

REFLEXIONS

A BIENNIAL DIGEST FOR THE REAL ESTATE INVESTMENT MANAGEMENT INDUSTRY

Issue 02 — October 2015

Spain—Spotlight on the real estate market

Capital flows from Asia into European real estate

Future of work—Real estate - Enabler or constraint?

Deloitte Property Index 2015 - Overview of European residential markets—Residential property prices increase

BEPS implications for the real estate investment industry—What is on the horizon?

Deloitte 2015 European real estate investment management survey—Forecast? Mostly sunny, with scattered clouds

The Canadian perspective—Retail landscape transformation



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Foreword

Dear readers,

Information, insight, enlightenment, or even prosaically news, come in many ways and forms. Some is best imparted in figures, some in words, some in sights and sounds. In many respects, no medium is complete without the others. In this edition of REflexions we have sought to put together a balance of all these elements; you will find statistics in the form of the Deloitte Property Index for 2015, you will find a blending of styles in the look at Spanish real estate from a macro-economic perspective which could also have been a look at Spanish macro-economics from a real estate perspective with equally intriguing conclusions. This is followed by an update on BEPS from a real estate perspective. We have a refreshing look at European real estate through the eyes of Asian investors and a thought provoking piece focusing on the broader and “softer” role of real estate in the socio-economic fabric of society. Thought provoking indeed. Changing perspectives, we also look at the other side of the Atlantic this time, when examining the transformation of the Canadian retail landscape. The drivers shaping the future of work, also from a real estate view, is another topic we dedicated our attention to. We round the whole off with our latest investment managers and asset servicers sectoral survey.

Can we claim the architecture of our publication is worthy of our subject? That it also soars, and informs, calculates and calibrates? Or should we be satisfied if we have reached our primary objectives, those of discussion, and thought, information and innovation? We prefer to leave you to be the judges. After all, REflexions is your magazine, dedicated to your sector, your interests and your world. We trust that you will enjoy reading it as we did preparing it and we look forward to your feedback and even contributions for future issues so that this modest endeavour itself may continue to be multifaceted, rich, new and inspiring, solid and reliable – all the qualities, contradictions and complementarities that characterise our industry.



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SPAIN

Spotlight on the real estate market

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Macroeconomic View

Introduction: The Spanish economy gathers momentum

Investment analysts are projecting continued and healthy growth in Spain over at least 18 months. According to the OECD, this will be driven by supportive financial conditions, the depreciation of the euro, lower oil prices, and strengthening growth among trading partners. Additionally, its fiscal stance is assumed to be mildly contractionary. Growth in private consumption will be supported by rising employment and incomes, household tax cuts, and lower fuel prices and interest rates. Export growth will be underpinned by gains in cost-competitiveness driven by the weak euro and the recovery in Europe.

The ECB's quantitative easing has provided a further boost and this—together with historic and prevailing conditions—will keep inflation low. Regardless of who will be governing Spain after the 2015 general elections, the Spanish government should continue to ensure the fiscal deficit is reduced to put public debt on a downward trend. Structural reforms to make it easier to start and expand a business as well as improving innovation are key to moving towards a knowledge-based economy and ensuring strong, inclusive growth and job creation. High unemployment, which has pushed up income inequality, is a key concern. Dealing with it will require greater efforts to improve both job search assistance and training options for the unemployed, many of whom are poorly skilled.

Figure 1: Spain - keys to economic recovery



OPPORTUNITIES

Healthy GDP growth through current account surplus and rising consumer confidence.

Export growth driven by **depreciation of the euro** against the British pound and the US dollar.

Ease of general financing conditions supported by **ECB's monetary policy (QE)**.

Low oil price prospects should prevent from inflation risks in the medium run.

Reduction of **public spending** specific weight to GDP through **austerity measures** and further structural reforms within local Administrations.



THREATS

Political uncertainty due to the upcoming parliamentary election in Catalonia and the general election which will be held by the end of the year.

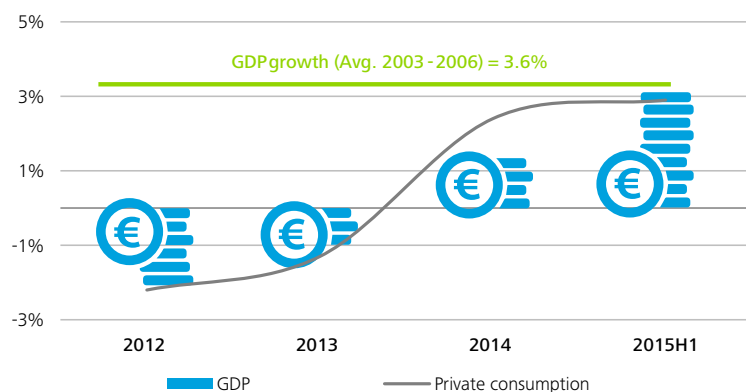
Unemployment and labour market imbalances and disparities explained by a historical overexposure of economic activity to the construction and tourism industries.

International net debt reached 97% of GDP as a result of the expansion of Spanish companies abroad.

Lack of innovation policies and R&D could act as a deterrent of further productivity growth.



Figure 2: GDP growth in Spain (%)



Source: Eurostat, IMF, EIU

The following reasons underpin our belief that Spain's economic recovery is gaining momentum:

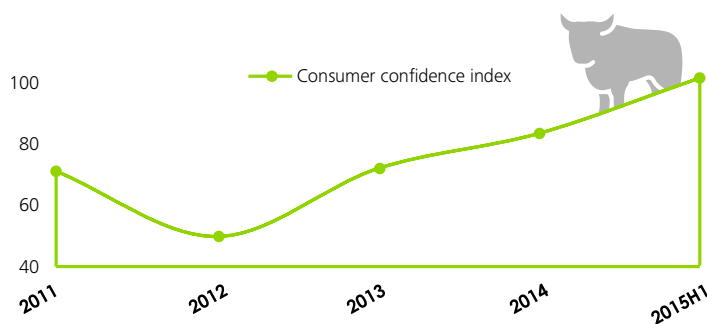
GDP growth

The current drivers of economic growth in Spain are different from the pre-crisis period, which was characterized by excessive public spending and domestic consumption driven by soft lending conditions. Exports were low, leading the economy to display a chronic current account deficit year on year. At present, economic growth is sustained by a current account surplus driven by structural reforms that have led to economic expansion, export growth, and rising levels of consumer confidence.

