Exploring new shores—Ardian Real Estate in the spotlight
The Italian real estate market—The road to recovery

Continental shift—The continuing evolution of the European investment market
New alternative investment vehicles rising—Exploring RAIF and ICAV

Commercial Real Estate Redefined—How the nexus of technology advancements and consumer behavior will disrupt the industry
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Dear readers,

To borrow from one of the articles in this edition – “Disruption is not a new phenomenon, yet it is a hot topic of discussion among executives and in every boardroom today.” In our daily lives we are all confronted by technology - at home, in the workplace and in time we consume and are entertained.

Our Deloitte Global and U.S. Real Estate Leader Bob O’Brien focuses on the impact of these disruptive changes in the real estate sector as emergence from brokerage business models to office design is pressured to evolve

In this edition of REflexions, we have focused on the European markets including interviews with two major players in the real estate market. The first interview is with Ardian Capital who recently expanded its core business lines to include a fifth pillar focussing on real estate. Find out the reasons behind the expansion and their views on future trends. The second interview is with Merlin Properties, the Spanish giant who concentrates on the acquisition and management of prime commercial properties in the Iberian peninsula. Read what the founder member’s thoughts are on why REITs play such an important role in the evolution of the Spanish market. To complement these interviews, our number crunchers have provided a detailed analysis on the continuing evolution of the European investment market.

The Italian economy is getting onto the path of recovery following the recent implementation of various political, economic and institutional reforms all aimed to stimulating growth. Do you know which Italian city had an increase of more than 200% in investment volume in comparison to 2014? No, well perhaps unsurprisingly (for those who invest in Italy) it is not the capital! Last but not least we concentrate on the introduction of the RAIF – Reserved Alternative Investment Fund – which is seen not only as a substantial innovation for Luxembourg but also a key driver in competing with other offshore investment structures once the AIFMD passport is extended. With the same objective, Ireland introduced the ICAV – Collective Asset Management Vehicle – which is covered in the second part of the article.

All these subjects will continue to be debated over the coming weeks and months, but for now, enjoy this edition of REflexion’s mini tour of Europe and beyond.

Benjamin Lam
EMEA Real Estate Funds Co-Leader

David Brown
EMEA Real Estate Funds Co-Leader
In September 2015, the French investment company Ardian launched “Ardian Real Estate,” focusing on investment in commercial and other European non-residential real estate assets across Europe. Driven by sector experts Bertrand Julien-Laferrière, Head of Real Estate; Olivier Piani, Senior Advisor and Chairman of the Investment Committee; and Rodolfo Petrosino, Managing Director Southern Europe, this new investment pillar aims at managing over €2 billion in the next five years.

Deloitte Partner Laure Silvestre-Siaz met them for an interview.
Bertrand Julien-Laferriere joined Ardian as Head of Real Estate in September 2015. He has held various executive positions in the past, including Chief Development Officer and Member of the Management Board of Unibail-Rodamco and Chief Executive Officer of Société Foncière Lyonnaise. He holds an engineering degree from Ecole Centrale de Paris, a Master of Sciences in Construction Management from UC Berkeley, and a Master of Business Administration from Insead.

Olivier Piani is supporting Ardian Real Estate as Senior Advisor and will also act as Chairman of the Real Estate Investment Committee. He has been Chief Executive Officer of Allianz Real Estate during eight years and previously Chief Executive Officer of GE Capital Real Estate Europe. He holds a business degree from ESCP (Paris) and a Master of Business Administration from Stanford (USA).

Rodolfo Petrosino joined Ardian Real Estate as Managing Director Southern Europe. He has been Chief Operating Officer of Idea Fimit, Chief Operating Officer of Pirelli Real Estate, and Executive Officer of Morgan Stanley REF. He holds a degree in architecture from Politecnico di Milano.
1. Ardian announced in September last year the creation of Real Estate as its fifth pillar. Why did Ardian decide to move into real estate and why now?

BJL: Ardian is the leading European private equity firm with US$55 billion assets under management (AuM) in its main lines of business: direct funds, infrastructure, fund of funds, and private debt. Real estate is one of the largest alternative asset class worldwide; it is a natural move for Ardian, as a global fund manager, to launch real estate as an extension of its current activities.

OP: It is a general trend among investors around the planet to consolidate their relationships with a fewer number of managers and to build up long term collaboration in a wide spectrum of investment lines. Since it became independent in 2013, Ardian has grown its AuM from US$36 billion to US$55 billion; it is intuitive that Ardian follows the main trends of the industry and acts as a global investment firm. Real Estate is clearly a significant element of a global investor’s strategy and it is key for Ardian to be active in this asset class.

BJL: With respect to timing, we think there is no good or bad time for Ardian to enter into this new line of business. It is the time for Ardian to get into real estate as a way to sustain its development and to better respond to its clients’ needs and requirements. The launch of Ardian Real Estate aims at establishing the fifth pillar of Ardian’s business and needs to be looked at with a long term view.

RP: We are not in an opportunistic mode, getting in and out of the real estate market depending on where we are positioned in the cycle. We are building up a long term business in an industry which does have cycles. Ardian Real Estate aims at being active in the market for the coming 20 years or more, and being recognized as a significant European actor in our industry.

2. Why did you decide to join Ardian?

BJL: I have known Dominique Senequier for a few years, and in several occasions we have had the chance to discuss the idea of launching a Real Estate practice within Ardian. As always, there is a proper time for things to happen and the right moment came within a couple of days at the end of July last year. I was amazed to see Dominique Senequier, Dominique Gaillard, and the Ardian management team taking this move in such a fast decision making mode. This entrepreneurial spirit and immediate trust in people are part of Ardian’s culture. It is also a fast moving company and an exciting business environment for all the senior executive people in the real estate team. We are at a stage in our professional lives when we don’t need to demonstrate any longer but when new exiting challenges are the booster for our professional energy.

OP: I knew Ardian’s name and reputation, as well as the tremendous success of its team in the past 20 years, but never had direct contact until Bertrand set up a friendly meeting with Dominique Gaillard one year ago. I also happened to occasionally meet Dominique Senequier as we are both members of the Council of Attractiveness of the City of Paris. Therefore, it became a natural decision for me to join this new real estate venture once my successor at Allianz Real Estate was in place.

RP: It is a great chance that we could join together to start this new activity in Ardian, all being available to take over a new challenge at the same time. Adding up the experience, the high reputation, and the impressive professional backgrounds of a handful of senior executives like Bertrand and Olivier should be a solid ground on which to build Ardian Real Estate.

OP: It is a very exciting challenge for the real estate team to join the most unique private equity success story in Europe and to work in a “startup” mode for the launch of a new real estate activity within the framework of a very structured, organized, and successful company. Supporting the implementation and the development of a new real estate business in such an environment is the best challenge I could imagine today to follow up with 35 years of various executive positions in major international companies.
3. How are you getting organized and structured?

**OP:** Bertrand has done an incredible job to prepare the ground for this new activity since he started with it in September last year. It is very impressive for me to be part of a company full of young and very talented professionals, getting all the support, enthusiasm, and energy from the various support teams—from investor relations, to legal, marketing, and compliance to name only a few. You can feel their energy, curiosity, and excitement for this new business of real estate and their ambition to contribute to its success.

**BJL:** We are building up the Ardian Real Estate team, a European multi-local team, which we believe is going to be an amazing and quite unique group of people in the real estate world. Olivier has built up great multi-local teams at GE Real Estate (Europe) and at Allianz Real Estate (worldwide) and I believe I also did it in my past professional life with Ricardo Bofill, Accor, and Unibail-Rodamco. Since our core business will take place, at least in the coming years, in Germany, France, and Italy where Ardian has a very strong presence, significant business, and excellent people, it has been our first priority to identify the best senior professional executives in each of these three main markets of Continental Europe.

We shall also announce soon the arrival of our Managing Director for France / Northern Europe and of our Managing Director for Germany / Central Europe. Both are well established French and German professionals with impressive investment track record in our target countries and, more widely, with an extensive international experience. We are delighted that they decided to accompany us and complement very well our senior real estate management team.

**RP:** In addition to this senior management team, we are moving forward with the structuring of the operational real estate teams, respectively in Paris, Milano, and Frankfurt. We are bringing in the best talents of the new generation, with high level educational backgrounds, great professional experience, and already impressive professional achievements. We are amazed to see how the mix of Ardian’s name, a startup culture, and the participation of some senior people like Bertrand, Olivier and myself make an incredible attraction for the best talents of this industry. We know that, in real estate more than in any other business, the quality of people makes the difference.

