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M&A Views

Deloitte M&A Views podcast:
Real estate roundup: Unlocking value through M&A

Transcript

Greg Jarrett: Welcome to Deloitte M&A Views, a Deloitte podcast series exploring the latest trends and topics and mergers and acquisitions (M&A). I'm Greg Jarrett, and today we discuss what's been happening with M&A transactions in the real estate sector and where things may go from here. We're joined today by two of the leaders of Deloitte's real estate M&A team, Tom Morrisroe, a partner with Deloitte Tax LLP, and Francisco Acoba, a managing director with Deloitte Consulting LLP.

As with many industries in the most recent cycle, those in the real estate industry and those who would like to be seem to be working very hard to maximize the benefit from the upturn since the economic downturn.

Francisco Acoba: The real estate industry seems to be on an accelerated disruption curve, highlighted by rapid changes in tenant dynamics, customer demographic shifts, and ever-increasing needs for better and faster data access to allow for improved services and amenities.

2017 was very strong for real estate mergers and acquisitions, with nearly $390 billion in announced transactions worldwide. Looking at the first couple of months in 2018, the US real estate and construction sector is seeing an increase in transaction volume, as well. In particular, engineering and construction could see a very strong 2018 given the large increase in large infrastructure demands. While there may be signs of some maturing in some of the larger, more established markets and areas, certain areas, such as industrials and logistics, show signs of potential growth given the need of increased distribution capacity associated with increased online sales activity.

A good amount of activity also is taking place in the retail REIT world, which has been impacted again by the ongoing brick and mortar retail challenges.

Greg Jarrett: Tom, could you help us out a little bit with how real estate companies and investors can look to find, unlock, and maximize value?

Tom Morrisroe: There are many ways that real estate companies can unlock value. One way of unlocking value, which certainly isn't new, but we've seen a good deal of recently is through M&A transactions. There's been a lot of press coverage recently regarding the perceived gap in public REITs underlying real estate value, calculated by comparing the private trading multiples to the real property to the implied value of the real estate based on stock trading price. This resulting value gap suggests that the underlying real estate is being undervalued or discounted by the public markets. Naturally one way to unlock this value is for public REITs to consider to either take private transaction or a merger with a strategic partner.

Another obvious benefit of M&A is the ability to reduce costs. Being a public company requires a good deal of cost that isn't present in the private environment or may be duplicative, and therefore able to be reduced in a merger. There's a lot of capital available and we've seen this born out in the significant deal announcements that have occurred through the first five months of 2018 that have all been consistent with these themes.

Greg Jarrett: You know valuations are obviously key, but the question is what drives them. Francisco could you summarize just what's happening with, what's influencing valuations?

Francisco Acoba: Sure, Greg. As I mentioned earlier, there's a significant amount of activity in the retail real estate arena right now. Some would argue that these assets are now undervalued, especially given the potential opportunity to reposition valuable land to its highest and best use. Potential buyers are debating about the future of bricks and mortar real estate, versus, online assets, and this can also impact valuations.

The bottom line is, unlike in past years, REIT valuations today are increasingly impacted by investor activism and media attention. This is compounded by the current dilemma faced by many REITs of highlighting intrinsic value and base fundamental economic improvements compared with the perceived value of those assets.

To unleash this value, companies should consider different approaches to reinstate shareholder enthusiasm, which would require critical assessment of existing corporate governance and communication strategies, as well as the current state of operations, growth opportunities, and strategic alternatives. These may lead to other M&A or company restructuring considerations.

Greg Jarrett: Let's look ahead now, Tom, is there anything you think we're going to see over the second half of this year?

Tom Morrisroe: Greg, I think a lot of what we've been seeing through the first five months of 2018 we'll continue to see as interest rates continue to rise, I think investors have rotated away from public REITs driving down a share price and interest rates also have the double whammy effect of also increasing debt service costs on floating rate debt, so I do think that, as valuations of public REITs continue to be challenged, there'll be opportunistic investors seeing if there is an opportunity out there for them to buy these assets as a discount to their underlying real property value.

Greg Jarrett: And finally, Francisco, for many, if not most industries, tech does seem to be a front runner in driving M&A. I'm wondering is this the case also with real estate? Is it really involved in this process?

Francisco Acoba: You know, we're certainly seeing, significant activity in the real estate technology arena. So there's lots of investment, lots of acquisition activity, you're seeing owner operators and developers going out and REITs going out and purchasing real estate technology firms to be able to leverage that technology within their portfolios, to improve the occupant experience, and what they're offering to their tenants. So they certainly see technology as a differentiator going forward in the tenant experience, and they want to make sure that they have the latest and greatest deployed across their portfolios. So I think we're going to see that as a continued trend.

Greg Jarrett: And finally, for you Tom, is there any chance as we've seen with other industries, of a big foot coming in and stepping right in to real estate and disrupting the way it's done completely? We've seen it before.

Tom Morrisroe: Well, I think in this case, Greg, the big foot we've seen come in is just tech in general, and its impact on the traditional brick and mortar show. I think, as Francisco mentioned a few minutes ago, one of the big shifts that we've seen over the past several years is the disruption that's taken place and the challenge that retailers now face and as a result, the flip side of that is that the industrial sector continues to grow and continues to draw a lot of investor demands. So from that standpoint I think we're kind of witnessing it and its name is tech and online retailing and just the impact that technology has on the physical presence throughout the industry.

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