Labour market

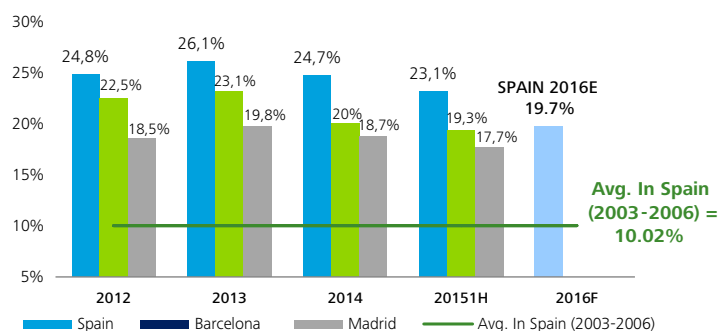
In 2013, unemployment started to fall progressively across agriculture, industry, construction and service sectors. Although 2003 to 2006 unemployment levels (around 10 percent) are still a long way off, the IMF has projected a further decrease in unemployment to 19.7 percent by 2016.

Figure 3: Consumer confidence (Basis 100)



Source: CIS

Figure 4: Unemployment rate (%)



Source: INE and IMF



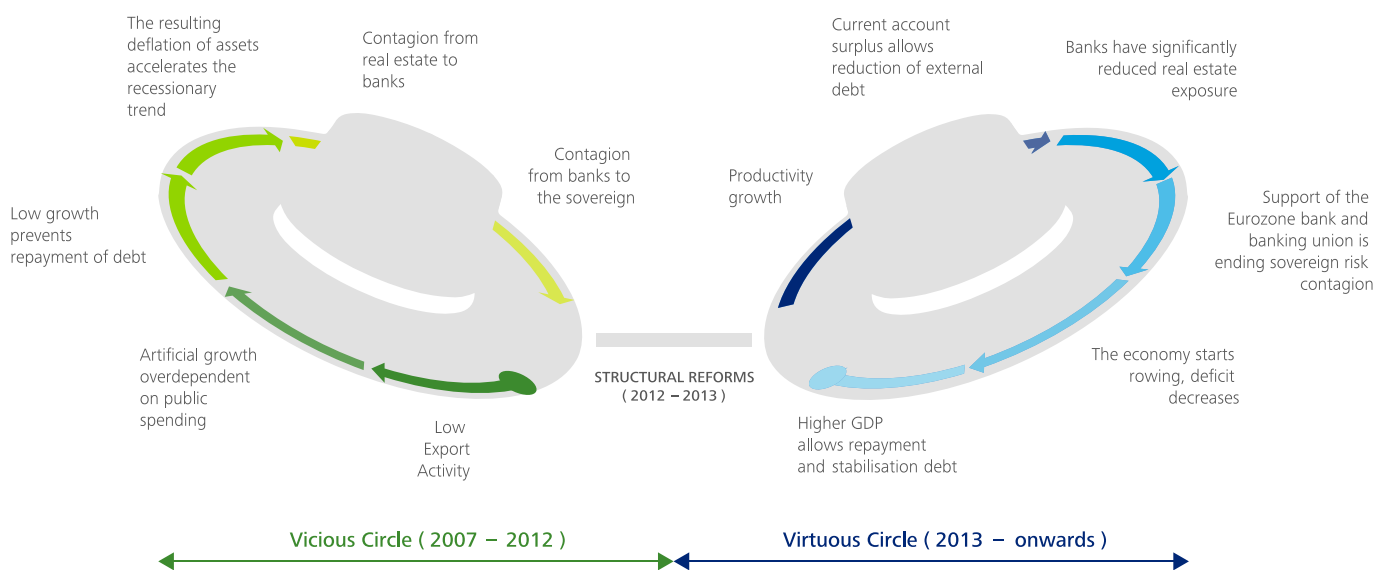


The turnaround

Spain's systemic risk has fallen considerably since 2013 to 2014, while political risk seems to remain for 2015 to 2016. The chart below reflects the change in perspective over the last 36 months in Spain.

Investment analysts are projecting continued and healthy growth in Spain over at least 18 months

Figure 5: From a vicious to a virtuous circle



Source: Deloitte and Arcano



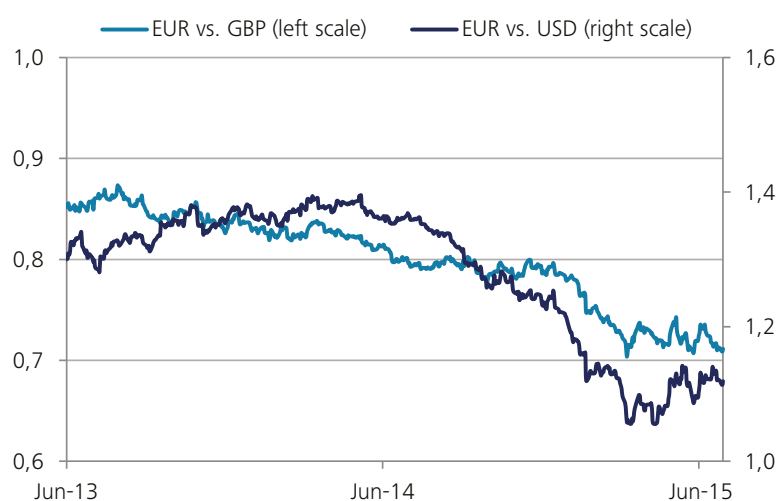
Other relevant factors: the risk premium and the euro

By mid 2012, the risk premium reached its highest level in recent years. As a result, the Spanish government undertook an ambitious economic program supported by a European Financial Stability Facility/European Stability Mechanism loan to recapitalize the banking system, paving the way for a recovery in confidence. Since then, the Spanish risk premium has decreased by more than 485 bps, from 638 bps in July 2012 to below 153 bps on 30 June 2015, despite recent volatility caused by the Greek debt crisis. This reduction in interest rates supports the ongoing recovery.