**BJL:** We want our investment and asset managers in Paris, Frankurt, and Milan to be fully in charge of and accountable for their operational business, from acquisition to disposal. We want them to act as entrepreneurs and deal with the properties as if they own them. This entrepreneurial culture is very much how it has been working within the private equity teams at Ardian for the past 20 years, and it will be a main driver for our success in real estate. I have spent a large part of my time in the past six months in the critical issue of building up a unique team. The outcome so far is much better than what I could have dreamed of when I started. It is not yet finished since we expect other key professionals to join in the coming months, including a managing director and a team of real estate professionals based in Frankfurt. We want our real estate of 12-15 persons to work in a very open, horizontal, and empowering structure with a great team spirit and very little hierarchy.

**OP:** We do want to promote Ardian’s multi-local model for Real Estate as a main piece of a successful business development. Every member of the team will have a full alignment and get his or her share of the collective success. It may look a little surprising but, the whole real estate team in Paris shares the same working space place Vendome; it is the first time in my life that I am working in an open space but I love it. It speeds up the sharing of information and the generation of ideas, it helps build a fast alignment, and it supports the team spirit. It is amazing and it changes the communication completely.

Ardian Real Estate shall be active in the main cities of the three largest economies in the Eurozone where Ardian has already the strongest position for direct private investment.
4. How do you see the market trends and how do you plan to address the main challenges of the industry?

**OP:** There is a clear objective by a number of investors around the world to increase their allocation in real estate both in absolute terms and relative terms. This strategy is identified in most of the reports which record the investors’ intents and forecast. This has been confirmed to us during the first series of meetings we held so far with European and North American investors, such as insurance companies or pension funds. This has to be understood in a lasting environment where the fixed income and risk-free government bonds deliver historically low returns. Therefore alternative assets, and among them real estate, are a desirable investment class for most of these investors at a time when interest rates are low and the potential for rental value growth is in sight. This will make the real estate investment market very sustainable in the coming years.

**RP:** Although the market situation in the main Eurozone countries looks globally good, we cannot stand with the beliefs that the improvement of the market conditions, at a macro-economic level, will be enough to generate sufficient return on real estate investments in the coming years. The cost of financing is historically low, it will probably continue being low in the future, but we cannot gamble on such interest rates to decrease significantly in the future. We share the same opinion regarding prime yields on our main markets of interest: they will probably be stable and sustainable but we cannot expect them to go much lower in any mature market. Therefore, we do believe that the return we will offer to our investors will come from the work on the assets themselves and not from a dramatic improvement of the market conditions. We will need to bring a true professional and economical added value at the asset level.

**BJL:** Today, the situation has changed: most of the international investors are ready to move a little higher in the risk curve than a few years ago when the two most active segments used to be the core/prime assets sought after by long term institutional investors and opportunistic highly-leveraged acquisition by the US-based fund managers. It is not reasonable to expect a 20 percent return in today’s real estate market and to keep a proper risk profile for the investment. We feel that investors will be comfortable with a 9-12 percent return on their real estate assets as long as the leverage and the risk are kept at a reasonable level and the assets are of good quality. This is why we feel that a 50 percent LTV on a core+value added strategy makes sense in Europe today.

**RP:** Our main challenge will be the sourcing of large scale assets (€100/250M) with potential in our targeted markets since the investment market has become very competitive in the last couple of years. Having a very senior real estate management team with a combined 120 years of real estate experience will certainly be helpful in this respect. Operating in a multi-local model with a capacity to be fully integrated into the real estate business environment and taking advantage of Ardian’s significant involvement in the French, German, and Italian business environment through all the networks with banks and financial institutions will support our capacity to source off-market deals. At the end of the day, Ardian Real Estate will be a European platform which will keep itself active regardless of the real estate market cycles; this will enable us to build long term relationships and consolidate trust and reliability with our main stakeholders. They will recognize that we are in this business for the very long term.
5. How will Ardian differentiate itself from the other large players in the industry and become a major player in Real Estate investment management?

BJL: When looking at the size of Ardian in its historical business, you may think the scale of operations is our main objective, but it is not. What matters is our success and achievement in delivering good results to our clients. There are many very large, good, and respected real estate fund managers around the world which are and will keep being much bigger than Ardian Real Estate. We want to create and develop our success on the ground of our particular strengths and specificities. When many US-based fund managers promote Pan-European real estate funds, they run their business from London and the investments are usually based on a mix of currencies from United Kingdom (pound sterling) and Germany/France (euro). Our main pan-European funds will be euro-based. Ardian is a European firm, mainly active in direct investment in France, Germany, and Italy where it has a strong presence, offices, business connections, and great reputation. Ardian Real Estate will be active in the main cities of the three largest economies in the Eurozone where Ardian has already the strongest position for direct private investment.

OP: We will not run our real estate business from HQ or centralized offices in New York, London, or even Paris. Although our team will always keep a global perspective and all investment decisions approved by the Ardian’s relevant governance at corporate level, our operational offices in Paris, Milano, and Frankfurt should be instrumental for operational actions and business undertakings. Real estate is a local business; it is important to look at global market perspectives and evolution, but at the end of the day, you need to act locally, you need to understand your market at the micro-level, and you need to know that a building on one side of the street has a different value than the exact same building on the opposite side of the street. This is what Ardian’s multi-local model is: a capacity to share a global vision but to act with a perfect understanding of the specificities of the local market and environment.

RP: The success of Ardian Real Estate will come from our capacity to appreciate the way the local market conditions evolve, secure the right assets, and work out the product to make it fit to the evolving needs of the market. The senior members of Ardian Real Estate’s management team have demonstrated in their past professional experience that they have the expertise to beat the market by having a good understanding of the local conditions and by having an efficient asset management and portfolio strategy.

OP: Our multi-local model and our local professional expertise are very well fit with pan-European and core+/value added funds. Many fund managers are based in London, working from a distance and using local partners. We will do the job ourselves, with our own small but very talented teams in each market where we are going to invest.
6. Where are you standing with the fundraising of your first fund and when do you plan your first activities?

OP: As you know, there is a limit on what we can disclose from a compliance/regulatory perspective during the time when a fund is raised. We have received our marketing passport for our pan-European Core+/Value added fund mid-February and we have started our contacts and discussions with potential investors. So far, the reactions have been very positive and we are confident that the process will develop quickly and smoothly. Obviously, we will prioritize communication toward the 470 investors that are already Ardian’s clients in our other business lines and with whom we have long lasting relationships. In addition, we believe that real estate might interest investors with whom Ardian has never collaborated in the past and be a gate to enlarge its list of clients.

RP: We all know that the market conditions are tough today when it comes to buying the right asset in the right place and at the right time. Core assets are in demand, mainly by institutional investors, insurance companies, or sovereign funds, and their price is quite expensive, although with a good premium over government bond yields. At the other side of risk spectrum, the opportunistic segment may look attractive but we do not currently feel very comfortable with it. The secondary products in secondary locations may very well be on the wrong side of the obsolescence curve and/or happen to be too far from the needs of the tenants in a market that is evolving very fast. The risk becomes higher for opportunistic investments when, and this is a paradox, a tremendous amount of capital is willing to flow into that segment, thus making the price become relatively expensive. This is why the positioning of our first core+/value added fund has a rationale that makes sense in the current environment and it is why it seems to be positively welcomed by most of the investors whom we have met so far in Europe and North America.
BJL: We anticipate having the fund up and running before the summer and we hope to proceed with our first real estate acquisitions in September or October this year. We are confident that with our professional networks, business contacts, and trustful relations, we will be able to rapidly secure the proper assets to seed our fund. Everything is moving well and ahead of schedule and we are very positive about the future.

In an environment of low cost of money, we have a unique opportunity to create a sustainable real estate fund management business which complements the scope of investment services offered to its clients by the leading private investment firm in Europe.
This article provides an overview of the Italian real estate market, its current situation and future prospects as it continues on the road to recovery. Starting from an overview of the current economic situation and a brief description of the measures that the government is taking to stimulate growth and improve efficiency, the article focuses on the performance and future prospects of the various segments of the Italian market. Finally a summary of the main deals in the market is outlined demonstrating the increasing attractiveness of the Italian real estate market.

Political and economic setting

**Italian political reforms**

The Italian economy is continuing on the path to recovery, which started in 2015 and is continuing in 2016.

The center-left party government, led by Matteo Renzi since the first quarter of 2014, has implemented several political, economic, and institutional reforms as well as legislative changes aimed to stimulate growth.

