Dear Valued Reader,

Welcome to the June 2017 edition of the Venue Market Spotlight. This month, we will examine the latest trends in real estate M&A activity.

Real estate M&A comprised just 9% of global activity with about US$70bn worth of deals in Q1 2017 – 14% higher compared with US$61.5bn for Q1 2016. In the current volatile environment, real estate will be attractive to many buyers for its reliability. Real estate M&A value reached an eight-year high in 2015, and remained steady throughout 2016.

The real estate investment trust (REIT) market in particular is expected to maintain high levels of activity. Following an interesting high-spike in activity last summer, many REITs are continuing to pump resources into their trusts, performing in ways historically similar to private equity shops.

Regionally, Asia-Pacific deal activity is expected to increase, driven by Chinese investors leaving the domestic stock market to seek cross-border assets. In May alone, real estate deals in Asia-Pacific reached US$3.8bn from just seven deals.

At Donnelley Financial Solutions, we understand how quickly companies must respond to continuous market changes within the economic, political, and regulatory environments. As we can see from today’s real estate market, how organizations react to these changes can provide unique dealmaking opportunities. This is one of the main reasons we are committed to the continuous growth of our Donnelley Financial technology solutions and service platform to address every aspect of the growing needs of the global capital markets.

As always, please enjoy this month’s Spotlight.

Sincerely,

Craig Clay
President, Global Capital Markets
Donnelley Financial Solutions
FOREWORD

Real estate M&A activity has long been a safe haven for investors. When the financial crisis of 2008 hit, and throughout the volatility of Brexit and the election of the Trump administration, real estate returns have remained reliable.

The REIT and commercial real estate industries have continued to experience strong M&A activity, with some sectors poised for large-scale consolidation even as new property types also continue to expand in the REIT space. More than half of respondents (56%) expect activity in REIT deals to remain strong.

At the same time, the ongoing presence of activist investors has changed the playbook for REITs, as it has for all public companies. All of this has occurred against the backdrop of continuing concerns about global economic recovery, interest rates, and political uncertainty.

So far this year, we have seen a strong Q1 of activity with top deals including Swedish fund manager Alecta’s sale of 21 US assets to Blackstone Group for US$1.7bn and the US$1.4bn acquisition of Silver Bay Realty Trust Corp. by Tricon Capital Group Inc.

However, investors are cautious about changes to regulations and reporting requirements expected in the coming 12 months, with some 52% saying they believe real estate M&A will either increase or stay the same, while 44% say activity will decrease somewhat. Despite this, respondents are generally positive about the activity in Q1 and beyond, predicting that transaction numbers will at least be comparable to 2016 figures.

Other key findings include:

- Asia-Pacific is the region predicted to receive the most real estate deals in the next 12 months (cited by 68% of respondents)
- Residential, healthcare, and office buildings are the areas where most deal interest will be seen in the next year (each named by 24% of respondents)
- Rising office prices/rents are the primary drivers of activity (followed by portfolio diversification)
- More than half of respondents believe that REIT activity will remain the same (56%)
- PE firms were named as the most likely type of buyer to be most active in real estate over the next 12 months (32%)
SURVEY

Q1 What do you think will happen to the instance of real estate M&A in the coming 12 months, compared to 2016?

While the majority of respondents believe real estate M&A activity will decrease (44%), it would appear that opinions are influenced somewhat by geography. Of those who believe activity will increase somewhat (24%) or remain the same (28%), the majority of these respondents are either Asia-Pacific or Europe-based.

“We expect real estate M&A to increase somewhat because it is one sector where returns that are generated are positive and the growth rate is improving more than other areas,” says a managing director of US PE firm. “Political certainty has eroded post-Brexit, but after the French election, we expect stability to slowly return to the EU market. Economic problems and sluggish economic growth have affected returns and forced companies to make acquisitions in real estate to reduce risks.”

The CFO of a corporation in India believes that little change will be seen in real estate M&A because it is a safe investment option for companies, the risks are low, and because the interest that companies get from acquiring assets is much higher than other sectors. “We expect the number of M&A deals to remain as high as they were last year but in new markets where growth rates are strong and the prospect of making profits over investments is high,” he says.