The progressive depreciation of the euro against the U.S. dollar and pound sterling since mid 2014 is helping the Spanish economy recover by growing exports and fostering international tourism. The expected rise in interest rates in the United States should potentially extend this trend in the coming quarters.

Regardless of who will be governing Spain after the 2015 general elections, the Spanish government should continue to ensure the fiscal deficit is reduced to put public debt on a downward trend

Figure 6: Exchange rates (EUR/USD & EUR/GBP)



Source: Bloomberg

Figure 7: Risk premium - 10 year sovereign bond yields/ spread over German equivalent (BP)



Source: Bloomberg



Real estate market

Setting the scene

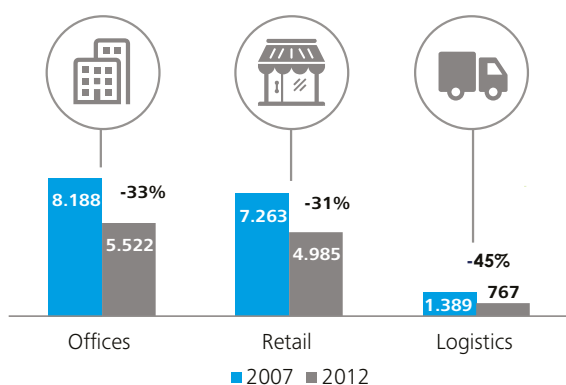
The Spanish commercial real estate market (CRE) was seriously impacted by the housing bubble that burst in 2008. At the time, Spain's economy was significantly biased towards the construction sector. This contributed to unprecedented growth in unemployment, which reached its peak in 2013. Investment in commercial real estate declined sharply given its poor fundamentals (vacancy, rental income and absorption rates), the high country risk premium, and the lack of financing from key Spanish banks. As a result, capital values in commercial real estate contracted significantly.

Compared to other European markets where the capital values trend was mixed from 2007 to 2012, at the beginning of 2013, Spain presented highly attractive CRE pricing. As such, from 2013 to H1 2015, opportunistic and value added investors undertook a significant number of transactions executed below replacement cost levels. This phenomenon triggered the return of investor confidence in Spain.

Since 2013, a total volume of €9.1 billion has been transacted within the key CRE segments (offices, retail and logistics). Value added and opportunistic investors accounted for 26 percent of the activity during this period, while 14 percent of the total investment was priced below replacement cost. This factor was especially pronounced within the retail segment, with 25 percent of total transactions executed at a price below replacement cost.

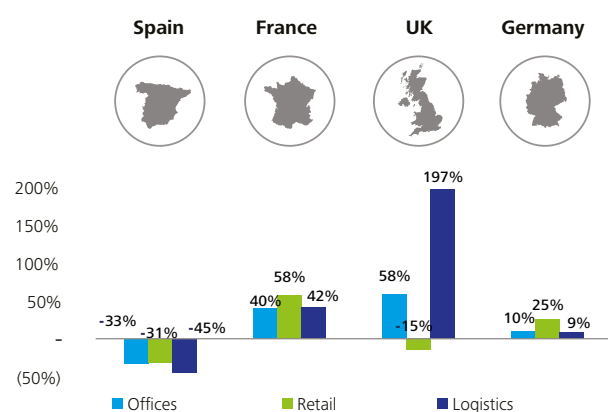
As shown in Figure 11, the most relevant transactions executed at a price below replacement cost were conducted by investors with notable asset management capabilities.

Figure 8: Average capital values - prime properties (€/sqm)



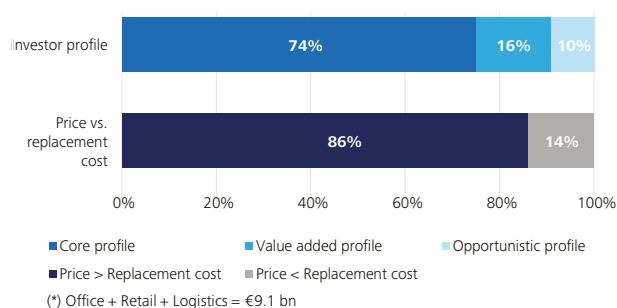
Source: Deloitte

Figure 9: Capital values average adjustment 2007-2012 (%): Spain vs. key European markets



Source: Deloitte

Figure 10: Key CRE segments transaction analysis: 2013-2015H1 (*)



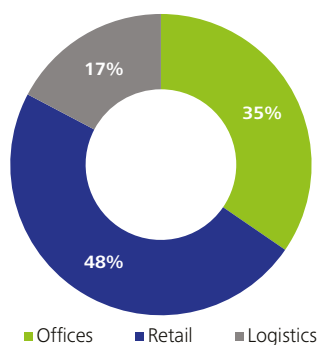
Source: Deloitte

Figure 11: 2013-2015H1 : Top deals per asset class (price < replacement costs)

Asset Class	Transaction	Buyer	Price (€m)	Year
Offices	Office portfolio	WP Carey	300	2014
	Generalitat buildings	Zurich	201	2014
	Parque de las Nacione	Axa RE	180	2014
	Castellana 89	March Family	147	2015
	IT headquarters	Bankia	144	2015
Logistic	Gran Europa	Blackstone	130	2014
	Parque Coslada	Prologis	100	2014
	Logistic portfolio	Confidental	60	2014
	Logistic portfolio	Blackstone	55	2014
	Logistic portfolio	Blackstone	50	2013
Retail	Puerto Venecia	Intu Properties	451	2014
	Plenilunio	Klepierre	375	2015
	Marineda City	Merlin Properties	260	2014
	TIAA Henderson	Islazul	230	2014
	Vastned portfolio	Baupost - GreenOak	160	2014