The most important implemented reforms have been the Jobs Act, approved in September 2015, aimed at rationalizing the labor market, and the Stability Law, which came into force in December 2015. In particular, the Stability Law introduced important changes to the tax regime such as the abolition of the municipality service tax (TASI) and municipal property tax (IMU) on the first residential property owned by individuals, as well as the reduction of the corporate taxation rate (IRES) from its current 27.5 percent to 24 percent starting from 2017.
<table>
<thead>
<tr>
<th><strong>OPPORTUNITIES</strong></th>
<th><strong>THREATS</strong></th>
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<tbody>
<tr>
<td>Ambitious reforms and austerity measures will be crucial for economic growth and attracting foreign investments</td>
<td>Slowdown in emerging markets could have an impact on the industrial sector that relies on exports</td>
</tr>
<tr>
<td>Low international oil prices will contain energy and commodity prices</td>
<td>Long term unemployment persists, especially in the youth segment</td>
</tr>
<tr>
<td>GDP growth has been forecasted</td>
<td>An increase in the ratio of public debt to GDP could affect credit rating</td>
</tr>
<tr>
<td>Reduction of unemployment and taxation are expected</td>
<td>Bank credit remains constrained due to the large and still rising amount of non-performing loans</td>
</tr>
<tr>
<td>Improvement in the labour market will help to drive domestic private consumption higher</td>
<td>Perceived complications in legal and administrative processes may dissuade investors</td>
</tr>
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The Italian Government has implemented several reforms in 2015. This will make Italy an important market for foreign investors.
Macroeconomic highlights

In a general climate of austerity across developed countries, the Italian market is showing signs of recovery. Estimates of GDP for the coming years are positive; in fact, GDP is forecast to increase to 1.4 percent in 2016, compared to 0.8 percent for 2015.

The ratio of debt to GDP is expected to remain substantially stable, slightly increasing from 132 percent in 2014 to 136 percent in 2015 (these are estimates as final data is not yet available), but is anticipated to reduce in the following years.

In 2016, private consumption is expected to grow by around 1.2 percent, a similar level to GDP growth.

Inflation in Italy is expected to increase to 1 percent in 2016 up from 0.3 percent recorded in 2015.
In a general climate of austerity across developed countries, the Italian market is showing signs of recovery.

Figure 3: Key indicators of the Italian economy

- Population (2015): 60.8m
- Ratio Debt to GDP (2014): 132%
- GDP per capita (2014): €26,545
- Exports growth (2014): 2.8%
- Imports growth (2014): 2.7%

Source: Deloitte on market data
The economic outlook for Italy is positive, with the diminishing risk of a return to recession

**Labor market**

Unemployment in Italy has started to show signs of improvement, reducing from 13 percent in Q1 2015 to 10.3 percent in Q3 2015.

In absolute values, the number of unemployed people in Italy for the entire year of 2015 is expected to reach about 3 million out of a total of 25.5 million people currently in the active labor force.

Unemployment is still a significant issue within the younger population (15 to 24 years) and reached 40.5 percent in Q3 2015. The recently enacted Jobs Act is designed to address this issue by providing tax breaks for companies that hire workers on permanent contracts and make the employment market more fluid.

In addition, the labor legislation will more accurately align the Italian employment market with the other European industrialized countries and stimulate interest and investment from multinational corporations in the coming years.

Overall, the measures taken by the government to improve the labor market, reorganize public administration, and support economic growth will have a positive impact on the economy over the medium to long term.

**Figure 4: Unemployed people in Q3 2015 (m)**

- Men: 2.7m
- Women: 1.2m
- Total: 1.5m

**Source: Deloitte on market data**

**Figure 5: Italian unemployment rate breakdown by gender (percent)**


**Source: Deloitte on market data**

Unemployment is forecast to decrease in 2016
Real estate market

Market overview
The Italian Real Estate market continues to show growth with a total level of investment in 2015 amounting to €8.2b, more than doubled compared to 2014, with the last quarter of 2015 accounting for around €3.1b of the total.

The majority of the investments have been made by foreign investors from the Middle East, Central Europe, and Asia. Of the total volume invested in Italy in 2015, 75 percent (6.1b€) involved foreign capital.

In 2015, total investment data showed that office properties were the preferred asset class, with the hospitality sector showing a good increase in the volume of transactions compared to 2014.

The retail and logistic sectors registered a reduction in investment volume compared to 2014, mainly due to the lack of quality in the offerings.

In terms of location, Milan and Rome still remain the main target destinations. A recent survey suggests Milan was the most attractive city, with 10 percent of respondents expressing their interest to invest in the Italian city rather than other European cities.

In fact, of the total investments in real estate made in 2015, 4.5b€ has been invested in Milan, representing an increase of about 3 times with respect to 2014, while 0.8b€ has entered the city of Rome, which represents an increase of 5 percent.

European investors are looking for assets in prime locations to ensure a long term and secure income

Figure 7: Total Real Estate investment in Italy in 2015

Figure 8: Total Real Estate investment in Italy in 2015

Milan continues to be an attractive target for real estate investors
Competition for quality assets towards the end of 2015 has led to the compression of net yields in the Italian commercial real estate market

Office
In 2015 the prime office market continued to dominate the interest of global investors, who targeted large assets and portfolios. Domestic investors showed the most interest in prime assets of a smaller size.

In Milan and Rome, prime net yields both decreased compared to 2014, passing from 5 percent and 5.2 percent respectively to 4 percent in 2015.

Prime rent in Milan and Rome CBD in 2015 remained stable at 490€/mq/yr and 380 €/mq/yr, a similar level to 2014.

Retail
In 2015, retail investments were focused on the northern and central regions of Italy with a focus on the shopping center segment.

Net yields generally decreased in 2015 in the main locations. Prime yields for high street, for example, decreased from 4.5 percent in Q4 2014 to 3.5 percent in Q4 2015.

Investment volume in shopping centers reached 0.7b€, equal to 51 percent of the total retail investment in 2015. Shopping centers are forecasted to remain the most attractive asset class within the retail segment.

Hotels
The Italian hospitality market continues to be one of the most attractive real estate segments, showing interest from key international investors as well as hospitality groups.

The key performance indicators remain very attractive with the average occupancy rate in the main cities reporting an occupancy rate above 70 percent. In fact, in 2015 Florence registered an annual average occupancy rate of 74.4 percent, followed by Rome and Milan, with 72.4 percent and 71.7 percent respectively.

The World Exhibition Expo 2015 Milano concluded in October 2015 and attracted millions of visitors to Milan and Italy, improving the occupancy of many hotels in the Milan area. This positive trend has continued in Rome, thanks to the ongoing Jubilee celebrations that started in December 2015.

Industrial
Investments in the industrial sector in 2015 have been mainly focused on high quality logistic warehouses in target geographical areas such as the north of Italy, where investments in Lombardy accounted for nearly 60 percent of the total investment volume, followed by Piedmont, with 19 percent of the total investment volume.

Prime net yields in Italy in 2015 showed a decrease, from 7.5 percent in 2014 to 6.5 percent in 2015.
Properties in secondary locations are becoming more attractive, especially within portfolio deals.

There is growing demand from retailers, not only for prime centers, with expected influence on the future rental trend.

Source: Deloitte on market data
Recent transactions in Italy

Figure 12: Top deals in 2015 and beginning of 2016 by asset class

<table>
<thead>
<tr>
<th>Asset Class</th>
<th>Property</th>
<th>Location</th>
<th>Buyer</th>
<th>Value (€m - est)</th>
<th>Year</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Office</strong></td>
<td>Porta Nuova (office complex)</td>
<td>Milan</td>
<td>Qatar Investment Authority</td>
<td>1,200 (60%)</td>
<td>2015</td>
</tr>
<tr>
<td></td>
<td>Palazzo Broggi</td>
<td>Milan</td>
<td>Fosun Group</td>
<td>345</td>
<td>2015</td>
</tr>
<tr>
<td></td>
<td>Office portfolio (2 buildings)</td>
<td>Milan</td>
<td>Partners Group</td>
<td>233</td>
<td>2015</td>
</tr>
<tr>
<td></td>
<td>Palazzo Turati</td>
<td>Milan</td>
<td>Sofaz</td>
<td>97</td>
<td>2016</td>
</tr>
<tr>
<td><strong>Retail / Mixed Use</strong></td>
<td>Via della Spiga 26</td>
<td>Milan</td>
<td>Thor Equities (USA)</td>
<td>164</td>
<td>2015</td>
</tr>
<tr>
<td></td>
<td>La Cartiera shopping center</td>
<td>Pompei</td>
<td>ECE Fund II</td>
<td>132</td>
<td>2015</td>
</tr>
<tr>
<td></td>
<td>Zara store – Corso Vittorio Emanuele 11</td>
<td>Milan</td>
<td>Gruppo Inditex</td>
<td>97</td>
<td>2015</td>
</tr>
<tr>
<td></td>
<td>Palmanova Outlet Village</td>
<td>Palmanova</td>
<td>Blackstone</td>
<td>80</td>
<td>2015</td>
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<tr>
<td></td>
<td>Trony store - Via Torino</td>
<td>Milan</td>
<td>M&amp;G Real Estate</td>
<td>75</td>
<td>2015</td>
</tr>
<tr>
<td><strong>Hotel</strong></td>
<td>Hotel Excelsior</td>
<td>Rome</td>
<td>Katara Hospitality</td>
<td>222</td>
<td>2015</td>
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<td></td>
<td>Gritti Hotel Palace</td>
<td>Venice</td>
<td>Nozul hotels &amp; resorts</td>
<td>105</td>
<td>2015</td>
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<td></td>
<td>Hotel Intercontinental De la Ville</td>
<td>Rome</td>
<td>Katara Hospitality</td>
<td>222</td>
<td>2015</td>
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<tr>
<td></td>
<td>Hotel Aldrovrandi</td>
<td>Rome</td>
<td>Dogus</td>
<td>90</td>
<td>2016</td>
</tr>
</tbody>
</table>

