## Contents

- Overview and outlook 1
- 2018 year in review 2
- Looking forward: 2019 outlook by sector 4
  - Office 5
  - Industrial 6
  - Retail 7
  - Hotel/leisure 8
  - Residential 8
- 2019 real estate M&A drivers and trends 9
- Moving forward: 2019 real estate M&A opportunities 18
Overview and outlook

Favorable global trends, a positive investment climate, and opportunities from technology-driven industry disruptions are building momentum for an active commercial real estate (CRE) mergers and acquisitions (M&A) environment in 2019:

• Global CRE volume continues to climb, with the United States the most attractive CRE investment destination. In addition, foreign investors are increasing their investments in CRE debt as they seek diversification from exposure to potentially moderating asset prices.
• The threat of a rising interest rate environment is moderating and is also being offset by strong CRE fundamentals.
• Real estate investment trust (REIT) M&A activity continues to increase. Several REIT asset classes are trading at a significant discount to net asset value (NAV), with regional mall and shopping center REITs trading at the largest discounts. The self-storage sector is trading at the largest median premium.
• Industrial REITs continue to get a high premium due to strong fundamentals, growth expectations, and demand.
• A digital and data-driven marketplace is attracting investors to tech-enabled CRE firms and generating disruptive M&A opportunities, as brick-and-mortar real estate owners realign to the internet economy and office/industrial investors consider the changing nature of work and tenant preferences.

As detailed in Deloitte’s 2019 Commercial Real Estate Industry Outlook, survey results of 500 global investors, which provide insights on factors that are influencing their CRE investment decisions, are also encouraging:

• A large proportion of respondents plan to increase their capital commitment to CRE, with the United States, Germany, and Canada leading the way.
• Nontraditional assets, such as mixed-use projects, and new business models, such as properties with flexible leases and spaces, are expected to attract an increased allocation of investment dollars.
• Many surveyed investors expect to prioritize their investments in existing and potential investee companies that respond rapidly to changes in business models and adopt a variety of technologies to make buildings future-ready.
• Survey respondents see a significant impact from technology advancements on legacy properties in fewer than three years.¹

This report looks back at 2018 and examines key trends for 2019 to help CRE owners and investors plan their M&A strategy as they position their organizations to adapt and grow for the future. While our primary focus is the US CRE market, we also examine issues and trends that are influencing industry M&A on a regional and/or global basis.
Global CRE volume continued its upward trend in 2018, bolstered by steady economic and employment growth in key global markets. The trend moderated a bit in the year’s second half due to some global uncertainty and slowing growth in China. Transaction volume increased 3.5 percent year over year to $733 billion (see figure 1).\(^3\) The Americas were the top CRE market in terms of volume growth, posting investment volume of $281 billion (+13 percent year over year). APAC was up 7 percent year over year even with the drag from China (figure 1).\(^4\)

Across industry segments and property types, a sample of the most notable 2018 US real estate transactions ranged in value from $1.8 billion to $28 billion (see figure 2).

---

**2018 year in review**

---

**Figure 1 Global CRE volume continued its upward trends in 2018.**

<table>
<thead>
<tr>
<th>2016</th>
<th>2017</th>
<th>2018</th>
</tr>
</thead>
<tbody>
<tr>
<td>Americas</td>
<td>EMEA</td>
<td>APAC</td>
</tr>
<tr>
<td>$131</td>
<td>$245</td>
<td>$293</td>
</tr>
<tr>
<td>$149</td>
<td>$310</td>
<td>$281</td>
</tr>
</tbody>
</table>