As in most sectors, regulatory hurdles, political instability, and capital volatility were also cited as barriers to deals — and potential reasons for why little increase, or potentially a slight decrease, can be expected in real estate M&A over the next year.

44% OF RESPONDENTS BELIEVE THAT REAL ESTATE M&A WILL DECREASE DURING THE NEXT 12 MONTHS
Q2 Which regions are most likely to see the most real estate M&A activity in the next 12 months? (Select top two)

The Asia-Pacific region will be the area most likely to see real estate M&A activity over the next 12 months, according to 68% of respondents. Europe (44%) and North America (40%) followed in second and third place.

One respondent, a managing director from a PE firm in the US, explains: “India is planning on introducing REITs, and so are countries like China and other countries in the APAC region. This makes investing in the APAC region a good option for companies. Investments in real estate will become a better option where growth options are high. With growth taking place in Africa, investment in real estate is developing.”

The CFO of a US-based corporate believes that Europe will remain a hotbed of M&A deals in the coming 12 months as a result of Brexit developments, as companies pull out of the UK and invest in acquiring assets in countries like Germany, France, and in the CEE region.

“It is better to invest in acquiring assets in these markets because growth rates are positive, buyers exist, and the operational costs of operating within the Euro zone would be easy,” he says.

Q3 Which sectors will see the most real estate M&A activity in the next 12 months? (Select top two and rank 1, 2, where 1 is the leading sector)

Office, residential, and healthcare properties are equally the first choice (24% each) for respondents. “The residential and office space sectors are good sectors to diversify and reduce risks. They are growing areas and there are many assets that can be acquired. Demand for real estate is very high, especially for assets in residential and office space that will promise strong returns. It is also not a mainstream investment option, which helps diversify risks that companies face,” says one managing director at an investment bank in China.

Developments in technology and continued growth in the healthcare industry are also likely to drive more healthcare real estate acquisitions. “The number of real estate deals that will be carried out (in healthcare) will increase significantly. The retail sector is also changing and companies within that sector will look to acquire assets in areas where they can...”
strategically grow. Because of competition, the need to acquire the best targets will increase significantly,” explains a partner at a UK-based PE firm.

**Q4** What will be the biggest drivers of activity in real estate M&A deals over the next 12 months? (Select top two and rank 1, 2, where 1 is the most important)

The increasing cost of rent is the primary driver of real estate M&A activity, according to 44% of respondents. A partner at a US PE firm explains that competition is contributing to this rent price hike: “The prices of offices are increasing because the market is expanding and there is an increase in competition. The cost of rents has skyrocketed. This extra cost has affected the returns that companies make, and to cut down on operational costs and acquire a strong investment, we expect the number of acquisitions of office spaces to increase.”

Portfolio diversification was the top secondary driver of activity (36%) – closely followed by the need for investors to seek safe havens amid market volatility.

“Investors will keep on looking for safe havens to invest capital. Other sectors are underperforming and companies need to develop their business in a way where they can develop and keep risks contained. Risks from other areas are already very high and companies need to develop their portfolio in a way where generating profits would be secure and sure. Even if returns are low, the risks are very low. The diversification of risks is also an important aspect for companies, especially because different sectors are underperforming a lot,” says a managing director at an Australian investment bank.

**Q5** What will happen to REIT M&A activity in the next 12 months? (Select one)

More than half of respondents believe that REIT activity will remain the same, citing steady returns and competition from PE and corporates as reasons for the forecasted consistency.

“REIT M&A activity will not change. The demand for land has not changed much,” explains the managing director at a PE firm in France. “Real estate

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### Table: Q4 Drivers of Real Estate M&A Activity

<table>
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<tr>
<th>Driver</th>
<th>Percentage</th>
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<tbody>
<tr>
<td>Rising office prices/rents</td>
<td>44%</td>
</tr>
<tr>
<td>Portfolio diversification</td>
<td>36%</td>
</tr>
<tr>
<td>Investors seeking safe havens amid market volatility</td>
<td>28%</td>
</tr>
<tr>
<td>Rising housing prices/rents</td>
<td>28%</td>
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### Table: Q5 REIT M&A Activity in the Next 12 Months