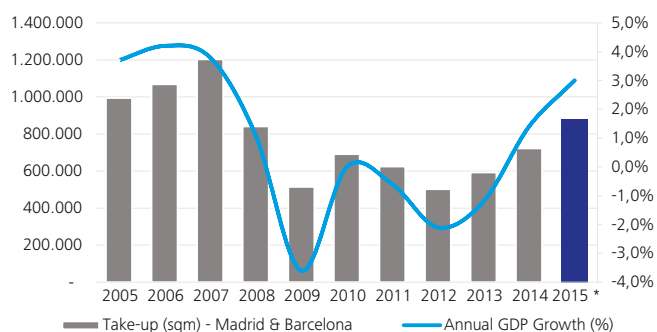
Source: Deloitte

Figure 12: CRE Investment pipeline breakdown: 2015H2



Source: Deloitte estimation

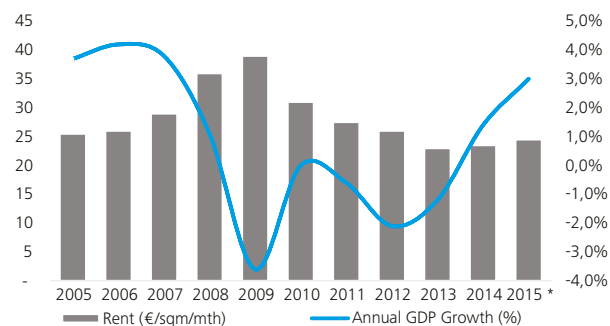
Figure 13: Correlation analysis - office take-up & GDP growth



(*) Run rate

Source: Deloitte

Figure 14: Correlation analysis - office rental prices* & GDP growth



(*) Madrid prime rental prices

Source: Deloitte

Figure 16: Office occupancy

2006-2015H1 Office Occupancy Analysis %	MAD	BCN	Average
1.- 2015H1 avg. occupancy rate	87,2%	85,8%	86,5%
2.- Maximum occupancy rate (2006 - 2015H1)	94,9%	94,5%	94,7%
3.- 10-year average occupancy rate	88,4%	88,4%	88,4%
GAP % (1 vs 2)	9%	10%	9%
GAP % (1 vs 3)	1%	3%	2%

Source: Deloitte

Figure 17: Rental prices office/retail/logistics

2006-2015H1 Rental Prices Analysis (*) €/sqm/mth	Office	Retail	Logistics
1.- 2015H1 avg. rental price	24,5	25,5	5,4
2.- Maximum rental price (2006 - 2015H1)	39,0	30,0	8,0
3.- 10-year average rental price	28,6	27,0	5,6
GAP % (1 vs 2)	59%	18%	50%
GAP % (1 vs 3)	17%	6%	5%

(*) prime properties

Source: Deloitte

The opportunity

At present, the Spanish CRE market still offers attractive investment opportunities given that both rental income and capital values fell significantly during the crisis and there is still a long way to recovery. The current estimated investment pipeline amounts to €3.5 billion. Given the limited sourcing of logistics investment opportunities, with an estimated investment pipeline of €600 million and the strong competition of dominant players such as Blackstone, Colony and other emerging specialized investors such as TPG, we consider this market segment limited in terms of accessibility. On the other hand, the retail segment presents enormous potential given its €1.7 billion heterogeneous investment pipeline of both shopping centers and retail parks throughout the whole country with different asset management strategies that can be matched with a wide range of investors and asset managers. The office segment has an estimated investment pipeline of €1.2 billion.

Qualified investors holding asset class expertise and asset management capabilities will focus on opportunities located in secondary areas where prices remain around replacement cost levels. Highly skilled asset management teams will be required to turn around the performance of mismanaged properties.

Large institutional investors are benefiting from the opportunity to enter the Spanish market, aiming to exit with expected returns of around 15 percent IRR. These expected returns can be explained by the gradual recovery of key fundamentals: rental prices and occupancy levels. Going forward, these factors are expected to be correlated with the economic cycle, as historical figures show. (Figure 13 and 14).

This correlation shows an increase in gross absorption of offices in Madrid and Barcelona, driven by GDP growth.

A correlation also exists between rental prices and GDP growth. However, it is delayed by 18 months because decision makers postpone negotiations until the earliest lease contract end or break option.

The general improvement in occupancy levels should lead to higher rental levels given the existing gap seen in Figure 17.

Before providing further sector-by-sector detail, it is worth highlighting two important variables in Spain's real estate sector, SAREB and SOCIMIs:

- SAREB, the Spanish bad bank, was set up in November 2012 to help restore the country's financial system and, specifically, those entities with high exposure to the housing market. As more than half of SAREB's funds are private, sale processes are not conducted through public channels. SAREB works mostly as a private entity whose aim is to maximize the asset sale price.
- SOCIMIs (*"Sociedad Anonima Cotizada de Inversión en el Mercado Inmobiliario"*) or "Listed corporations for investment in the Real Estate Market" are Spanish REITs. This regime was launched in 2012.

We consider the SOCIMI structure as the most suitable vehicle to make real estate investments and divestments in Spain.