**2016 vs 2017 vs 2018 (US$ billion)**

Source: JLL Global Capital Flows, Q4 2018

---

**Figure 2 Top 10 2018 real estate deals**

**Top 10 global transactions**

<table>
<thead>
<tr>
<th>Announced</th>
<th>Acquirer</th>
<th>Acquirer nation</th>
<th>Target</th>
<th>Target nation</th>
<th>Target sub-sector</th>
<th>Value (SB)</th>
</tr>
</thead>
<tbody>
<tr>
<td>04/26/18</td>
<td>Two Harbors Investment Corp.</td>
<td>US</td>
<td>CYS Investment Inc.</td>
<td>US</td>
<td>REITs</td>
<td>11.5</td>
</tr>
<tr>
<td>07/31/18</td>
<td>Brookfield Asset Management Inc.</td>
<td>Canada</td>
<td>Forest City Realty Trust Inc.</td>
<td>US</td>
<td>REITs</td>
<td>11.4</td>
</tr>
<tr>
<td>04/29/18</td>
<td>Prologis Inc.</td>
<td>US</td>
<td>DCT Industrial Trust Inc.</td>
<td>US</td>
<td>REITs</td>
<td>8.1</td>
</tr>
<tr>
<td>05/07/18</td>
<td>Blackstone Real Estate Partners VIII LP</td>
<td>US</td>
<td>Gramercy Property Trust</td>
<td>US</td>
<td>REITs</td>
<td>7.2</td>
</tr>
<tr>
<td>05/02/18</td>
<td>Annaly Capital Management Inc.</td>
<td>US</td>
<td>MTGE Investment Corp.</td>
<td>US</td>
<td>REITs</td>
<td>5.6</td>
</tr>
<tr>
<td>06/18/18</td>
<td>WP Carey Inc.</td>
<td>US</td>
<td>Corporate Property Associates 17-Global Inc. (remaining 96% interest)</td>
<td>US</td>
<td>REITs</td>
<td>5.5</td>
</tr>
<tr>
<td>03/28/18</td>
<td>Pebblebrook Hotel Trust</td>
<td>US</td>
<td>LaSalle Hotel Properties</td>
<td>US</td>
<td>REITs</td>
<td>5.4</td>
</tr>
<tr>
<td>01/29/18</td>
<td>Investor Group¹</td>
<td>China</td>
<td>Dalian Wanda Commercial Properties Co. Ltd. (14.273% stake)</td>
<td>China</td>
<td>Other Real Estate</td>
<td>5.4</td>
</tr>
<tr>
<td>02/15/18</td>
<td>Choice Properties Real Estate Investment Trust</td>
<td>Canada</td>
<td>Canadian Real Estate Investment Trust</td>
<td>Canada</td>
<td>REITs</td>
<td>4.6</td>
</tr>
<tr>
<td>06/28/18</td>
<td>Lone Star Fund X(US)L P</td>
<td>US</td>
<td>CaixaBank SA-Real Estate Business (80% of ownership interest)</td>
<td>Spain</td>
<td>REITs</td>
<td>4.6</td>
</tr>
</tbody>
</table>
In terms of inbound transactions, the United States continues to be the most preferred CRE market globally, followed by Hong Kong and China (see figure 3). These three countries comprise nearly 50 percent of total inbound investment.

Figure 3 Globally, the United States, Hong Kong, and China are most favored CRE markets

![Globe of CRE Markets]

When Deloitte surveyed global real estate investors about their primary objective for doing deals in the United States, respondents cited the potential for higher returns, the breadth of the market and liquidity, a stable economic environment, and a preference for new and emerging business models.¹

Corroborating the United States’ popularity as a CRE investment destination, 86 percent of respondents to an Association of Foreign Investors in Real Estate (AFIRE) survey said they planned to maintain or increase their investment in US real estate in 2018.⁶ Respondents cited several strengths of the US market, including a strong and stable economy, transparent capital markets, and a reputation for innovation. In addition, about 50 percent of AFIRE survey respondents feel that US real estate prices are less expensive than their home market. The United States also continues to lead the world in terms of offering the best opportunity for capital appreciation, followed by Brazil and China.

Foreign investors showed keen interest in alternative asset classes including senior housing, infrastructure, medical office buildings, and student housing. There is also increasing foreign investment in CRE debt.
Looking forward: 2019 outlook by sector

We expect 2018’s real estate M&A winners to again lead the way in 2019. Retail and lodging, last year’s top-performing sectors (see figure 4), should continue to generate a major share of deal volume due to their attractive valuations and appeal to opportunistic investors. Meanwhile, real estate buyers looking to add the “last mile” (e.g., storage space) to their portfolios should drive increased M&A in warehouses/logistics/storage, which are likely to continue to demand the highest premiums in terms of value.

