations to present to the potential tenants, investors or public officials in Brazil.</p>

Organizational Structure	For the first expansion project in Brazil, the most experienced and skilled manager should travel to the project site and stay there for the entire development period. The local office should have a good mix of Brazilian experts. In this way, the firm will be able to implement core strategies and product qualities in the market, while integrating local expertise and resources. After the first major project, decide whether or not the local office will be able to operate independently.
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**CONCLUSION**

This thesis has examined the growing level of interconnectedness of the modern world and the potential for future growth of the global markets. The shifting of the economic center from the more developed western countries to emerging markets provided great opportunities for U.S. firms to seek future growth potential in these fast growing markets. Brazil, with its current economic development, status as an emerging power and its relatively short cultural and political distances from the U.S. is an attractive market that U.S. enterprises should consider expanding into. Sustained economic growth and stability, as well as an exponentially growing middle class, created a tremendous amount of growth potential in the real estate sector in Brazil, and real estate developers in the U.S. should attempt to rise to the challenges, if they want to seek robust future growth for their firms and capitalize on the opportunities of globalization. However, given the nature of the real estate development industry that engages specialized expertise in a few selected markets, globalization has not yet been a viable option for many of the real estate developers in the U.S.

Challenges do exist in pursuing real estate development in Brazil, especially given the excess of regulation and high levels of bureaucracy in the country. Thus, formulating a set of strategic guidelines to tackle these issues should be a crucial part of due diligence in a global expansion plan. The findings



from the case studies and interviews with industry experts helped us formulate a set of recommendations that American real estate developers should follow once they decide to pursue global expansion into Brazil. Using these recommendations, they will be able to, to a certain degree, predict and reduce risk factors in Brazilian real estate development.

Lastly, it is also important to note that there are some limitations to these findings. The scope of the research was limited to one country, Brazil, in a specific timeframe – the late 1990s to the early 2000s. Economic and political conditions change rapidly in markets such as Brazil's, so these guidelines may not necessarily provide the 100%-accurate framework for new development proposals in the country. Further research and the adjustment of the suggested model to reflect the particular conditions for a specific project will greatly increase the effectiveness of the findings in this thesis.

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