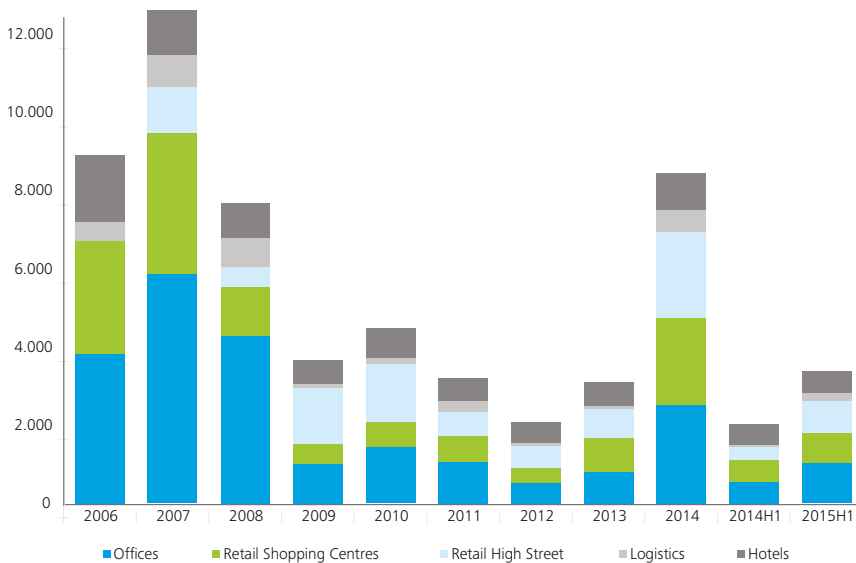
At present, the Spanish CRE market still offers attractive investment opportunities given that both rental income and capital values fell significantly during the crisis and there is still a long way to recovery

Investment volume

Spanish CRE investment volume fell from its peak in 2007 when the financial crisis hit capital markets throughout the world. After five consecutive years of decreasing activity, investment bottomed out in 2012 to grow back to 2006 levels, with turnover at almost €8.5 billion in 2014 and bolstered by the increasing activity of REITs (SOCIMIs). It should be noted that investment volume executed in H1 2015 grew by 67 percent compared with H1 2014. This phenomenon can be explained by the improvement in macroeconomic fundamentals and the progressive easing of lending conditions.

Spanish CRE investment volume fell from its peak in 2007 when the financial crisis hit capital markets throughout the world

Figure 18: CRE investment volume trend - breakdown by typology



Source: Deloitte

Figure 19: Investment volume by asset typology

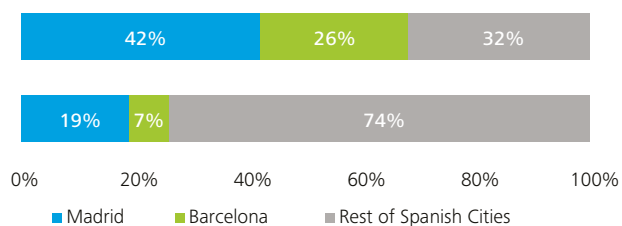
Asset Typology	2006		2007		2008		2009		2010		2011		2012		2013		2014		2014H1		2015H1		Var. (%) 2014H1 2015H1
	€m	%	€m	%	€m	%	€m	%	€m	%	€m	%	€m	%	€m	%	€m	%	€m	%	€m	%	
Offices	3.818	43%	5.879	47%	4.289	56%	1.013	28%	1.460	33%	1.056	33%	544	26%	807	26%	2.520	30%	554	27%	1.044	31%	88%
Retail Shopping Centres	2.889	32%	3.591	28%	1.261	16%	504	14%	644	14%	687	22%	365	17%	867	28%	2.247	27%	562	28%	751	22%	34%
Retail High Street	n.a.	n.a.	1.200	10%	500	7%	1.438	39%	1.467	33%	591	19%	571	27%	740	24%	2.177	26%	329	16%	837	25%	154%
Logistics	500	6%	800	6%	750	10%	103	3%	150	3%	279	9%	88	4%	90	3%	579	7%	58	3%	205	6%	254%
Hotels	1.700	19%	1.150	9%	880	11%	596	16%	750	17%	576	18%	519	25%	607	19%	933	11%	522	26%	540	16%	3%
Total	8.907	100%	12.620	100%	7.680	100%	3.653	100%	4.470	100%	3.189	100%	2.087	100%	3.110	100%	8.456		2.025	100%	3.377	100%	67%

Source: Deloitte

Madrid and Barcelona: key targets for CRE investment

Madrid and Barcelona have been gaining momentum in terms of CRE investments over other Spanish cities, given the growing importance of both cities in terms of economic activity and tertiary real estate developments and refurbishments.

Figure 20: Spanish investment volume breakdown by location



Source: Deloitte







Capital flows from **Asia** into European real estate

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By the end of 2015 we expect investors from Asia to have invested around €90 billion into global real estate with increasing capital flows into Europe.

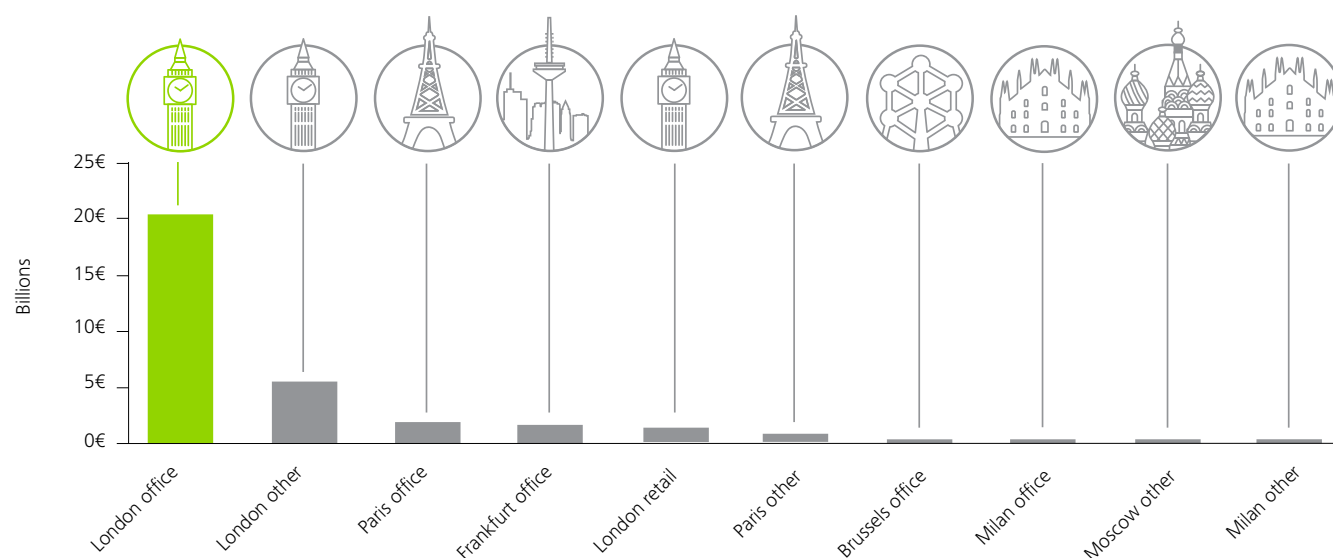
Since 2010, we have witnessed a growth of capital from Asia into European real estate. A total of €50 billion has been invested over the last five years, and this stream of investment is set to continue. Asian investment in Europe, which typically has come from Singapore, China, Hong Kong, Malaysia and South Korea, currently accounts for around 5 percent of total European investment with a far larger concentration in London as a percentage. However, we expect the flow to increase, driven by a number of factors that continue to boost Asian investors' appetite for European real estate.