Figure 4 Retail and lodging lead US real estate M&A activity by sector

While we see momentum building to support an active real estate M&A market in 2019, each of the major asset classes—office, industrial, retail, hotel/leisure, multifamily, and residential—is likely to experience one or more market disruptions that may influence M&A volume and value.

Sources: Public filings, SNL, Capital IQ, Jefferies LLC., NAREIT
Notes: Transactions involving US real estate entities between 2015 and 2017. 2018 YTD values are based on recently announced transactions that have not yet closed as of 7/2/2018.
Office

Many office sector stakeholders remember the glory days of the early 2000s, when the office asset class dominated real estate M&A activity. Today, while still strong in select cities, the office sector lags other asset classes; however, the untapped potential of shared office/co-working spaces is generating significant investment interest from traditional and nontraditional real estate investors (see figure 5).

Figure 5 Shared office/co-working trend is disrupting office M&A

Distribution of co-working spaces by region and type

![Pie chart showing distribution of co-working spaces by region and type](image)

- United States: 22.24%
- Asia/Pacific & India: 13.47%
- Europe: 10.69%
- Rest of the world*: 21.30%
- Global maker spaces: 4.72%
- Other**: 27.58%

(*) Rest of World – Africa, South and Central America (including Mexico), Eastern Europe, and Canada.
(**) Non-office, non-maker spaces such as shared kitchen, biolabs, etc.

Global demand and supply

![Bar chart showing global demand and supply](image)

PE investments in co-working spaces

![Bar chart showing PE investments in co-working spaces](image)

Sources:
- Global Co Working Forecast – Small Business Labs December 18, 2017
- Why big corporations are moving into Coworking Spaces – Andrew Broadbent
Several demographic and economic drivers are converging to disrupt the traditional office space market, including an increase in self-employed professionals and a more flexible, globalized workforce supported by technology innovations; cost-conscious organizations seeking to trim facilities expenses; large global organizations looking to match office space needs with the preferences of a younger, more mobile workforce; and large demand-supply and investment gaps. CRE executives in the Deloitte survey say they plan to diversify their portfolios through higher investments in newer and emerging business models and thematic investments (e.g., flexible spaces and leases); they appear to realize that their investments should be tied to the changing nature of work and tenant preferences.7

Shared office/coworking is anticipated to bring about a paradigm shift in leasing, property management, valuations, and financing. Already, nimble startups are leveraging private equity investments and their own resources to pursue innovative acquisition and partnering deals. For example, US-based coworking space owner WeWork has been acquiring companies at a rapid pace, with four transactions in 2018 alone.8 Shanghai-headquartered rival naked Hub9 (part of WeWork’s continued expansion outside of the United States); SEO and digital marketing startup Conductor;10 workplace software and analytics company Teem;11 and education startup MissionU.12 Since its inception in 2010, WeWork has grown from a single space in New York City to 287 physical locations across 77 cities and 23 countries globally. The company’s growth outstrips many traditional CRE companies.13

Coworking spaces are moving beyond catering to startups and the small business sector; some of the world’s largest companies are renting WeWork spaces for their employees and testing more involved partnerships. WeWork now manages entire buildings for various global Fortune 500 companies.

**Industrial**

The industrial sector continues to post the real estate industry’s highest transaction premiums due to its strong fundamentals, growth expectations, and buyer demand. In addition, the traditional warehousing segment is undergoing a technology-driven transformation that is attracting investment interest by venture capital and PE firms.