Source: Deloitte on market data
The majority of deals in Italy in 2015 involved foreign investors
CONTINENTAL

The continuing evolution of the European investment market
With the dust having settled on 2015, we can now look back on the investment trends that defined the year and ask what 2016 might have in store.

There is certainly a lot to talk about: 2015 saw global real estate investment reach US$877 billion, the highest since 2007, driven by rising activity in both the Americas and EMEA. Yet beyond the headlines, the data point to a market that is evolving in terms of the sources of capital, the type of vehicles most active, and the type and location of properties being targeted.

In the EMEA region, although overall activity in 2015 was weaker than in 2007, Ireland, Italy, Norway, and Switzerland all saw investment exceed this previous peak. While parts of the region are yet to see activity recover to 2007 levels, a number of the larger markets including Germany, the Netherlands, and Belgium are seeing double-digit growth.
The office sector has long been a favorite for international investors, and still accounts for well over one third of investment globally. Within the EMEA region, 12 of the top 20 locations by investment volume were office markets. Predictably, London, Paris, and Frankfurt recorded the highest volume of office investment in 2015 within the EMEA region, but investors showed a clear renewed interest in other EMEA office markets.

A clear characteristic of investment post-recession, and especially in 2015, is that purchasers have shown a growing preference for alternative types of property, such as retail, hotels, student housing, and apartments. The strong growth in many of Europe’s retail property markets is partly cyclical, reflecting the gradual economic recovery taking hold and improving consumer sector confidence, as well as the increasing willingness for investors to look beyond traditional “core” cities. Yet the rising interest in other types of property is arguably of greater interest, as it provides proof that investors are willing to consider an altogether broader range of investment types in their hunt for yield.

Figure 2: Investment volume growth 2015 vs. 2007

Figure 3: Investment volume growth 2015 vs. 2007
Figure 4: Top 20 EMEA markets by volume 2015
Another clear trend during the recovery cycle has been the internationalization of real estate investment in the EMEA countries. The year 2015 saw a further significant increase in the share of cross-border transactions, especially within the main European destinations, with overall cross-border purchases of European real estate up by almost 20 percent compared with 2014. This has come in part from cross-border trading within Europe, but has also been heavily supported by a rise in demand from North American and Asian investors.

Focusing on the source of global capital into real estate shows a number of different trends. For example, while US players invested heavily across EMEA real estate in 2015, the foreign real estate that Singaporean investors bought was mainly in the Americas and the UK; whereas Chinese foreign investment was expanded in 2015 across all major regions. Similarly, while French investment abroad has been almost entirely in Europe, around one third of German foreign investment went to the Americas or Asia.
Another clear trend during the recovery cycle has been the internationalization of real estate investment in the EMEA countries.

In Europe, some markets recorded extremely high levels of foreign investment activity in 2015. Nearly 100 percent of all investment in Polish real estate was from foreign sources. Investment from foreign sources was also high in Italy, Belgium, and Denmark, reflecting improving expectations for returns in these markets.

Equity funds, institutional funds, and private and unlisted companies were the most active purchasers in 2015, accounting for 62 percent of all purchases made globally. However in net terms, REITs and listed companies were the most active acquirers of real estate. Meanwhile, private and unlisted companies accounted for a much smaller share of total net investment, selling over US$320 billion of real estate globally, which was nearly as much as they purchased—therefore neither increasing nor decreasing their exposure to global real estate.

Figure 7: 2015 investment from foreign sources

Figure 8: Investment by investor type 2015
While US equity funds and institutional funds were the biggest buyers of real estate in 2015, REITs and listed companies in Asia Pacific, specifically J-REITS, were the most active investors. They spent over US$126 billion whilst only selling US$53.5 billion, and therefore significantly increasing their global real estate allocation.

There is also some evidence that the weight of capital targeting real estate is causing some investors to pursue portfolio deals and club deals as a means of deploying funds more quickly—a trend clearly visible in the US, UK, and other parts of Europe.

EMEA investment was boosted in 2015 by recovering prospects for real estate returns, growing diversity in the type and location of real estate that investors are willing to consider, and further net increase in acquisitions by listed investors. Looking ahead, we expect these drivers to remain largely intact during 2016, but highlight some factors that we believe will exert additional influence on the EMEA market during 2016:

1. **Improving fundamentals for core European property**
   The outlook for rental growth is relatively positive, in particular in the Eurozone, and is underpinned by comparatively buoyant economic prospects (see Figure 10) and rising consumer sentiment. Furthermore, there are many locations in which further yield compression could be seen as investors compete for the best assets. This combination of rental growth and yield compression could be enough to elevate total returns to levels not seen for some years, attracting further interest from investors.

2. **Financial and political instability will continue to impact global demand for real estate**
   Falling oil prices and political instability have hit investment levels in global real estate. Demand from Middle Eastern Sovereign Wealth Funds (SWFs) slowed at the end of 2015, and there is an ongoing risk that some may need to repatriate foreign capital (such as that invested in real estate) to meet domestic budget obligations.

   Nevertheless, in other emerging markets, economic instability is driving some investors to look abroad for investment opportunities. For investors who may be seeking diversification—or may simply be looking for lower risk assets—real estate in core European and North American cities is likely to remain very attractive.

3. **The relative weakness of the Euro could support investment**
   Although currency is rarely a primary driver of investment activity, it is difficult to ignore the fact that the strength of the US Dollar has made Euro (and Sterling) denominated investments look increasingly attractive to Dollar-based investors. If anything, the Euro weakness could be exacerbated, as US and Eurozone monetary policies diverge over the coming year.

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**Figure 9: EMEA net investment by investor type**

![Graph showing net investment by investor type in EMEA from 2007 to 2015.](source: RCA/Deloitte)
4. **Attractive yield premium of property over government bonds will persist**

With little prospect of significant interest rate rises across Europe in the medium term, government bond yields will remain close to historic lows in many counties, meaning that real estate yields will stay comparatively attractive for investors seeking income. In particular, we expect this differential to remain a driver for global investment funds—many of which remain entirely focused on bonds and equities—to consider increasing capital allocations to real estate.

5. **Competition for core assets will cause some investors to broaden their search**

London remains an extremely attractive location for overseas investors but the sheer weight of money has put strong pressure on pricing. For some investors, London and other core European cities may have become overpriced, and so a trend has emerged to increase investment into other core European markets. Additionally, the weight of capital chasing core investments may drive cash-rich investors to development opportunities in order to deliver the required returns. However, lenders are still cautious about lending on speculative development.

6. **Evolving regulations could help Asian institutions increase real estate allocations**

Recent changes in Chinese regulation have permitted institutional funds to invest a higher allocation to real estate within their portfolios, and to invest in overseas real estate. Lately, Taiwan and Malaysia have also seen a liberalization of regulation surrounding investment in real estate. As a consequence of ongoing liberalization, it is expected that funds in Asia will continue to climb the rankings as significant players in global real estate investment in the future.