At present, London is the main market within Europe in which Asian investors have made significant moves: over the last five years, 62 percent of all capital flows from Asia into Europe have been invested in London. Asian investors, in particular Asian institutions, have joined a raft of other international and local purchasers in buying up London property. They have favored direct investment and the London office sector in particular. So far, a relatively small proportion of Asian capital has been invested in other European cities including offices in Paris and Frankfurt.

Asian equity funds and institutions have been the major players to date, consistently accounting for more than half of all Asian investment in Europe since 2007. Institutions are likely to remain the dominant investor type in the medium term, however, we predict a rise in private, unlisted, and listed investors as they become more comfortable with investing in other European markets.

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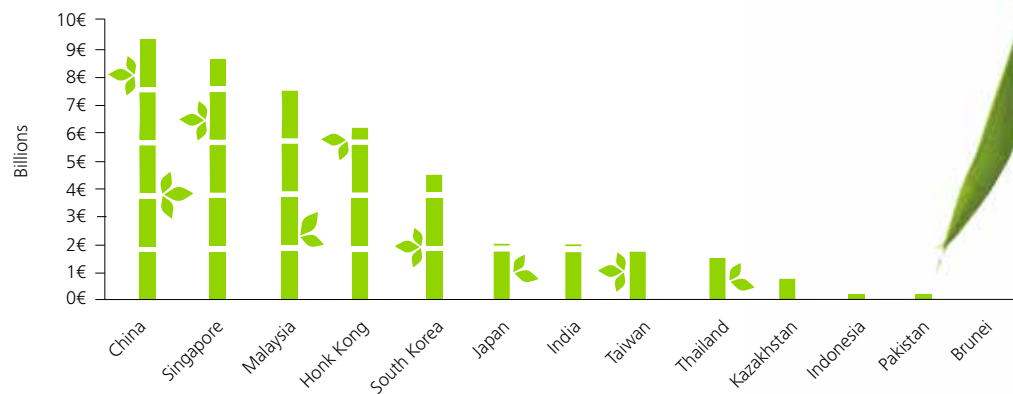
Top 10 Asian investment destinations in Europe (last 5 years)



Source: Real Capital Analytics

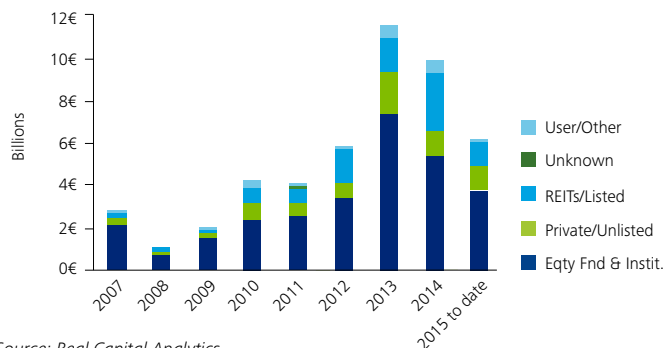


Top 10 Asian sources of Asian investment in Europe (last 5 years)



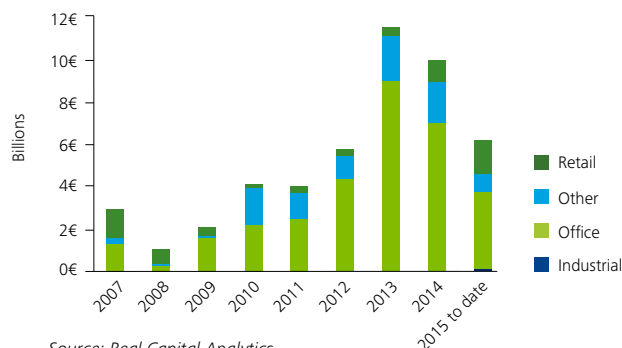
Source: Real Capital Analytics

Asian investment in Europe by buyer type



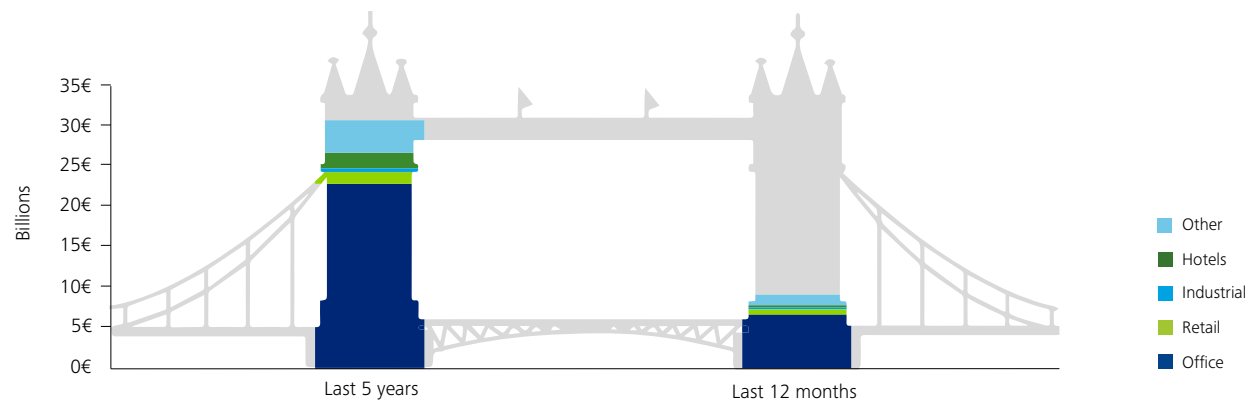
Source: Real Capital Analytics

Asian investment in Europe by sector



Source: Real Capital Analytics

Asian investment in London by sector (€bn)