As e-commerce brings warehouses closer to the end customer, retailers’ demand for “last mile” storage space is accelerating, even though developers may have difficulty finding land for new warehouses in increasingly crowded and expensive cities.14 New warehouses are larger—Prologis recently built the first US multi-story facility just outside downtown Seattle15—and robotics and artificial intelligence (AI) are bringing about huge changes in the way warehouses are set up and operated. Several Fortune 500 companies are testing robotic technology in warehouse operations and industrial REITs.
Retail

Attractive discounts to NAV helped the retail sector lead US real estate M&A activity in 2018. We expect retail M&A volume to remain healthy in 2019, as traditional brick-and-mortar searches for a “new normal” in a dramatically changing industry. The boom in online shopping is driving the transformation of these physical assets into community destinations that rightsize the retail footprint and attract nontraditional tenants such as gaming centers, bowling alleys, and breweries.

Yet, despite a retail penetration rate far higher than other countries (see figure 6) and persistent announcements about store closures, brick-and-mortar retail is not dead. Savvy merchandisers are embracing technology and combining their online and offline strategies to give customers a personalized, curated experience. Many of these retailers may turn to M&A and partnering for the capabilities and scale they'll need to succeed in both online and offline markets.

Figure 6 Brick and mortar retail is in rightsizing mode

Retail penetration

Effective retailers are giving customers a curated experience

Sources:
Is US over retailed? May 15, 2017
National Real Estate Investor America’s “Retail Apocalypse” Is Really Just beginning – November 8, 2017, Bloomberg, GGP Investor Presentation
Hotel/leisure

The hotel and leisure space is more fragmented than other REIT sectors; this opens the door to 2019 M&A in the form of large REIT consolidations. We also expect to see acquisitions by single companies looking to expand their inventory and geographical footprint. For example, home-sharing giant Airbnb, which did not have significant acquisitions in 2018 (although, in a minor deal, it did acquire Luckey Homes, a French concierge services/property management company, in December),16 started the new year with the purchase of Gaest, a Danish startup that provides a platform for people to post and book meeting venues in hourly or daily increments.17 Airbnb also appears to be interested in potential M&A that would expand its offerings into hotel bookings.18

One sector disruption that may drive technology-focused acquisitions or partnering agreements in 2019 is the increasing permeation of data analytics to improve revenue management and guest retention processes. For example, the 2018 global merger of the Marriott and Starwood guest retention programs—now called Marriott Bonvoy—forms the foundation for the largest loyalty program of its kind.19 Marriott Bonvoy is designed to improve the customer experience and provide company management with better data on customer preferences and trends. Meanwhile, PE firms looking for better insights into their existing investments and potential acquisition candidates continue to expand and broaden their data analytics capabilities.

Residential (multifamily, single-family)

The residential multifamily sector is trading at a premium to NAV entering 2019, which may begin to slow M&A activity. The high cost of initial home ownership is driving many would-be home buyers, particularly Millennials, into the multifamily space for more extended periods of time. This trend continues to drive up rents and add value to the multifamily sector. In addition, the high cost of big-city living is beginning to push some residents in larger markets to look for greener pastures. Three key attributes will differentiate secondary-city destinations that attract Millennials’ interest: 1) knowledge hubs with a strong concentration of educational institutions and employment opportunities in high-skill industries; 2) markets offering cultural diversity; and 3) lower cost of living than cities such as New York, San Francisco, and Chicago.
2019 real estate M&A drivers and trends

Across real estate sectors, executives whose companies are contemplating M&A in 2019—whether that means selling, buying, investing, or partnering—should plan for the following trends that may either help or hinder their ability to execute on their strategic growth plans.

Global economic and political uncertainty

Escalating political tensions and ongoing tariff and trade disputes between the United States and its trade partners, particularly China, are raising concerns about a potential economic slowdown, if not a full-fledged recession, as early as 2020. Some expect the economic stimulus from federal tax cuts and additional government spending to peter out by 2020, while rising interest rates could perhaps discourage consumer borrowing, housing construction, and business expansion.\(^2\) Vanguard recently warned that the chances for a recession by late 2020 are 30–40 percent.\(^3\) One warning sign cited by economists was a flattening yield curve between short- and long-term interest rates—a development that has historically indicated a recession ahead.\(^4\)