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**Figure 10: Economic overview**

<table>
<thead>
<tr>
<th>Country/Region</th>
<th>Overview</th>
<th>Real GDP growth 2016</th>
<th>Inflation 2016</th>
</tr>
</thead>
<tbody>
<tr>
<td>United States</td>
<td>Despite global economic and financial market volatility, short-run indicators suggest a reasonably positive outlook for the US. Growing business investment is expected to cement the recovery and, as hiring picks up, the labor force participation rate of younger cohorts will begin to rise. The large amount of slack will prevent rising demand from translating into inflation, despite relatively accommodative Fed policy.</td>
<td>2.40%</td>
<td>1.49%</td>
</tr>
<tr>
<td>Eurozone</td>
<td>The Eurozone is in recovery, but the variance in growth rates between counties is widening. Ireland and Spain have bounced back in a spectacular fashion, while Germany grew very slightly above the Eurozone average in 2015; Italy and France failed to reach the Eurozone average by a substantial margin. A key question for 2016 will be the extent to which corporate investment activity will recover.</td>
<td>1.95%</td>
<td>1.02%</td>
</tr>
<tr>
<td>UK</td>
<td>Despite uncertainty, momentum in the UK domestic economy remains resilient. Yet while the consumer sector has picked up, the outlook in the corporate sector is more mixed; against a backdrop of the Sterling’s rise in the last two years, moderating global growth does not bode well for UK export demand. In addition, the United Kingdom may hold a referendum on EU membership in 2016.</td>
<td>1.70%</td>
<td>1.50%</td>
</tr>
<tr>
<td>Japan</td>
<td>The economy narrowly avoided recession in 2015, with sluggish growth in domestic consumption and external demand weighed down by slowing growth in China. Despite healthy profits, Japanese corporations have been loath to increase capital expenditure—possibly due to factors such as uncertainty in the global economy and subdued domestic demand.</td>
<td>1.10%</td>
<td>0.44%</td>
</tr>
<tr>
<td>China</td>
<td>China’s economy has continued to disappoint those observers who had expected that the slowdown would abate and possibly reverse. Growth in domestic and foreign investment into China is still falling, although domestic consumption remains relatively robust, driven partly by rising wages.</td>
<td>6.50%</td>
<td>1.50%</td>
</tr>
</tbody>
</table>

*Source: Deloitte/EIU/Statista*
The alternative investment fund industry has had to face several changes over the last few years in terms of regulation (e.g. the EU Alternative Investment Fund Directive) and tax (e.g. the OECD Base Erosion Profit Shifting reports and recent EU developments). Luxembourg and Ireland have been actively trying to provide alternative asset managers with answers to some of these challenges.
The upcoming Luxembourg Reserve Alternative Investment Fund

The Luxembourg Reserved Alternative Investment Fund (RAIF) is the newest type of vehicle proposed by the Luxembourg government at the end of last year. This new draft law is expected to be adopted by the parliament (subject to amendments) before the end of the second quarter 2016.

Why a new regime?

Luxembourg already offers several opportunities and investment fund regimes to asset managers. However, current regulations in the EU and Luxembourg require both the Alternative Investment Fund Manager (AIFM) and the fund vehicle (a Luxembourg Specialized Investment Fund\(^1\) or a Luxembourg venture capital fund\(^2\)) to be authorized and supervised by a regulatory body—namely the CSSF in Luxembourg.

Such an overlapping of a regulatory framework at the product and manager levels has previously weakened the position of Luxembourg compared to offshore fund regimes notably due to time-to-market issues.

The new RAIF regime proposes to extend all the existing benefits associated with the SIF or SICAR regimes without the corresponding constraints. The RAIF will not be approved and supervised by the CSSF; the supervision will only be indirect since the RAIF must appoint an authorized AIFM as manager.

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\(^1\) Law dated 13 February 2007 on Specialized Investment Funds (SIF).
\(^2\) Law dated 15 June 2004 on Société d’Investissement à Capital Risque (SICAR).
AIFMs will now have the ability to choose to set up their Luxembourg Alternative Investment Fund (AIF) vehicle as either a regulated fund or an unregulated fund under the RAIF regime. It will mainly depend on whether the potential investors need the AIF vehicle to be regulated.

Main features
The industry will benefit from the following (main) features:

- There will not be any CSSF supervision of the vehicle and hence only a few days will be sufficient for setup. As indicated above, the RAIF should appoint an AIFM as manager
- The eligible investors are institutional, professional, and well-informed investors similar to the SIF or SICAR regime
- The RAIF could be set up as a mutual fund, a SICAV, or under a legal regime that is neither an FCP nor a SICAV, thus offering a wide range of possibilities. In all cases, it will be possible to implement compartments to segregate investors or investment policies
- A fixed or variable capital will be permissible
- There should not be any limitations in eligible assets and the diversification ratios should apply in principle. If a RAIF restricts its investment policy in its constitutive documents to investment in risk capital, it should not be required to operate under the principles of risk spreading

It should also be noted that the central administration and the depositary function should be established in Luxembourg. In addition, the RAIF will need to appoint an independent auditor emphasizing the key role this stakeholder has in monitoring the fund structure.

Tax regime
The main objective of the Luxembourg government was to propose a tax neutral vehicle which would allow fund managers to accommodate investments and/or investors’ tax needs or constraints.

1. By default, the full SIF tax regime would applicable.

The RAIF will be fully exempt from Corporate Income Tax (CIT), Municipal Business Tax (MBT), and Net Wealth Tax (NWT). Being exempt, the access to double tax treaties should be confirmed on a case-by-case basis. Tax transparency will also apply to RAIF setup as mutual funds or as limited partnerships. In both cases, a 0.01 percent subscription tax will apply to the vehicle with certain exemptions available. Furthermore, there will not be any withholding tax on distributions and the Luxembourg non-resident speculative gain taxation rules will not apply.

2. Alternatively, the RAIF would be subject to the SICAR tax regime in case it is investing in risk capital assets.

The RAIF will then be subject to CIT and MBT but any income from transferable securities and temporary investments would be eligible for an exemption (i.e. in practice, no tax pick-up on dividends, liquidation proceeds, and capital gains). Being subject to tax, the RAIF should in principle have access to double tax treaties, although this is subject to confirmation on a case-by-case basis. Net Wealth Tax will not apply. Tax transparency will also apply to RAIF setup as limited partnerships. Furthermore, there will not be any withholding tax on distributions and the Luxembourg non-resident speculative gain taxation rules will not apply.

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3 Undertaking for Collective Investments governed by Part II of the Law dated 17 December 2010, SIFs or SICARs.
4 Investors who confirm in writing that they adhere to the status of “well-informed” investors and who either (i) invest a minimum of €125,000 or (ii) have been assessed by a credit institution, an investment firm, or a management company which certifies the investors’ ability to understand the risks associated with investing in the SIF.
5 Fond Commun de Placement.
6 Société d’Investissement à Capital Variable, also known as société anonyme, société en commandite simple, société en commandite spéciale, société en commandite par actions, société à responsabilité limitée or société coopérative organisée sous forme de société anonyme.
7 Société en commandite simple or société en commandite spéciale.
8 Saved for the minimum NWT.
9 Société en commandite simple or société en commandite spéciale.
It will accordingly be possible to set up the RAIF as a tax transparent vehicle to accommodate source country tax considerations or be able to rely on the tax profile of the ultimate investors. It should also be eligible to the US’s “check-the-box” election which would allow the vehicle to be disregarded for US federal income tax purposes. This would provide certain tax benefits to US investors and increase the efficiency of the structure from their standpoint.

VAT is generally a key factor when deciding on the location of the fund, especially in comparison to offshore funds. It has been confirmed that the fees paid in consideration of the management of the fund vehicle would be eligible for the Luxembourg VAT exemption, both if the RAIF opts for the SIF tax regime or opts for the SICAR tax regime.

Creating your RAIF
There will be various ways to set up a RAIF, including from scratch (in case this is a new fund structure), through the conversion of an existing foreign or Luxembourg vehicle, or through the migration of an offshore fund to Luxembourg. In the two latter cases, potential foreign tax implications should be analyzed on a case-by-case basis (e.g. a migration could be a taxable event for a given foreign investor or for capital gain tax purposes in one source country) although this would probably be fully tax neutral from a Luxembourg tax standpoint.

We expect this vehicle to be widely used by AIFMs, given the regulatory and tax benefits offered but also considering the current global tax environment post-BEPS.

The model whereby the AIF vehicle (as a RAIF), the various special purposes vehicles, and possibly the AIFM are located in the same jurisdiction should reduce risks and make the structure more robust from a BEPS and a foreign tax perspective. There is indeed a clear convergence between tax and regulation which favors the single investment fund platform strategy.

Alternatively, AIFMs would use tax transparent AIFs, which the RAIF regime allows, in order to be able to rely on the tax profile of the ultimate investors and directly apply double tax treaties with source countries.
The Irish Collective Asset-management Vehicle

The Irish Collective Asset-management Vehicle (ICAV) is the newest type of regulated Irish fund vehicle, introduced into Irish legislation in March 2015. The ICAV offers many benefits to investors and promoters including enhanced distribution and a simplified compliance model. The indications are that there has already been significant activity in the ICAV market; with expectations that this will continue, ICAVs are set to become the corporate vehicle of choice for new fund setups in Ireland.

