Lessons learned from M&A due diligence

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How active is your business?
US property fundamentals and RE transaction volume outpace 2014 YTD levels by 26.3% as confidence continues to trend upward

- Transaction volume totalled $328.2b in YTD August 2015, up 26.3% year over year
- Retail volume totalled $58.3b in YTD August 2015, up 6.6% year over year
- Office volume totalled $94.6b in YTD August 2015, up 27.6% year over year
- Industrial volume totalled $44.4b in YTD August 2015, up 50.1% year over year
- Hotel volume totalled $32.2b in YTD August 2015, up 45.2% year over year
- Apartment volume totalled $84.0b in YTD August 2015, up 28.1% year over year
- Development site volume totalled $14.7b in YTD August 2015, up 7.0% year over year

Source: Real Capital Analytics
Cap rates for most property types are at all-time lows, but have flattened in recent months.

Source: Green Street Advisors
Real estate price recovery

Since 2009, property values have fully recovered the ground that was lost during the financial crisis.

Source: Real Capital Analytics Big Picture Report
Deal markets: halfway through calendar 2015, M&A value and volume are holding after strong gain in 2014

Americas corporate and private equity (PE) transactions – All Industries

(US$B)


Value (US$b) Volume

Source: ThomsonONE — based on acquisition of assets based in Americas and outbound transactions; excludes real estate acquisitions

(A) = annualized
Who’s lending today?
Commercial real estate lenders willing to take more risk

**Rise of Covenant-Light Loans**

“Alongside positive developments in economic fundamentals, the search for yield has continued in U.S. credit markets. Signs of excesses in credit markets include underwriting standards that continue to deteriorate, with covenant-light loans now accounting for two thirds of new issuance of leveraged loans.”

- International Monetary Fund

- YTD borrowing through Q2 2015 is 29% higher year over year and 16% higher than Q1 2015. The year over year is driven by:
  - 58% increase in dollar volume lending multifamily
  - 32% increase for industrial
  - 22% increase for office properties
  - 17% increase for retail
  - 16% increase for hotels
  - Healthcare lending decreased 50% year over year
What will be the impact of rising interest rates?
Interest rate impact….

Cap rates have not historically demonstrated a strong correlation to U.S. Treasury yields and the current climate will allow room for compression.

The 2Q 2015 average spread between cap rates and the 10-year Treasury yield was larger than the long run average spread and the lows in 2Q 2007.

<table>
<thead>
<tr>
<th>Product type</th>
<th>Average spread: 2Q 1986–2Q 2015</th>
<th>2Q 2015 spread</th>
<th>2Q 2007 spread</th>
</tr>
</thead>
<tbody>
<tr>
<td>Office</td>
<td>257 bps</td>
<td>290 bps</td>
<td>1 bps</td>
</tr>
<tr>
<td>Industrial</td>
<td>304 bps</td>
<td>366 bps</td>
<td>134 bps</td>
</tr>
<tr>
<td>Retail</td>
<td>269 bps</td>
<td>350 bps</td>
<td>102 bps</td>
</tr>
<tr>
<td>Multifamily</td>
<td>231 bps</td>
<td>276 bps</td>
<td>49 bps</td>
</tr>
<tr>
<td>Hotel</td>
<td>499 bps*</td>
<td>524 bps</td>
<td>307 bps</td>
</tr>
<tr>
<td>Average</td>
<td>286 bps</td>
<td><strong>361 bps</strong></td>
<td><strong>119 bps</strong></td>
</tr>
</tbody>
</table>

*Hotel data begins in 4Q 2003.

Source: Federal Reserve Economic Data, St. Louis Fed, 2015; Green Street Advisors, 2015.

Source: Federal Reserve Bank of St. Louis, Green Street Advisors 2015.
In 2015, there remains no shortage of capital looking to invest in the Real Estate sector.

**Data through June 2015**

- **$223bn**
  - Closed-ended PE real estate dry powder available. Up $185bn from December 2014.

- **$43bn**
  - Capital raised by US REITs year-to-date 2015. 32% more than the same period last year.

- **$27bn**
  - Capital raised by real estate funds in Q3 2015, the third highest quarterly figure in the last six years.

- **$575bn**
  - Current allocations to real estate by the world’s Sovereign Wealth Funds (SWFs). 59% of SWFs now invest in real estate.

*Sources: DTZ, Preqin, SNL, and SWF Institute*
What sectors and markets are you focusing on?
While fundamentals are strong across all property types; you must know your markets….

► **Multifamily**: the 64 largest markets absorbed 261,700 units in 2014 – the highest since 2010 and an increase of 87% over 2013; rents rose 5.3%, the strongest since 2005

► **Office**: Net office absorption totaled 52.7 million sf in 2014, the highest since 2007 and above the long-term average of 40 million sf; rents have risen for 15 quarters and are still below the 2008 peak

► **Industrial**: 66 million sf was absorbed in 2014; rents grew 4.8%

► **Retail**: mixed results depending on product type and market tier

Sources:
1. Ernst & Young LLP calculations from data from Real Capital Analytics 2015
2. Ibid 2015
3. Real Capital Analytics 2015
Have you worked with partners or dealt with competitors from abroad?
Foreign investors in the US in trailing twelve months ending Q2 2015

Total foreign capital invested in the US in TTM Q2 2015: $62.2 billion

Source: Real Capital Analytics
What type of development activity are you involved in today?
Supply: major property sector average moving off of generational lows

The last downturn was remarkable for: 1) the lack of overbuilding that preceded it; and 2) the near-complete shutdown of the supply pipeline. Low supply set the backdrop for a recover in fundamentals that was more impressive than the weaker than normal recovery in demand would otherwise support.

Source: Green Street Advisors
Apartments are the only major sector where supply exceeds levels that existed prior to the downturn. Industrial, office and storage pipelines are also filling, but they are not yet problematic. Senior housing supply is a concern, and is starting to impact rental rates.

Source: Green Street Advisors
NOI growth has been solid over the last couple of years. A continuation of that trend is likely, although growth will remain capped by the arrival of new supply.

Source: Green Street Advisors
What is your outlook for the next 12 months?
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