Deloitte.

M&A Outlook

An Australian real estate perspective

September 2022

The global and Australian M&A deal volumes in the real estate sector were particularly strong in 2021 and are expected to remain at a high level in 2022.

In this article, we have analysed the outlook for M&A in the Australian real estate sector with insights from our interviews with Australian M&A leaders in the real estate sector as extracted from our Deal in Focus – Heads of M&A survey 2022 and compared against the Global 2022 real estate M&A outlook.

Key takeaways

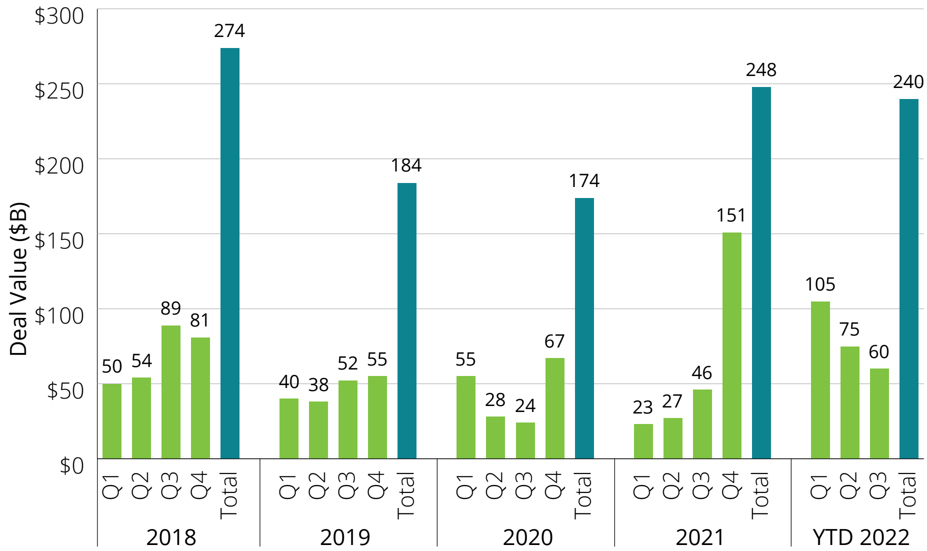
- Global and Australian Real Estate deal volumes are at relative highs
- M&A Leaders expect deal volume to remain at similar levels
- Macro-economic challenges may support opportunistic M&A activity
- ESG is a key factor in M&A decision making
- Alternative asset classes are becoming less “alternative”

Global and Australian real estate M&A activity

The global level of M&A activity in the real estate sector is set to reach record levels in 2022 with completed deal value of US$248 billion in 2021 compared to US$240 billion recorded in the first eight months of 2022 alone[1]. While completed deal values have declined consistently from a high in Q4 2021 they remain at historically high levels.

It will be challenging for global real estate heavyweights to navigate the volatile economic environment in the final quarter but assuming they do, we could see close to US$300 billion of deals complete in the calendar year.

Chart 1: Global real estate M&A deal value (Completed deals, US$ billion)



Source: Refinitiv and Deloitte analysis

Note: Q3 2022 and YTD 2022 include results up to the end of August 2022.

M&A activities in the real estate sector in Australia have seen a strong recovery from COVID-19, with $18.5 billion of completed deal values in 2021 (66% year on year growth) and $10.3 billion for eight months of 2022[2].