Early 2019 economic indicators also may be pointing to a slowdown: the World Bank cut its growth forecast; Apple’s downgraded sales forecast (which led to a market sell-off) was one of several companies’ warnings of earnings issues; and China is investing hundreds of billions of dollars in its slowing economy.\(^5\) One indicator of China’s current economic softness is the decline throughout 2018 in domestic CRE investment and outbound investment from Chinese firms. The information in figure 7 represents the trend through the first half of 2018; investment continued to slow through the remainder of 2018. A continuation of these trends in 2019 may have several implications for global real estate M&A:

- China is second only to Canada in leading cross-border investments into the United States.\(^6\) If its outbound investment volume continues to lag, US inbound real estate investment may decline—unless investors from other countries take advantage of less competition to make their own M&A plays.
- Foreign investors may become more active in China’s commercial real estate sector in place of domestic investment.

Figure 7 China lagging in 2018 global CRE investment volume

Top 10 global commercial real estate markets by investment volume (US$ Billion)

![Figure 7](image-url)

Source: JLL Global Market Perspective, August 2018

Another economic factor that has the potential to be either a positive or negative M&A influencer is the whipsawing stock market. If falling prices and sell-offs extend far into 2019, they may spur real estate companies and financial investors with strong balance sheets to scoop up distressed assets or, conversely, ratchet up corporate uncertainty and reduce M&A activity. Of the two possible outcomes, we anticipate an uptick in M&A, given current industry dynamics.
PERE fundraising and dry powder

The boom in private equity real estate (PERE) fundraising has created record levels of capital—often referred to as dry powder. Value-added and opportunistic funds accounted for two-thirds of fund closures and capital raised in 2018; this trend is expected to continue in 2019 (see figure 8).

Figure 8 PERE fundraising and dry powder retain their momentum

Global annual closed-end private real estate fundraising
Closed-end private real estate dry powder, 2007-2018

Note: Dry powder refers to cash reserves on hand, especially to cover future obligations

Source: Preqin Fund Raising Update 2018
The investments from these funds likely will be focused on value opportunities in sectors trading at a discount to NAV, as well as in emerging growth areas such as proptech and disruptive real estate plays in the industrial and other sectors. These investors will continue to use data analytics to drive their investment thesis, and those businesses that are able to provide quality data to support their growth strategies will have more success attracting this capital.

The surge in real estate debt funds hit a peak in 2017 and began to moderate in popularity in 2018 (see figure 9). We expect these funds to continue to attract capital as CRE debt may provide a safer investment option for foreign investors, with less downside risk if/when prices fall.

**Figure 9** Global real estate debt fundraising declined in 2018

**Real estate debt fundraising**

Source: Global RE Debt Fundraising sees 48% drop, recapitalnews.com, Jan 2019
REITs trading at an attractive discount to NAV is a primary driver of increased M&A, as evidenced by several recent large transactions. Regional mall and shopping center REITs have traded at the largest discounts to NAV, while the self-storage sector traded at the largest median premium.

Value-focused investors considering REITs for M&A, joint venture, or partnering opportunities should leverage data-driven analyses to craft a robust strategy around current market positions and analyze how expansion into newer properties could complement their existing ones. Strategy linkage driven by supporting data can help demonstrate how a single REIT investment not only presents operational synergies but also evolves the broader portfolio. For instance, retail owners could conduct highest and best use analysis based on location, surrounding demographics, and other macro factors to repurpose some of their vacant assets into nontraditional uses such as data centers and senior housing and create new sources of revenue. Deloitte survey respondents also suggested several ways that REIT investors can unlock value in the current market environment:

- Transform the business with technology investments to optimize revenues, reduce costs, and generate operating efficiencies
- Optimize and rescale property portfolios
- Consider private company status
- Change the capital structure of the entity by issuing additional debt or preferred equity
- Engage in M&A activities to acquire rivals or merge with others to achieve greater scale.

**REIT M&A activity**

US REIT M&A volume and value are rising, although both remain well below pre-financial downturn levels (see figure 10).