Source: Real Capital Analytics



So what is driving these flows from Asia into European property markets? There are a number of factors.

A long-term demographic shift is driving growth in savings and pension institutions within Asia, with growing inflows but limited opportunities to invest domestically. Meanwhile, growth in high and ultrahigh net wealth in Asia is leading to a rise of family offices.

The domestic Asian investment environment has provided a backdrop for the fundamental drivers of cross-border flows into Europe. Asia accounts for over 50 percent of the world's population. Recent years have seen increased flows into pension and savings funds, especially in Malaysia and South Korea, and this growth is set to continue as the population ages. High net wealth individuals' investments in foreign real estate have been driven by various factors including portfolio diversification, risk spreading, capital preservation, their children's education in world-renowned European universities, immigration drivers facilitated in Europe by the Schengen visa program and the desire to have capital outside their home jurisdiction due to economic, political, or business risks. This is in addition to the fact that we have witnessed major growth in high net wealth individuals and family offices across the major Asian economies. The Forbes 2015 billionaires list shows that after the United States, China and Hong Kong have the highest number of billionaires—30 and 24 respectively—and that Asia-Pacific leads the world in terms of real estate wealth by being home to 96 of the 157 global real estate billionaires. Wealth-X and UBS estimate that by 2024 Asia ultra-high net wealth individuals will overtake Europe in terms of wealth, and by 2027 in terms of population. The increase in wealth across Asia has led to growth in family offices looking to invest capital.

The increase in wealth across Asia has led to growth in family offices looking to invest capital

Sovereign wealth funds' appetite for real estate is on the rise

The volume of Sovereign Wealth Funds (SWFs) has reached a record high of US\$6,977 trillion (SWFI November 2014), with more than 50 percent invested in real estate. According to the Preqin Sovereign Wealth Fund Review 2014, SWFs allocate at least 5 percent to real estate. On this assumption, we can estimate that there is currently US\$348 billion to be invested in this asset class. It therefore comes as no surprise that Asian SWFs (including Chinese SWFs that represent approximately 30 percent of the total value of global SWFs) have become increasingly active in Europe. In recent months, they have been involved in some very large transactions, including recent acquisitions of more than US\$1 billion in commercial real estate.

An overhaul of institutional regulations across Asia over the last three years is facilitating greater overseas investment in real estate

Since 2012, changes in Chinese regulation have allowed institutional funds to allocate more assets to real estate within their portfolios, and permitted funds to invest in overseas real estate. Lately, Taiwan and Malaysia have also seen a liberalization of regulations on investment in real estate for institutional and regulated investors such as insurance funds and companies. Despite these moves, many Asian institutions remain underallocated to real estate. However, as a consequence of the liberalization, it is expected that insurance funds in Asia will become increasingly focused on real estate investments and climb the rankings as significant players in global real estate investment in the future.

The weakness of the euro (and past weaknesses of the pound) has increased the attractiveness of European real estate to overseas investors

The improving economic landscape in many parts of Europe has made the continent increasingly attractive to foreign investors. The weakness of the euro is rarely cited as a primary reason for investing in the eurozone, but it is one of many factors that have increased the popularity of European real estate to cross-border investors.

The attractive risk/return profiles on certain European markets are not always easily obtainable in domestic Asian markets


For some types of investors, sourcing the right product within Asia can be difficult. In particular, this can be a hurdle for institutional investors that demand stable income streams at levels that are not always easily achievable in their own markets. In the core Asian markets of China and Taiwan, exceptionally low yields are often quoted on prime investments. In addition, the tradition of "building to hold" by Asian construction companies has made Asian markets comparatively illiquid. A high level of owner-occupation by conglomerates is a particular feature in South Korea. Compare this to Europe, where there are opportunities to invest in relatively transparent, highly liquid markets with strong growth potential and diversification benefits. Liquidity is an especially important factor, with the ability to disinvest as well as invest seen as an attractive feature of real estate markets in Europe.

Financial and political instability driving investors towards perceived safe havens and in search of diversification opportunities

The recent volatility of the Chinese stock market might serve to boost capital flows into overseas real estate further as Asian investors seek to invest in perceived safe havens. These are likely to be trophy assets in core global cities, such as London, New York and Paris. There is precedent for this: during the recent global financial crisis, huge amounts of overseas capital were ploughed into prime London residential property, whilst political instability in the Middle East has also resulted in vast quantities of sovereign wealth flowing into core European real estate markets, including London.

An explosion in the number of Asian (particularly Chinese) tourists visiting continental Europe

Over the past few years, the rise of the middle class in China, the fall in the cost of air travel, and the growing interest in European luxury items have generated waves of new Asian tourists in Europe. Major players in the Asian tourism sector have understood the economic stakes of this new trend and have started to invest heavily in the sector, including in European hotels, resorts and apartments. Developing an approach fully focused on Chinese tourism has led large Chinese private equity and hotel groups to purchase real estate in popular tourist locations such as Paris, Rome, and Stockholm.