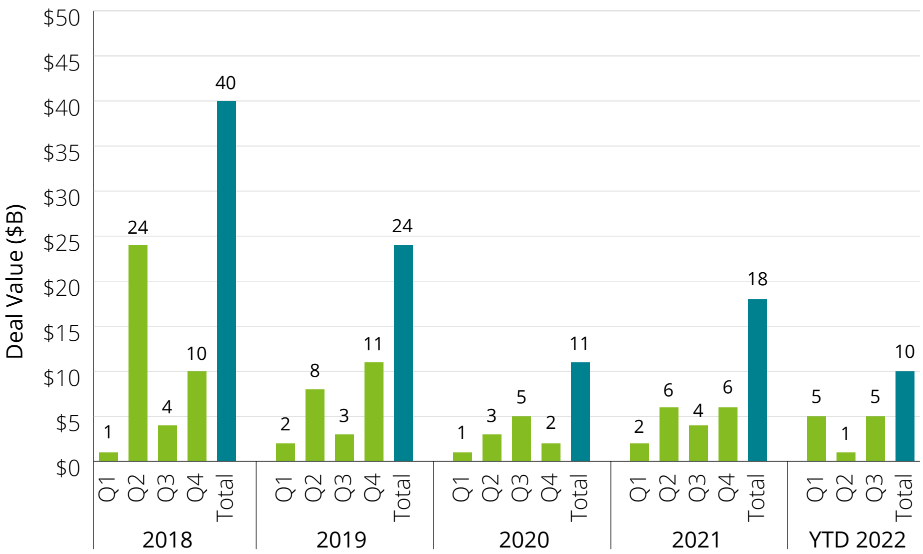
Notable recent completed M&A transactions include the merger of HomeCo Daily Needs REIT and Aventus Retail Property for the takeover value of $2.9bn completed in February 2022, Charter Hall's acquisition of an 80% interest in Irongate Group for $1.0bn in July 2022 and EQT Infrastructure's acquisition of Stockland's retirement living business for c. $1.0bn in July 2022.

During the recent period it's been widely recognised that demand for industrial and logistics assets has been high driven by the increased volume and depth of the online retail market. At the same time some interesting activity in the retail sector has emerged as landlords optimise their portfolios and investors see better value in key markets. However, we also see investment driven by the ageing population into land-lease retirement living communities and other types of senior-living development. Within the Australian market there has been much discussion on the attraction of the Build-to-rent or Multi-family model and there is clearly capital seeking investment in these areas but tax and policy settings remain an inhibitor to doing deals in this space.

1 Refinitiv, Deloitte analysis

2 Refinitiv, Deloitte analysis

Chart 2: Australian real estate M&A deal value (Completed deals, in A$ billion)



Source: Refinitiv and Deloitte analysis

Note: Significant M&A value in 2018 was driven by Unibail-Rodamco's acquisition of Westfield Q3 2022 and YTD 2022 include results up to the end of August 2022.

Chart 3: Recent notable completed M&A transactions in the Australian real estate sector

Target	Acquiror	Deal Value (A$m)	Effective Date	Description
Milestone Logistics (*)	ESR	3,800	Jun-21	Funds managed by ESR acquired the Blackstone owned Milestone logistics portfolio, comprising 45 assets under management.
Aventus Retail Property Fund (*)	Home Consortium Ltd HomeCo Daily Needs REIT	2,865	Feb-22	Home Consortium and its managed fund HomeCo Daily Needs REIT acquired the Aventus management rights and assets respectively. After the acquisition, HomeCo Daily Needs REIT portfolio value was $4.1b.
AMP Capital Retail Trust	Investor Group: Cbus Property Pty Ltd, UniSuper Ltd, AMP Capital Holdings Ltd	2,200	Oct-21	Cbus Property Pty Ltd and UniSuper Ltd joined AMP capital as partners in the AMP Capital Retail Trust taking the majority ownership in Pacific Fair shopping centre in Queensland and 50% ownership in Macquarie Centre in New South Wales.
Irongate Group	Charter Hall PGGM Industrial Partnership	1,030	Jul-22	Charter Hall PGGM Industrial Partnership acquired Irongate Group (IAP), a Sydney-based fund via scheme of arrangement.
Stockland Corp Ltd-Retirement Living Business	EQT Infrastructure V Fund	987	Jul-22	EQT Infrastructure acquired Stockland Retirement, comprising 58 villages housing over 10,000 residents, with a pipeline of 1300 units in development.
Grosvenor Place, Sydney, NSW	Blackstone Inc	925	Dec-21	Blackstone acquired a 50% stake in Grosvenor Place Tower located in Sydney from Dexus and Canada Pension Plan Investment Board.
AOFI I Trust (*)	Link REIT	596	Jun-22	Link Australia Holdings Pty Ltd acquired a 49.9% stake in the Investa Gateway Office Fund which owns a prime office portfolio in Sydney and Melbourne worth $2.3b.
EY Centre Sydney	Mirvac M&G Real Estate Asia Pte Ltd	575	Jul-21	Mirvac and M&G Real Estate bought a 50% investment in Sydney's EY Centre Tower from AMP Capital Wholesale Office Fund; Mirvac currently owns the other 50%.
Primewest Group Ltd	Centuria Capital Ltd	542	Jul-21	Centuria Capital Ltd acquired Primewest Group's $5.6b portfolio after an off-market bid was accepted by Primewest security holders. The combined group have $17.4b assets under management.
50% stake in Queen Victoria Building, The Strand and The Galeries portfolio (*)	Link REIT	538	Dec-21	Link REIT acquired 50% of interest in a retail portfolio comprising Queen Victoria Building, The Strand and The Galeries from GIC on a 5% capitalisation rate.