---

**Figure 10 US REIT M&A deal volume is rising but remains below pre-financial downturn levels**

### Annual number of deals

<table>
<thead>
<tr>
<th>Year</th>
<th>Deals</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td>29</td>
</tr>
<tr>
<td>2008</td>
<td>4</td>
</tr>
<tr>
<td>2009</td>
<td>2</td>
</tr>
<tr>
<td>2010</td>
<td>2</td>
</tr>
<tr>
<td>2011</td>
<td>3</td>
</tr>
<tr>
<td>2012</td>
<td>3</td>
</tr>
<tr>
<td>2013</td>
<td>9</td>
</tr>
<tr>
<td>2014</td>
<td>14</td>
</tr>
<tr>
<td>2015</td>
<td>17</td>
</tr>
<tr>
<td>2016</td>
<td>17</td>
</tr>
<tr>
<td>2017</td>
<td>21</td>
</tr>
<tr>
<td>2018*</td>
<td>12</td>
</tr>
</tbody>
</table>

### Annual deal value

<table>
<thead>
<tr>
<th>Year</th>
<th>Value (Bn)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td>129</td>
</tr>
<tr>
<td>2008</td>
<td>6</td>
</tr>
<tr>
<td>2009</td>
<td>0.4</td>
</tr>
<tr>
<td>2010</td>
<td>0.3</td>
</tr>
<tr>
<td>2011</td>
<td>24</td>
</tr>
<tr>
<td>2012</td>
<td>3</td>
</tr>
<tr>
<td>2013</td>
<td>19</td>
</tr>
<tr>
<td>2014</td>
<td>53</td>
</tr>
<tr>
<td>2015</td>
<td>41</td>
</tr>
<tr>
<td>2016</td>
<td>42</td>
</tr>
<tr>
<td>2017</td>
<td>55</td>
</tr>
<tr>
<td>2018*</td>
<td>76</td>
</tr>
</tbody>
</table>

Deals include both public and private
*Includes pending transactions

Source: Bloomberg, SNL, LaSalle Investment Management Securities. Data as of 6/30/2018. According to these sources, “there is no guarantee this trend will continue.”
2019 Real Estate M&A Outlook | Building momentum
Interest rates may shift real estate returns

The potential continuation of an increasing US interest rate environment may result in a shift in returns from real estate M&A (see figure 11) and put some strain on transaction prices; however, strong industry fundamentals should continue to drive returns and attract investors in 2019. As the current cycle moves through its ninth year, it brings the potential for slowing growth in CRE returns and future interest rate increases. With limited capital appreciation, CRE will rely on income to drive total returns moving forward. Recent signs from the Federal Open Market Committee (FOMC) are for a more conservative stance on interest rates in 2019, thereby moderating the impact on real estate returns expected/budgeted in late 2018.

Figure 11 Potential for continuation of increasing interest rate environment may shift returns from real estate

![Figure 11](image)

Despite a flattening yield curve between short- and long-term interest rates, which sometimes signals an approaching recession, it is significant to note that real estate occupancy rates and rent growth are solid; there does not appear to be significant overbuilding, overheating, or overleveraging; the domestic US investment environment is favorable; and foreign investors have a positive outlook about the US CRE market.
Tax reform and regulatory relief

The US Tax Cuts and Jobs Act of 2017 (the “2017 Tax Act”) introduced the most comprehensive overhaul to the US tax system in more than 30 years. The changes were both broad (impacting businesses and individuals) and significant (introducing meaningful changes to existing tax law). Below are a handful of key provisions that are expected to impact the real estate industry and 2019 M&A planning and execution.

Interest deductibility: Following tax reform, net business interest is allowable as a deduction limited to 30 percent of a business’s adjusted taxable income (generally equal to EBITDA prior to 2022; EBIT thereafter). Taxpayers engaged in a Real Property Trade or Business (RPTOB), however, may make a RPTOB election that would allow net business interest to be fully deductible. The ability for an electing RPTOB to fully deduct interest expense is favorable from an M&A standpoint, as tax efficiency on acquisition leverage is maintained and provides for flexibility in capitalizing transactions.