Ireland already offers several vehicles for fund structuring purposes which have been the bedrock of Ireland’s hugely successful fund industry to date. The ICAV is Ireland’s first tailor-made corporate fund vehicle, designed specifically to offer the most attractive features of each of the existing structures into one. The new ICAV structure runs parallel to, rather than replaces, existing fund structures. Some of the key benefits of an ICAV include:

- The ICAV is eligible for the US “check-the-box” election
- Financial statements can be prepared on a sub-fund basis
- The requirement for an AGM can be disposed
- Risk spreading is not required
- Amendments to the ICAV’s constitutional documents are possible without shareholder approval
- The ICAV has a streamlined incorporation and authorization process, with both steps carried out simultaneously by the Central Bank of Ireland (CBI)

The ICAV may be established as a UCITS or an AIF and will have the standard features of existing Irish fund structure, such as the ability to establish an umbrella, sub-funds, and share classes, and the benefit of segregated liability between sub-funds. There is also significant flexibility concerning the type of assets in which an ICAV can invest, meaning it is quickly becoming the Irish investment vehicle of choice for new product launches.

The ICAV benefits from standalone fund legislation (Irish Collective Asset-management Vehicles Act 2015) outside the scope of European and Irish company legislation. This protects it from future company law changes, making it immune to amendments that these regimes intended for trading companies, which could have caused unintended consequences for investment funds. However, like other corporate entities, the ICAV has a board of directors and company secretary and can be listed on the stock exchange.

Existing Variable Capital Companies (VCCs) have the option of converting to an ICAV, where existing unit trusts, Common Contractual Funds, and Investment Limited Partnerships can merge with the newly created ICAV. There is also a simplified, one-step re-domiciliation and migration process available for foreign funds looking to convert their fund to an ICAV. However, before a conversion or re-domiciliation is undertaken, a cost-benefit analysis is advisable to determine whether the potential savings would justify the costs of conversion.

Tax Considerations of the ICAV

From an Irish tax perspective, the ICAV is treated as an investment undertaking under Part 27 of the Taxes Consolidation Act 1997. The ICAV will be treated exactly the same as a VCC from an Irish tax perspective (i.e. it is effectively not subject to tax in Ireland on its income or gains, and Irish tax only arises for the fund in the occurrence of certain chargeable events where the investors are resident in Ireland or the appropriate investor declarations are not in place). However, there are a number of tax considerations, both in setting up an ICAV and in converting an existing fund structure to an ICAV.
As with setting up any Irish fund, consideration should be given to matters such as:

- The appropriate tax registrations (e.g. IUT, VAT, payroll, FATCA)
- The appropriate non-residency declarations/exempt Irish investor declarations
- Investment considerations around withholding tax and capital gains tax
- Reporting requirements, such as FATCA, returns under SB91C TCA 1997, and the Common Reporting Standard (CRS)
- Availability of treaty access for the ICAV
- Foreign withholding tax reclaims
- Foreign tax reporting requirements

**Check-the-box election**

One of the key benefits of the ICAV is the eligibility of the ICAV for the US “check-the-box” election. This election allows a fund to be treated as a transparent entity for US federal income tax purposes. This means that any US investor is placed in the same tax position as if they had invested directly in the underlying investments of the ICAV. This status makes the ICAV particularly attractive for US investors seeking tax efficient returns from a regulated corporate fund vehicle.

It is worth noting that this election applies for US investors only and the ICAV would continue to be treated as opaque for investors resident in other jurisdictions. Where an ICAV intends to “check the box” for US tax purposes, US tax advisers will need to review the proposed ICAV structure to ensure that any sub-funds are suitable for the “check-the-box” election and meet the US tax objectives of the fund. One should also consider if there are any adverse US tax consequences of exercising the right to “check the box,” especially for non-US investors in the fund. Finally, “checking the box” may give rise to reporting requirements and the ICAV should ensure that they have a service provider able to provide such reporting.

**Converting to an ICAV**

Existing VCCs have the option to convert to an ICAV, and overseas investment companies have the option of redomiciling to Ireland as an ICAV. Conversion is also available for corporate AIFs and corporate UCITS. The conversion or migration by continuation enables a fund to maintain its track record by changing the seat of incorporation rather than starting anew.

With regard to other jurisdictions, a fund considering converting to an ICAV needs to consider the implications in all jurisdictions where investors are resident and also where its investments are held. For example, while there would be no adverse Irish tax implications from converting an existing fund to an ICAV, the fund would need to consider if there is any risk that the tax authorities in the other jurisdiction would regard it as a disposal and re-acquisition of the units in the fund or the investments held by the fund, perhaps giving rise to capital gains tax risks or reporting/tax return requirements.

**Uptake of the ICAV**

As of 31 December 2015, there were 129 ICAVs registered with the CBI, including at least eight funds converted from existing Irish PLC funds to ICAVs. It is expected that this activity in the ICAV market will continue and that the ICAV will become the corporate vehicle of choice for new fund setups.

**Conclusion**

The alternative investment fund industry has had to adapt its business model and structures to the various tax and regulatory changes over the last couple of months or years. Luxembourg and Ireland have proven to remain highly attractive compared to offshore fund regimes by making flexible fund regimes available to fund managers, which could also accommodate foreign tax considerations.
Commercial Real Estate Redefined
How the nexus of technology advancements and consumer behavior will disrupt the industry

Disruption is not a new phenomenon, yet it is a hot topic of discussion among executives and in every boardroom today. Many of these discussions center around the potential impact of technology on their business, and while this trend is also not new, nearly every traditional business is feeling the heat more than ever.

The convergence of multiple technologies, such as advanced cloud computing, mobile, social media, and analytics, is leading to fast-paced, big-bang disruptions in many industries (see Figure 1). For example, this convergence is enabling high-quality Internet enabled services such as advanced payment systems, Internet of Things, and geolocation services globally. Furthermore, small and large technology companies are leading the charge by constantly experimenting with product innovation. These companies use hackathons and other approaches to innovate products and services that have the potential to obliterate existing businesses. As a result, traditional value chains are being transformed with transfer of power to the consumer. The technology advancements are increasing global interconnectedness, data ubiquity and transparency, and speed of information access and exchange. As a result, disruption in one part of the ecosystem is rapidly spreading to the broader world.
Figure 1: A nexus of technology advancements and consumer behavior will disrupt the industry.
Other evolving trends include rising urbanization and changing global consumption patterns. Urban population is expected to grow to 66 percent of the global population by 2050, compared to 54 percent and 30 percent in 2014 and 1950, respectively. This rising urbanization is redefining how and where people live, work, and play. Consumption patterns are tilting toward more customized goods and services. Some consumers are increasingly environmentally conscious, preferring to reuse and share goods rather than own and acquire new ones.

The nexus of technology advancements and consumer behavior changes has the potential to redefine urban planning and fundamentally change Commercial Real Estate (CRE) demand-supply dynamics and business models, including real estate usage, site location, development, design, valuations, leasing, and financing.

That said, as the disruptive trends evolve, regulators will likely have to develop policies and regulations to strike a balance between protecting public interest and enabling innovation.

As we move into 2016 and beyond, CRE executives will increasingly be challenged to evolve the business-as-usual, traditional sector services by four key macro trends that will result in significant disruption for the CRE industry over the next decade:

• Collaborative economy
• Disintermediation of brokerage and leasing
• War for talent
• The last mile

While there is no certainty about the extent of disruption in each of these trends, CRE companies will have to be agile and flexible in embracing technological innovations to keep pace with their new competitors and maintain their edge. Given this, we are now facing a critical time for change in the sector where businesses will either have to disrupt—or be disrupted. We all recognize that it is best to get out in front of the curve and be the disruptor.
The collaborative economy will reshape CRE demand and use (see Figure 2)

Growth in the collaborative, or “sharing,” economy is spilling over into CRE, creating a variety of new challenges for traditional players and incumbents, including the creation of excess capacity. Moving into next year, businesses will need to compete against the expansion of online marketplaces—which are quickly moving beyond travel rentals into the office sub-sector—and find innovative ways to fulfill the demand-based needs of tenants.

As a result, redefinitions of commercial space usage and fluid design will emerge, while dynamic revenue models simultaneously replace existing business models to allow for flexible-term leasing. For now though, CRE leaders can begin positioning themselves for future change by rethinking approaches to designing, developing, and redeveloping both new and existing spaces. We are moving from an ownership society to an access society, i.e. share and get what you need when you need it.
Improved access to market information and data will bring buyers and sellers of real estate, and lessors and lessees of real estate, closer together and increases the potential for broker-less transactions.