Source: Deloitte market intelligence

Note: (*) Deloitte has provided transaction support services for these M&A transactions.

Taking the temperature of the M&A market

During May through June 2022 Deloitte Australia conducted interviews with 120+ Heads of M&A from Australia and New Zealand corporates, of which a number were participants in the real estate sector. The results of the survey were summarised in our Deal in Focus – Heads of M&A survey 2022 which was released in August this year.

The report provides a summary of dealmakers' views on the economy and likely M&A activity over the next 12 months. While there are many similar viewpoints, we also observe some differences between the Australia real estate sector and other sectors, as well as between the outlook for Australian M&A in the real estate sector and the findings contained in our Global 2022 real estate M&A outlook.

80%+ are confident that M&A activities will increase or remain stable in 2022

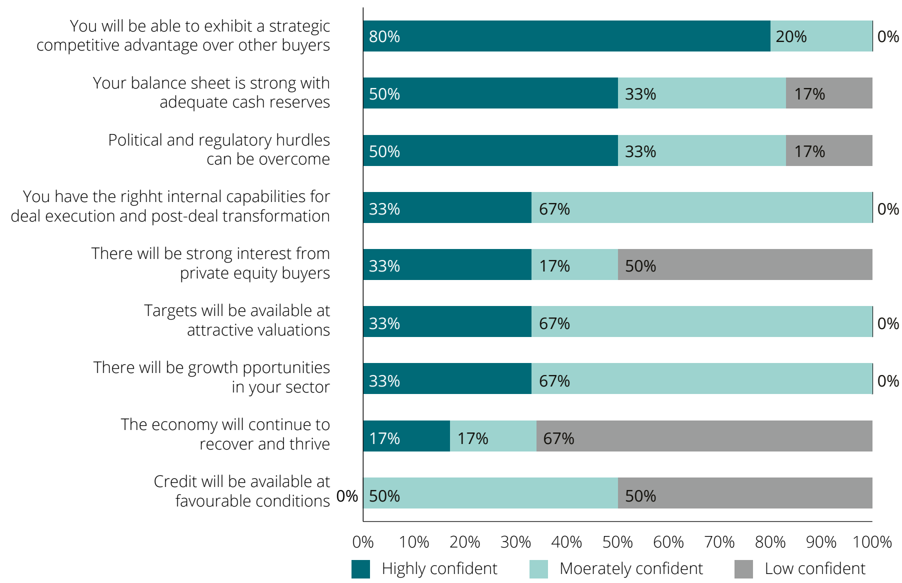
83% of the surveyed heads of M&A in the Australia real estate sector expect the number of M&A deals to increase or remain stable in the next 12 months, which is consistent with results reported across other Australian sectors. The survey responses are also in line with the findings shared in our report on the global real estate M&A outlook, in which a high level of commercial real estate M&A activity was expected to continue but likely to spread unevenly across different real estate segments.

While there are inherent concerns over the macroeconomic outlook, executives are confident that there will be growth opportunities in the real estate sector. Two thirds of respondents believe that current market conditions are supportive of M&A activity (compared to almost 80% across sectors).