Depreciation—Immediate expensing for qualifying property: The 2017 Tax Act allows taxpayers to immediately expense certain qualified property acquired after September 27, 2017, and prior to January 1, 2023 (after January 1, 2023, the ability to expense is phased out 20 percent each year). Qualified property generally includes tangible personal property and land improvements with a recovery period of 20 years or less. To the extent an RPTOB election is made (as discussed above), immediate expensing is permitted; however, property that does not qualify for immediate expensing (e.g., residential and nonresidential real property and qualified improvement property) must be recovered over a longer period (using their respective ADS lives). From an M&A point of view, the ability to expense certain capital expenditures is favorable as it allows for accelerated tax deductions resulting in a reduction of current tax bills, thereby increasing the present value of potential investments as well as expected returns. For electing RPTOBs, the benefit is even greater because the ability to claim immediate expensing (offset by longer depreciation on certain other property) is coupled with the ability to claim full interest expense deductions.

State and local tax itemized deductions capped at $10,000: Prior to the 2017 Tax Act, taxpayers were able to deduct state and local taxes (including income and property taxes) when itemizing their deductions, subject to an overall itemized deduction phaseout. Following reform, taxpayers that itemize their deductions are limited to $10,000 with respect to state and local taxes. It is expected that this will have a more pronounced impact on residential home ownership in high-tax states (e.g., California, New York, New Jersey), effectively making home ownership more expensive; this may lead to: (1) increased/continued demand for residential rentals in high-tax states, and/or (2) increased population outflows to low-tax states. From an M&A standpoint, this could result in residential rentals in high-tax states and residential developers in low-tax states becoming more attractive.

Twenty percent deduction on qualifying pass-through businesses: The 2017 Tax Act introduced a 20 percent deduction for income earned from certain qualifying pass-through businesses. Certain real estate businesses appear to qualify for this deduction and may benefit from the alternative limitation calculation allowing taxpayers to consider wages and the unadjusted tax basis of qualified property (as opposed to just wages), thereby making after-tax returns more attractive. In addition, REIT dividends are considered qualifying income for purposes of the 20 percent pass-through deduction, resulting in a better after-tax return to shareholders and making REIT stock an attractive investment.

Qualified opportunity zones: One aspect of tax reform that did not get much focus initially but has gained momentum in the industry is the newly created Qualified Opportunity Zones. Generally, taxpayers may defer and partially reduce capital gains tax due on the disposition of property when such capital gains are reinvested in a Qualified Opportunity Zone through a Qualified Opportunity Fund within a specified time period.

• Qualified Opportunity Zone (QOZ): A population census tract that is low income and has been designated by the governor (or other chief executive officer) as a qualified opportunity zone.

• Qualified Opportunity Fund (QOF): A self-certified entity taxed as a partnership or corporation that holds at least 90 percent of its assets in Qualified Opportunity Zone Property (“QOZ Property”).

Institutional investors and developers, as well as family offices, are establishing QOFs to solicit taxpayers with unrealized capital gains who may be considering triggering such gains and investing in QOFs. This may lead to further opportunities for institutional investors to expand product offerings and increase developments in low-income areas.

Overall, as taxpayers continue to digest tax reform and its implications for their circumstances, we expect that the impact to the real estate industry and its deal-making participants should be favorable.

Also serving as an M&A enabler: a business-friendly regulatory environment. Regulatory barriers to M&A continue to fall, which is good news for well-capitalized companies looking to real estate investments or acquisitions as ways to boost inorganic growth. Legislators and regulatory agencies have been shifting their focus from creating new regulations to reviewing and refining requirements that are already on the books. We expect that pro-business tax and regulatory conditions will extend through 2019.
Proptech innovation

Proptechs—a collective term used to define startups offering innovative, technology-driven products, services, or new business models for real estate markets—are increasingly popular with investors across the real estate value chain. Proptechs use existing and emerging technologies to develop innovative offerings that enhance operational efficiency, tenant experience, and information flow. Solutions can include everything from construction and building materials, architectural design, and smart building automation to property management, energy-efficient landscaping, and smart contracts.

Compared with its broader financial services peers, parts of the real estate industry—for example, pricing, mortgages, and building management—have been slow to adopt software that could make business more efficient. This, however, is changing. CRE leaders are recognizing that a proptech relationship can produce a win-win situation in which CRE companies match their industry knowledge and business opportunities/needs with proptechs’ technology know-how and nimbleness.

