

# *Real Estate Monetisation Strategies: Emerging trends*

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*In an effort to realise untapped value for shareholders, many real estate-heavy companies are looking to monetise their real estate assets to fund core operations and expansion plans. Traditional real estate monetisation methodologies include non-recourse financing, sale-leaseback transactions and, more recently, REIT conversions/spin-offs.*

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Despite the fact that real estate may make up the most significant portion of a company's assets, operating costs or strategic value drivers, the existing corporate real estate structures currently used by many were either initially designed to support a very different operational structure than needed today or motivated by financing, accounting or tax considerations that are no longer relevant. Furthermore, other factors are on the horizon – such as the proposed changes in US lease accounting – that may affect the way many companies think about their real estate operating strategies. Real estate also plays a key part in long-term corporate sustainability.

In many organisations, the corporate real estate department is viewed as more of an administrative function or cost centre, instead of as a driver of strategic or competitive advantage. Also often overlooked is the fact that market shifts frequently result in significant rises in real estate values – especially for companies that have built and developed a portfolio of assets over a long period of time or through substantial acquisitions.

Unfortunately, there is no one-size-fits-all answer to how companies can either realise or create enhanced real estate value. The right answer for one company may be completely different for another. Optimal decisions around real estate strategy are affected by a large number of factors, including the perceived need to control particular assets, operational flexibility, the availability of alternatives, common industry practices, tax and regulatory impacts, and the expectations of management and investors. Therefore, carefully considering a company's unique circumstances is crucial when deciding on the most effective way to capitalise on real estate's true value. Even within the

same company, different transaction types may be more appropriate for different departmental needs, making it necessary to apply several different methodologies.

Today, many companies are evaluating the feasibility, benefits, costs and other factors associated with potential real estate monetisation strategies. While some of these strategic evaluation initiatives have been spearheaded by company management, others have emerged as a result of pressure from activist shareholder groups and investment bankers.

## **Rise of activist investors and real estate-driven M&A**

Activist investors are increasingly focusing on the value of a company's real estate. Why now? These types of monetisation transactions are not new – they have been employed by many in the past.

Since World War II, owning real estate has generally been viewed as favourable, but now, we seem to be in an aggressive cycle of trimming real estate ownership in favour of selling and leasing back. Who wins and who loses? In many cases, everyone wins!

Many private equity firms that acquire companies with large amounts of owned real estate use sale/leaseback structures as a means to finance their acquisitions, but they are not the only ones thinking about monetisation. As companies monitor and respond to market trends, an increasingly wide variety of transactions and restructurings have emerged. Also increasing is the pressure companies feel directly from corporate activist investors or as a result of takeover activity. A common focus of many of these investors is identifying companies they perceive have hidden value that can be unlocked through structural changes or divestitures, such as a spin-off. Given the volatility of real estate valuations, changing dynamics in their use and the market's quest for yield, real estate is a common focus of these activist investors and acquirers.

These activists may espouse transactions where underlying financial theory suggests that total value can be created, through financial surgery, to separate the bond-like elements of a company – such as real estate that can pay a stable yield

from rental income – from the company’s more cyclical operations. As a result, the operations of the company can be free of the capital intensity often seen in the real estate industry and offer higher equity returns. Their premise appears to be asset light. Companies see their stock prices increase because capital can be invested into activities with higher returns on investment, rather than weighing down the balance sheet with real estate capital investments. The real estate could also trade in a separate vehicle or be sold to realise its benefits.

Other drivers of activist pressure on companies are the beliefs that: a company’s corporate structure may not be the most efficient way to hold the real estate, assets are under-utilised and would be more valuable if repurposed or split into separate parts, or a portion of the business is capital-starved and needs to be separated to reach its true potential.

Activist pressure on management increases even more when a competitor demonstrates the potential value that can be derived from a real estate monetisation transaction. When investors and shareholders see how successful various real estate monetisation methodologies are for others, they want to know why their organisation is not doing this too.

As industry participants continue to discover how broad the category of real estate truly is, the number of methods used for realising the value of this real estate also continues to expand. Often, organisations attempt to share the same success as competitors by mimicking their real estate monetisation strategies. Over the course of several years, these transactions/structures can become normal operating procedure for an entire sector. For example, over the past 10 to 15 years, we have seen entire industry business models migrate to real estate structures, such as REIT-through-REIT conversions or the consummation of REIT spin-offs. This occurrence is even more pronounced in so-called non-traditional real estate transactions, such as timber, cell towers, billboards and, more recently, power transmission and telecommunications infrastructure.

Finally, the value of an organisation’s real estate may not be leveraged to its full potential or highest and best use. This is often difficult for management to address or even accept – especially for companies that are otherwise performing well. For example, the value of a specific property, used by the company as a discount retail operation, may be worth more used by a high-end retailer, sub-divided and used by multiple users, or converted to another use – such as a hotel. In other cases, for companies in the midst of an operational transition or with financial difficulties, it is clear to management that real estate must be addressed as a part of broad, strategic change. Perhaps the most difficult situation for management to acknowledge – and the most significant source of activist pressure – is in cases where the value of real estate is higher than the value of an entire company.

### **Activist investors: Taking a pre-emptive approach**

Activist investors actively study many company operations in an effort to identify perceived inefficiencies that indicate the potential opportunity for outsized returns – one of which is the potential to unlock the hidden value of real estate holdings.

Before an activist investor becomes a shareholder and raises this issue, companies should analyse their real estate holdings, evaluate whether or not an opportunity to unlock tied-up real estate exists, consider tax efficiencies and develop a pre-emptive response to future anticipated questions.

In order to make this assessment, management and the board should:

- **Be proactive.** Don’t wait until a shareholder activist takes a position in your company. Pre-emptive measures can prevent the need for reactive, defensive actions.
- **Be strategic.** Assess if your company owns or controls real estate or qualifying real estate assets that present valuable monetisation opportunities, drive tax efficiencies or provide cost-effective ways to redeploy capital that is more strategically aligned with business needs. These are factors that shareholder

activists are likely to focus on. Use an integrated approach to conduct an analysis and develop responses that align with the overall objectives of the company and its shareholders.

*This is an extract from Unlocking shareholder value: Real estate monetisation strategies. The full paper can be downloaded from: <http://www.pwc.com/us/en/asset-management/real-estate/publications/assets/pwc-real-estate-monetization-strategies.pdf>*





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