The likely focus for M&A activities in the real estate sector would be consolidating the core portfolio, seeking "alternative" assets, which are now increasingly becoming mainstream for sophisticated global real estate investors and divesting non-core assets to hedge risks and unlock fresh capital for reinvestment.

Our participants felt that there would likely be more opportunities arising as a result of potential distress caused by increased interest rates and higher effective borrowing costs, particularly benefitting those groups with low debt and cash reserves.

Chart 4: How confident are you of the following factors that could influence your M&A decision over the next 12 months?

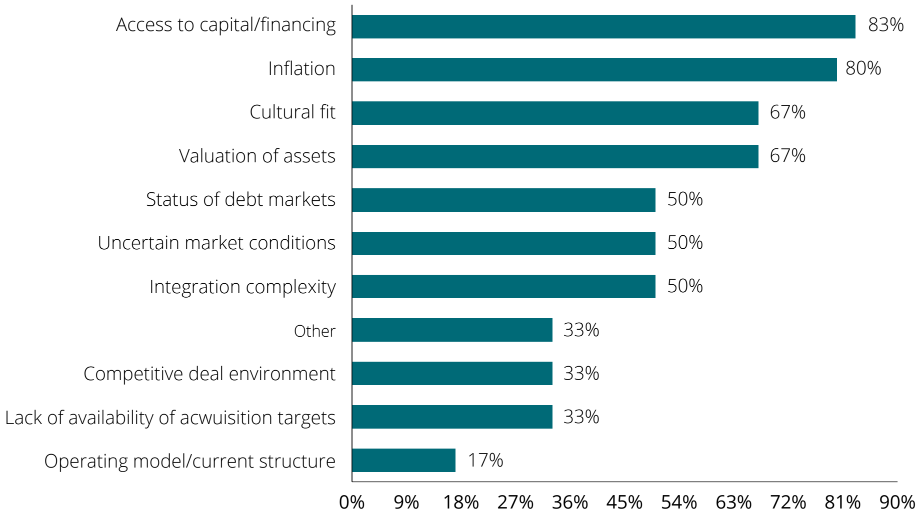


Source: Deloitte's Heads of M&A survey 2022 – extraction for the real estate sector

Interest rates and inflation perceived as the most challenging factors

While valuation of assets is perceived as the greatest challenge to M&A across the Australian sectors (80% of all Australian respondents), access to capital/ financing and inflation risks are reported as the greater challenges to the Australian real estate M&A outlook. Australian real estate companies are mostly concerned with funding availability for development and increasing effective interest rates. When interest rates increase, buyers will have to pay for a higher cost of debt which may limit their funding capacity for M&A activities. Also, when costs are rising but a company's earnings are not rising to the same extent, it may mean less available capital for M&A. This is likely to be especially troubling in the office and retail sectors, where new tenants may not be able or willing to accept rent increases on new leases or renewals.

Chart 5: In the current economic environment, what is your company's greatest challenge to M&A success?



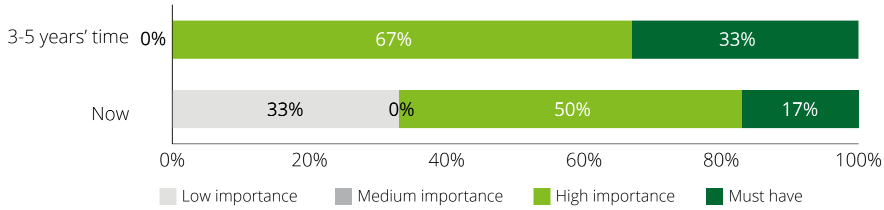
Source: Deloitte's Heads of M&A survey 2022 – extraction for the real estate sector

ESG is increasingly recognised as a value enhancer

Given that buildings are responsible for nearly 50% of annual global carbon dioxide emissions, of which building operations are responsible for 27% and building materials and construction (typically referred to as embodied carbon) for an additional 20% annually[3], the commercial real estate sector has a huge role to play in helping combat climate change. Australian real estate companies are increasingly incorporating ESG factors into M&A deals, with 67% of survey respondents factoring ESG into deal decision making all or most of the time, compared to 63% across other sectors.