Approximately $6 billion in venture capital has been invested globally in proptechs since 2011; about 70 percent of that in 2016 and 2017. OpenDoor, one of the largest startups in the proptech category, raised $725 million in its Series E financing in 2018 from a long list of venture capitalists, including SoftBank’s Vision Fund, one of the most aggressive investors in real estate tech startups. The volume of proptech financing globally has been on a steady increase, rising 36 percent year over year. And there is plenty of room for the sector to grow. On average, investors responding to Deloitte’s global CRE survey plan to commit 14 percent of their CRE capital to proptechs. We expect proptech-related M&A will proceed at a brisk pace in 2019 and subsequent years. According to Deloitte survey results, CRE companies have several preferred options to engage with proptechs: investing, acquiring, collaborating, or using their services (see figure 12).

Figure 12 CRE investors’ preferred modes of engaging with proptechs

Invest and partner are most preferred modes of engaging with proptechs

To maximize proptech deal value, potential investors should acknowledge and understand the potential transformation that proptechs could bring to their organization; develop a clear strategy and/or internal guidelines for engagement; develop a list of decision-making criteria to guide proptech target selection; form a dedicated team to engage with proptechs; and identify metrics to measure success.
Moving forward: 2019 real estate M&A opportunities

Strong industry fundamentals, plenty of available capital, tax reform and a pro-business regulatory environment, and the search for proptech capabilities provided a solid foundation for 2018 real estate industry M&A. Many of these positives remain in place for 2019; still, market conditions remain in flux, and there are likely to be plenty of challenges to overcome in the year ahead. Real estate companies and financial investors contemplating M&A to boost their bottom line, broaden their portfolio, and strengthen future competitiveness should:

• Evaluate trends in their particular asset class and determine where market dynamics are creating tailwinds or headwinds.

• Conduct upside/downside scenario planning that accounts for, among other things, a potential economic slowdown and rising interest rates in the next 18–24 months.

• Be clear on what they are solving for in evaluating organic/inorganic options (e.g., scale, geographic expansion and diversification, data/tech capabilities, an opportunistic value play).

• Develop an M&A strategy that supports what they are solving for and frames their appetite in approaching market opportunities.

• Select investment/alliance/acquisition targets that are consistent with the overall strategy, accretive, and synergistic. Avoid chasing a shiny object that may not support long-term goals.

• Focus on high-quality properties in locations with strong fundamentals, conduct thorough diligence to identify what they do/don’t have of value and what could be carved out.

• Consider proactively reaching out to potential candidates to let them know about interest before others seize the moment and the acquisition becomes an auction situation.

• Be mindful of the changing tax and regulatory landscape in both domestic and cross-border deals.

• Examine and potentially enhance in-house corporate development and overall integration capabilities to facilitate efficient and successful negotiations before embarking on deals.
Contacts

Authors

Anthony Scalese
Partner
Deloitte & Touche LLP
+1 404 631 3375
ascalese@deloitte.com

Tom Morrisroe
Partner
Deloitte Tax LLP
+1 212 436 6278
tmorrisroe@deloitte.com

Thank you to the following individuals for their insights and contributions to this report:

Eva Lee
Senior Manager
Deloitte Business Transactions & Analytics LLP

Mark Sleightner
Manager
Deloitte Tax LLP
Endnotes


2. Ibid.


4. Ibid.

5. 2019 Deloitte Commercial Real Estate Outlook: Agility is key to winning in the digital era.


7. Ibid.


10. Ghaffary, “WeWork is on an acquisition spree—and they’re all over the board.”


15. Ibid.


26. Ibid.

27. Phillips, “What’s the yield curve? A powerful signal of recessions’ has Wall Street’s attention.”

29. Ibid.


33. Griffith, “The hot property that’s next on tech’s agenda: real estate.”

34. Armstrong, “5 Emerging PropTech startups you need to watch in 2018.”

35. Verman, “What is PropTech and how is it changing real estate investment?”