Technology will disintermediate brokerage and leasing

With the continued rise of direct-to-consumer CRE services—spurred onward by customer demand for data ubiquity and transparency—executives in the traditional brokerage and leasing space will find that disintermediation is the theme of the next decade (see Figure 3).

Figure 3: Incumbents and new entrants are offering more technology-driven services

1. Demand supply gaps can be met in real-time
2. Traditional model for selling and aggregating CRE information is getting inefficient and irrelevant
3. Increased data ubiquity and transparency will eliminate the competitive edge of proprietary data
4. Topline growth and margins of traditional players can potentially be under pressure
Improved access to market information and data will bring buyers and sellers of real estate, and lessors and lessees of real estate, closer together and increases the potential for broker-less transactions. In order to adapt to market demands and accommodate shifting tenant expectations, it will become critical for companies to develop new service models and non-brokerage revenue sources that push the envelope (see Figure 4). Many, for instance, will need to shift from regional to central client relationship management and build up their IT to harness the power of tools such as artificial intelligence and cognitive technologies to truly deliver the value clients demand.

Unlike the more tangible collaborative economy and technology trends discussed above, consumer preferences and talent are markedly different because they represent abstract market shifts. As a result, CRE executives must have an even deeper understanding of them in order to gauge how and to what extent they will disrupt their businesses. So as we look out into the next ten years, CRE executives should keep the following in mind:

**Figure 4: New players are providing innovative service to landlords and tenants**

- Ensure free and open access to otherwise private CRE data such as lease comparables (comps) and tools
- Provide a platform to track transaction activity, manage property portfolio, and collaborate seamlessly
- Help companies with surplus space to connect directly with businesses that are looking for flexible workspace solutions
- Enable tenants and landlords to evaluate market data and support leasing decisions
- Have online listings of development opportunities in cities
- Enable virtual property tours and property access through remote-controlled robots

Innovative brokerage and leasing services
Big changes are on their way regarding where CRE is located and the way it is designed and used.

**Consumer preferences will blur the lines between retail and industrial properties**

The on-demand and same-day delivery expectations consumers now crave, as well as technology innovations in areas like additive manufacturing, 3D printing, robotics, and virtual reality are already impacting the location and use of retail and industrial properties (see Figure 5).

Resulting on-demand retailing and manufacturing will continue to reduce inventory holding and demand for large warehouse spaces, while leading to the rise of inventory optimization technology. In response, CRE executives operating in retail and manufacturing should consider exploring smaller, local distribution centers and flexible store formats as a way to adjust and capitalize on shifting trends. Changes in transportation including self-driving or driverless cars and drones will have a major impact on the delivery of goods to the consumer.

**The war for talent will revolutionize demand for office and mixed-use properties**

Big changes are on their way regarding where CRE is located and the way it is designed and used. The source? A growing talent gap and evolution in the talent marketplace. As the war for talent intensifies, office property owners will increasingly have to think about how talent dynamics factor into location-based decision making and development projects. Tangentially, the continued rise of a robust millennial workforce (see Figure 6) and its unique demands for a non-traditional employment experience will require companies to adopt mixed-use spaces that incorporate office, residence, and recreation options over stand-alone properties.
Transportation Oriented Development (TOD) will become a CRE must in major cities, where the creation of compact, walkable, mixed-use communities will locate near high quality transportation. Remember: Millennials, who will comprise the vast majority of the workforce by 2030, prefer an open and flexible work culture that allows them to work anywhere, anytime—meaning properties will need to be developed to match their expectations of Live-Work-Play environments (see Figure 7).

In the face of these growing trends, there is vast potential for traditional CRE models to be turned upside down, meaning that executives need to understand now how to best prepare themselves for what comes next.

For further information, download a copy of the Deloitte Center for Financial Services report, “Commercial real estate redefined: How the nexus of technology advancements and consumer behavior will disrupt the industry,” available on Deloitte’s website.

Figure 6: Millennials have distinct work preferences

Workforce composition by 2030

<table>
<thead>
<tr>
<th>Millennials</th>
<th>Rest</th>
</tr>
</thead>
<tbody>
<tr>
<td>75%</td>
<td>25%</td>
</tr>
</tbody>
</table>

Millennials prefer open and flexible work culture that allows them to work from anywhere, anytime

Millennials want less hierarchy and better emotional and physical well-being at workplace

By 2020, 40 percent of workforce will favor part-time or contractual employment

Figure 7: How can CRE players deal with the war for talent?

Strategies to navigate the rising war for talent

- Redevelop existing properties to tailor to the changing talent dynamics
- Build expertise in designing and developing mixed-use and flexible properties
- Collaborate with owners of other property types
- Evaluate areas where knowledge workers are likely to live, work, and play
OPPORTUNITIES AHEAD
Interview with Ismael Clemente of Merlin Properties

Ismael Clemente
Being the founding partner of Merlin Properties, Ismael Clemente is currently President and CEO, in charge of the origin and structuring of real estate investments in Spain and Portugal. Over the last 20 years, Ismael has worked at Bankers Trust, DB Real Estate, and RREEF, where he was Managing Director. He has completed transactions with an aggregate value of more than €5 billion across all property sectors. He holds degrees in Law and Economics & Business Administration, majoring in Finance, from ICADE, is a teacher of the MRE program at Instituto de Empresa, and is a member of the Spanish Council of the Urban Land Institute (ULI).
Merlin Properties SOCIMI, S.A. is the largest real estate company listed on the Spanish stock exchange, and its main line of business is the acquisition and management of commercial property assets in Spain and Portugal. It is traded on the IBEX-35 stock market index and has assets totaling €6,050 million; on 3 March 2016 its market capitalization stood at €3,200 million.

The company’s main activity is the acquisition, management, operation, and selective rotation of prime commercial property assets in the core and core plus investment segments in Spain, and to a lesser extent in Portugal. Merlin focuses on the office, retail, logistics, and leased urban hotel markets. Shareholder returns are driven by annual distribution of dividends and value creation through increases in the company’s EPRA NAV.

In his interview with Deloitte Partner Alberto Valls, Ismael Clemente, Founding Partner and Chairman of Merlin Properties, talks about his company and shares his views on the real estate market.
What is Merlin’s current target dividend yield?

Our guideline figure stands at a minimum of €140 million pro forma in 2016 or €0.43 per share. This represents a dividend yield of close to 4.75 percent for those who have subscribed to the IPO and the subsequent capital increases. A full dividend will be reached this year as it was established in our business plan.

What are the returns on your asset portfolio?

According to our most recent portfolio appraisals, we are looking at an estimated gross yield of 5.3 percent and a net yield of 5.0 percent.

What is the company’s shareholder structure?

The shareholder structure has undergone substantial rotation since the IPO. A common feature has been a move toward increasing institutionalization. The current shareholders are more focused on the long term: their attention is fixed on dividend-based returns. In contrast, the shareholders who entered at the beginning of the IPO were generally macro-investors attempting to speculate on a possible increase in the company’s share price.

In 2015 over 72 percent of the transactions are attributable to core or core plus investors, does this mean that Spain is now considered a core market?

The market performed as expected. Firstly, opportunistic investors played their part, although little by little these type of investors have been losing strength since institutional investors have moved in the market.

Secondly, for Spain to be recognized as a core market, it must improve in terms of legal protection and institutional response speed, among other things.

Do you see any room for growth in capital values or rents in the Spanish market?

In terms of capital values, we are seeing a certain leeway as appraisers are lagging behind the market and they are still capturing the compression of yields. Last fiscal year (2015), a substantial portion of the compression of yields was captured, however an additional portion of yield-compression will need to be captured in 2016.

Regarding rentals, we are seeing a visible improvement in shopping centers and logistics.

In shopping centers, this improvement can be attributed to an increase in footfall (7 percent in our portfolio) and sales per square metre (10 percent). Regarding logistics there is a patent improvement in this segment, both in rentals and in occupancy.

In terms of offices, we are seeing a slight nominal improvement in rent renewals, but this improvement is still countered by two factors: the first is that there is a continued downward trend in inflation. The second is that both the old and the new markets continue to coexist, what means that in a portfolio as extensive as ours there are buildings with ten year leases which were signed in 2006 at rents that currently are 20-30 percent above market. When one of these matures, it offsets the effect of many upward renewals. However, these leases will disappear this year and next. Recent, shorter lease agreements will allow us to capture faster the expected rent increase at renewals in the coming years.

In 2015 was a record year with a total transaction volume totaling €11,700 in Spain. What are the prospects for 2016?