In addition, two thirds of respondents expressed views that ESG initiatives are a source of value creation and provide a competitive advantage rather than a risk to address. This is consistent with the global survey in the Deloitte 2022 Commercial Real Estate Outlook, in which 60% of Deloitte survey respondents believe that ESG initiatives are driving new business opportunities for their organization, with half seeing these initiatives as a competitive edge.

Chart 6: How important is ESG performance as a consideration in the M&A due diligence process?



Source: Deloitte's Heads of M&A survey 2022 – extraction for the real estate sector

3 Architecture 2030, "Why the building sector?," accesed September 2022, https://architecture2030.org/why-the-building-sector/

Alternative assets are actively being pursued

A number of surveyed real estate companies are looking closely at alternative asset classes, given the traditional office and retail segments of the market have been facing headwinds as patterns of work and shopping undergo changes. This trend is also observed globally as investors, REITs and PE firms are increasingly funnelling more of their investments into alternative assets, such as data centres, health care, agriculture and build-to-rent projects, as described in our Global real estate M&A outlook.

About the Authors

David Hagger, National Real Estate Leader

David is the national sector leader for real estate and a senior M&A partner. He has worked across the spectrum of construction, property development, retirement living, funds management and building supplies businesses

Hannah Vu, M&A Transaction Services Director

Hannah is a director in the M&A transaction services team with extensive experience in real estate M&A, investment and fund management across residential, commercial, hotel, industrial and retirement living sectors

Deloitte.

This publication contains general information only, and none of Deloitte Touche Tohmatsu Limited, its member firms, or their related entities (collectively the "Deloitte Network") is, by means of this publication, rendering professional advice or services. Before making any decision or taking any action that may affect your finances or your business, you should consult a qualified professional adviser. No entity in the Deloitte Network shall be responsible for any loss whatsoever sustained by any person who relies on this publication.

Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited ("DTTL"), its global network of member firms, and their related entities. DTTL (also referred to as "Deloitte Global") and each of its member firms and their affiliated entities are legally separate and independent entities. DTTL does not provide services to clients. Please see www.deloitte.com/about to learn more.

About Deloitte

Deloitte is a leading global provider of audit and assurance, consulting, financial advisory, risk advisory, tax and related services. Our network of member firms in more than 150 countries and territories serves four out of five Fortune Global 500®companies. Learn how Deloitte's approximately 286,000 people make an impact that matters at www.deloitte.com.

About Deloitte Asia Pacific

Deloitte Asia Pacific Limited is a company limited by guarantee and a member firm of DTTL. Members of Deloitte Asia Pacific Limited and their related entities provide services in Australia, Brunei Darussalam, Cambodia, East Timor, Federated States of Micronesia, Guam, Indonesia, Japan, Laos, Malaysia, Mongolia, Myanmar, New Zealand, Palau, Papua New Guinea, Singapore, Thailand, The Marshall Islands, The Northern Mariana Islands, The People's Republic of China (incl. Hong Kong SAR and Macau SAR), The Philippines and Vietnam, in each of which operations are conducted by separate and independent legal entities.

About Deloitte Australia

In Australia, the Deloitte Network member is the Australian partnership of Deloitte Touche Tohmatsu. As one of Australia's leading professional services firms. Deloitte Touche Tohmatsu and its affiliates provide audit, tax, consulting, and financial advisory services through approximately 8,000 people across the country. Focused on the creation of value and growth, and known as an employer of choice for innovative human resources programs, we are dedicated to helping our clients and our people excel. For more information, please visit our web site at www.deloitte.com.au

Liability limited by a scheme approved under Professional Standards Legislation.

Member of Deloitte Asia Pacific Limited and the Deloitte Network.

© 2022 Deloitte Touche Tohmatsu.

Designed by CoRe Creative Services. RITM1178840