<table>
<thead>
<tr>
<th>Change</th>
<th>Percentage</th>
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<tbody>
<tr>
<td>Increase somewhat</td>
<td>16%</td>
</tr>
<tr>
<td>Remain the same</td>
<td>56%</td>
</tr>
<tr>
<td>Decrease somewhat</td>
<td>24%</td>
</tr>
<tr>
<td>Decrease significantly</td>
<td>4%</td>
</tr>
</tbody>
</table>
is underperforming but the rate of return it is offering is still higher than most sectors. Uncertainty will boost investments in the real estate sector because of the need to get capital to pay back shareholders. To balance costs and reduce debt, investments in REITs will increase. Companies will go on investing in REIT companies, forcing them to acquire assets.”

Q6 Which types of non-REIT acquirers do you believe will be most active in real estate M&A over the next 12 months? (Select top two and rank 1, 2, where 1 is the most important)

As respondents suggested in their answers to the previous question, PE firms and corporates are likely to be the most active non-REIT acquirers over the next 12 months, cited by 32% and 28% of respondents, respectively. PE’s current abundance of capital – Prequin estimated in January that PE investors had an aggregate amount of US$237bn raised for investment in commercial real estate globally – makes them well-positioned to take advantage of companies needing to sell assets.

“PE companies will be investing in real estate to improve their portfolios and to acquire companies that can add value to their existing business,” says a managing director at a Japanese PE firm. “It will also help get land that can be sold later for a large amount. Corporates looking for strategic assets will enter the market and acquire companies to increase their holdings and get companies that can be used to help them grow.”

Hedge funds and government entities were equally the top second-ranked type of non-REIT acquirer expected to be active in real estate M&A over the coming year, with 24% of respondents naming each.

“Hedge funds need to keep risks under control because of problems in the stock market, and to make sure the value of hedge funds does not get affected, the number of deals in real estate will increase,” explains the CFO at a US corporation. “Government bodies will also be increasing their acquisitions in real estate to acquire assets to allow for infrastructure and other developments.”
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The Specifics

**ASC 606**
Issued jointly by the FASB and IASB, ASC 606/IFRS 15 Revenue From Contracts With Customers provides accounting guidance related to revenue from contracts with customers.

Public entities are required to adopt the revenue recognition standards for reporting periods beginning after December 15, 2017, and interim and annual reporting periods thereafter. For nonpublic entities, the adoption date is for annual periods beginning after December 15, 2018.

**ASC 842**
This change comes as a result of IASB launching IFRS 16 to replace IAS 17, and the FASB introducing ASC 842 to replace ASC 840 (formerly FAS 13).

Although the actual change to financial statements will not go into effect until 2019 (depending on your FYE), companies will first have a comparative parallel Income Statement for transition to the new rules required for:

<table>
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<th>FYE</th>
<th>Comparative Income Statements Required</th>
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<td>December 31, 2017, 2018, 2019</td>
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<td>March 31:</td>
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<td>June 30:</td>
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<tr>
<td>September 30:</td>
<td>September 30, 2018, 2019, 2020</td>
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<table>
<thead>
<tr>
<th>Energy: Transportation</th>
<th>Agriculture, Chemicals</th>
<th>Computer software, Services</th>
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<td><strong>RAYONIER ADVANCED MATERIALS</strong></td>
<td><strong>APOLLO GLOBAL MANAGEMENT</strong></td>
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<td><em>— Acquires—</em></td>
<td><em>— Acquires—</em></td>
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<tr>
<td><strong>HOUSTON FUEL OIL TERMINAL</strong></td>
<td><strong>TEMBEC</strong></td>
<td><strong>WEST CORP</strong></td>
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<td><strong>PEMBINA PIPELINE</strong></td>
<td><strong>KORDSA</strong></td>
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<td><strong>VERESEN</strong></td>
<td><strong>INVISTA CHATTANOOGA FACILITIES</strong></td>
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<td>$6.4B</td>
<td>$9.7B</td>
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<td><strong>CLAYTON WILLIAMS ENERGY</strong></td>
<td><strong>CLAYTON WILLIAMS ENERGY</strong></td>
<td><strong>MAXIM CRANE WORKS</strong></td>
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