A similar year could only be achieved if another extraordinary transaction, such as our acquisition of Testa in 2015, came about. However, excluding transactions of this magnitude, I foresee 2016 will be similar but with slightly lower total transaction volumes.
Why are the REITs playing such an important role? How far do you think they can go?

In Spain, REITs have captured more than €6,000 million, yet in terms of percentage of GDP in comparison with other similar OECD countries, in the long run REITs should stand at around €25,000 million to €30,000 million. This will require time, since major property holdings would have to enter the market for this to occur, which is currently not the case. In other countries, most property investment institutions are listed.

What do you believe to be the keys to success as a manager in terms of performance, transparency, fees, portfolio managers, and governance?

The most important key to success is performance. However, if you want to work with international investors, transparency is required. This is a non-issue to management, since your only two options are that you are either transparent or penalized on the long run.

With regards to fees, we believe in internal management systems. This means that there is no “fee” concept, but rather the concept of overheads. In our case, we benchmarked ourselves against the companies with the lowest overheads worldwide, and although we are considerably smaller, we matched their limits and maximums, a fact which has been recognized and applauded by international investors.

Portfolio managers are absolutely vital: without portfolio managers you have no performance. In this regard we have improved our portfolio management teams significantly, due to the fact that we have incorporated the human capital from Testa. We now have specialist rental teams and portfolio and asset managers devoted to specific assets.

Lastly, regarding governance, it’s a bit like transparency: if you want to be in the market, you have to have it.

What is your current perception of the markets—are there windows to capture capital or do they appear to be slightly closed?

I think the possibility of creating blind pools has disappeared, but there is a market for relatively large companies which have to go to the market on a recurring basis in order to fund their development programs, since we don’t have the possibility to retain earnings. We also see that there are investors willing to invest in projects that make sense, keeping the market open. It is true that you have to be slightly more reactive because of the high volatility, although in the end, there still is a market.

Where is the REIT market heading—toward asset class specialization?

Specialization is great; unfortunately, the problem is that specialization is unfeasible in Spain because such a company would be tiny. This would mean that what you gain from specialization, you would lose in liquidity and in concerned shareholders due to the aforementioned disappointing liquidity and size. In Merlin Properties, we work solely in Commercial Real Estate: offices, shopping centers, high street retail, and industrial logistics; this gives us a fairly significant degree of specialization. In the future, we would like to be a mono-asset class, but for that to happen Spain must become a larger market than the one it is now.

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**On financial structure: what is your LTV target?**

We are currently below 50 percent; in 3 or 4 years we would like to be below 45 percent; and in 6 or 8 years below 40 percent; this is a trend we want to maintain in the long run. It is true that the interpretation given to us by the tax authorities concerning the sale of non-strategic assets is not helping our deleveraging objectives. The possibility of disposing non-strategic assets in order to reduce leverage would be very interesting—one must pay the corresponding taxes, but at least not be obligated to distribute dividends.

With regards to capital markets, in Spain there are very few bonds and companies which have obtained a rating. We are satisfied with the rating awarded to us by Standard & Poors (BBB), because it enables us to access a fairly liquid capital market. As soon as we see a window of opportunity, we will attempt to perform an issue in order to extend the shortest maturities, although at all times within the cost parameters that we set ourselves.

**Have you noticed a cooling-off of the debt markets in 2016?**

No, we have not noticed a cooling-off of the debt markets in 2016, there are many issuers receiving good responses. However, we have noticed a higher degree of volatility, meaning that spreads are widening as a result of the heightened uncertainty.

**What do you believe to be key factors in trading trends?**

When it comes to rents, in shopping centers we are seeing a clear improvement in our tenants’ trade: that we hope to capture through either variable income or in the next wave of renewals.

In logistics, our tenants are obtaining contracts and things are going well for them, which will also result in an improvement in rents. In the office sector, although things are also going better for our tenants, the new prevailing ways of doing business today and the fact that many offices are rented with less space available than what would be required for the number of people working there is having an impact on them. The final result is an improvement, although not as significant as for shopping centers and logistics.

We therefore foresee that the improvement in office rents will take place towards the end of 2016 and the beginning of 2017. The issue lies in the fact that it is a market that generally lags behind improvements in the underlying economy and, although the market agents expect a rapid increase, we believe that it is going to be a little more back-ended.
Do you think that now, having acquired Testa, it is time to manage NOI then go on to consider refurbishment projects?

Our goal is to optimize the company’s NOI. This will come about in several ways—firstly, as a result of the entry-into-production of certain assets. That is to say, in 2015 our aggregates reflect one year of Merlin and half a year of Testa. At the same time they reflect a year in which we have had an overly-high average cash balance; if the average cash balance decreases, it is because you have bought assets which are entering into production.

We are also improving the energy certifications of all our buildings in the portfolio. This involves a three-year plan, in which we expect to have over 90 percent of our buildings certified in the areas of logistics, offices, and shopping centers.

Returning to development, do you believe this area to be vital for your business?

Yes, we will develop our own assets—if you want to have Leed Gold or Platinum rated buildings in Spain you have to develop them yourself. It is very difficult to obtain Leed Gold or Platinum buildings by buying them. Platinum is virtually impossible as there are none; as for Gold, there are very few up for sale. The result is that if you want to have a high quality portfolio it is necessary to develop it yourself.

How do you see the company’s growth? Will there be more corporate transactions?

International ones, no. We are a company that operates exclusively in Spain and Portugal; going international is not what our investors are asking for.

It would be difficult to find opportunities for big corporate transactions, and if there are any, it is probable that these are in the form of transactions in shares rather than in cash because the possibility of raising substantial cash on the market is currently far harder than it was in the past.

Lastly, we would like to leave a heavier footprint in the area of shopping centers and assert our dominance in the office and logistics markets.

How do you think the change in the account treatment on long-term leases will affect the market? Do you think it will lead to a shortening of lease terms?

In the long run it will have an effect, leading to a shortening of the average lease term (WAULT). In Spain, lesseer terms are unusually long (contracts are five plus five on average) compared to other markets. For us, far from representing a threat, we believe that this represents a great opportunity as it will require a more active portfolio management. This will result in that shortcomings in marketing and management, among others, will appear among those that are not able to handle this change in the market. This will give rise to more opportunities for trading and a larger market, and moreover, those of us with large portfolios will have a wider statistical spread of risks and stand out more clearly from the competition as a consequence.
Recent thought leadership
Interested in further reading on real estate? Take a look at Deloitte’s recent thought leadership.

International Property Handbook H2/2015

The second edition of the International Property Handbook provides Deloitte’s view on real estate market conditions across the 21 countries attracting the highest volume of investment around the globe. Drawing on our global network of expertise, it includes a range of data and commentary, from key deals in each of the largest markets, through current prime yields, to a detailed comparison of entry and exit tax rates.

Key results include:

• Total investment volumes were up in the US, broadly flat across Europe, and down in Asia Pacific
• Investment is more concentrated in the largest countries. Only 12 of the top 21 countries saw y/y growth, against 15 earlier in 2015
• REITs and other listed vehicles have become the most active net investors
• Prime office yields have continued to fall in most markets – in some cases by 75bps
• Poland had the highest share of foreign investment (over 80%) followed by the Netherlands. Taiwan and China had the lowest
• The strongest growth in overall investment was seen in South Korea and Norway where volumes more than doubled y/y
• The most liquid markets over the year to Sep 2015 were Norway (15% transacted), followed by Spain, Ireland and Australia

Electronic or paper copies are available upon request

http://deloi.tt/1S8qpDD

Deloitte 2015 Real Estate (RE) Investment Management Survey

Portrait of a healthy industry

The Deloitte 2015 Real Estate (RE) Investment Management Survey portrays a healthy industry that is currently adapting to new business paradigms and patterns—both those imposed by regulations and those requested by investors.

Survey participants were top players in the pan-European market with more than €200 billion regulated assets, and covered topics such as regulatory and tax challenges, growth and outlook of the industry, etc.

http://deloi.tt/1S8qw2c
Private Equity and Real Estate (PERE) Asset Servicers’ Survey

Confidence and dynamism of a growing sector

The Deloitte 2015 European Private Equity and Real Estate Asset Servicers’ Survey highlights an industry in transformation, seeking to adapt its activities to reflect the asset management industry’s increasingly global context. Conducted among PERE asset servicers with an aggregate asset size of approximately €197 billion in assets under management and €107 billion in assets under depositary management, it was primarily designed to foster an understanding of key areas of their business, their operations and their insights into business growth and development.

http://deloitte.1S8qlyh

UK Property Handbook Q1 2016

The UK property handbook provides a detailed commentary on each of the market sectors, including selected deals, placed within a discussion of the broader economy and highlighting other Deloitte research relevant to real estate.

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