It is worth considering whether there is anything that might stem the flow of capital from Asia into Europe. It is unlikely that the volume of money moving from Asia into Europe will decline in the short to medium term. From a performance perspective, we can question whether Asian investors will continue to allocate funds to real estate over bonds and equities, increasing their weighting of this asset class, especially when interest rates start to rise. Given the fact that Asian institutions are, at present, underallocated to real estate, that Asian equity markets are looking increasingly volatile, and that there are uncertainties surrounding Chinese economic growth, we see no current reason why Asian institutions will not continue to invest in overseas real estate.

In addition—and as alluded to earlier—at times of political or financial instability in a region, we have witnessed money flow from the troubled region into markets such as London and other perceived safe havens. However, there are several factors that could suppress cross-border flows into core European markets. Firstly, if there were an adverse change in business taxation or if, for example, London were to lose its ranking as one of the most important financial centers in the world, the attraction could fade.

Additionally, if Europe could no longer deliver attractive returns to Asian investors, then this would have an impact on cross-border flows. We should not underestimate the risk of the current weight of capital leading to an overheated market. In London, investment from Asia and the Middle East has contributed to huge downward pressure on yields and has priced some UK-based investors out of the market. Given the low yields in London, and the expectation of interest rate rises in early 2016, we question how much yield-driven growth is left and whether the attractive yield-to-risk opportunities for Asian investors in London may diminish.

Even so, there are good reasons to suggest that capital flows from Asia will continue to gather pace. The strategy of Asian investors is quite diverse and depends on the investor profile, however we anticipate as Asian investors become increasingly comfortable with European markets, they will move away from the core cities and search for higher growth opportunities.

This is already apparent in the UK where we have seen Asian investors venture out of London and invest in other cities, including Manchester, Leeds and Liverpool. The UK should continue to receive a large share of capital from Asia in Europe, however Asian investors are showing interest in other jurisdictions such as Germany, France and Northern Europe, attracted by the lower risk opportunities, or in Spain, Italy and Eastern Europe, where potentially higher returns can be found. The current weakness of the Euro should support the shift towards these other European countries

So how much capital do we estimate is still expected to come out of Asia into European real estate over the next five years? According to Real Capital Analytics, in January 2015 to July 2015, Asian investors had already invested €50 billion in global real estate. At this rate, we can expect around €90 billion in total to be invested globally in 2015 alone, and of this around one quarter to one third is likely to be invested in European real estate this year. Although this is a small proportion of total Asian investment in global real estate, we believe all indicators suggest this figure will increase in 2016, and we expect these to remain in place in the medium term, bringing an increased movement of capital from Asia into European real estate.

As Asian investors become increasingly comfortable with European markets, they will move away from the core cities and search for higher growth opportunities



FUTURE OF WORK

Real estate - enabler or constraint?

Martin Laws
Partner
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Pick up any business article, podcast or blog by an economist, social scientist, business strategist or human capital expert and each appears to be offering their own perspective on “the future of work”;

the re-emerged “war for talent” following the global recession, the rise of the virtual worker and global talent networks, the collision of talent with fast-moving cognitive workplace technology, or the challenges of managing a Millennial generation that will rapidly become the majority of our future workforce. Images of modern, innovative, flexible, and creative workplaces serve to fuel our imagination as to how “the future of work” could look from a real estate perspective.



The latest global research by Deloitte suggests that this corporate focus on the fast-changing world of work is both long overdue and also increasingly high up the executive agenda of many of the world's largest corporations. So what is driving this?

Advancing technology and automation is undoubtedly a trigger, with Oxford University research of the U.S. market and joint Deloitte/Oxford University research of the UK market indicating that 47 percent of U.S. and 35 percent of UK jobs could be replaced by automation within two decades. This is potentially a depressing picture, until one realizes that economic history has proven time and time again that economic adoption of technology invariably lags its innovation. It has also proven that industry and humankind has actually adapted to, and often thrived on, equivalent major change in working practices ever since the industrial revolution.

Employees today work more hours and are nearly continuously connected to their jobs by pervasive mobile technologies

The more positive perspective is that the adoption of exponential technological change and the shifting skill sets required by many of tomorrow's businesses—indeed by today's businesses if they are to survive for tomorrow—presents a huge and positive opportunity to every business at a corporate and, more importantly, at a functional level. And many of the most forward-thinking organizations are grasping this opportunity.



It is the sourcing, managing and retaining of the fast evolving skill sets required by many of tomorrow's businesses that presents perhaps the largest opportunity and most current challenge for many businesses. Yet many corporates, worryingly, appear to be behind the curve in their readiness to attract, retain and manage tomorrow's workforce, supported by evolved working practices and technology, and the right working environments in the optimal locations.

Deloitte's research is demonstrating that a carefully considered, and well-delivered, alignment of these organizations' talent, technology, location, and real estate strategies is no longer optional if they are to succeed in tomorrow's world of work.

According to Deloitte's 2015 Global Human Capital Trends survey—a survey of more than 3,300 organizations across 106 countries—the new world of work is changing the way employers need to engage people: employees today work more hours and are nearly continuously connected to their jobs by pervasive mobile technologies. They work on demanding cross-functional teams that often bring new people together at a rapid rate. Flexibility, empowerment, development and mobility all now play a big role in defining a company's working culture. One in three workers surveyed reported that being able to flexibly integrate work and life is the most important factor in their choosing a job. Recent entrants to the employment market no longer talk about the work-life balance; they talk about work-life integration. They expect their work and the other parts of their lives to connect seamlessly.



Deloitte's research is demonstrating that a carefully considered, and well-delivered, alignment of these organizations' talent, technology, location, and real estate strategies is no longer optional if they are to succeed in tomorrow's world of work

For the emerging workforce generation, the work-life fit is valued more than compensation growth or skill development; with more than half believing that increased mobile working would improve their personal productivity. And when this workforce is actually present in "the workplace", their expectations on the environment, the functionality, the flexibility, and the experience that the workplace provides them is fast evolving.

The growing influence of Generation Y—or the millennial workforce born between 1982 and 2004—is proving critical. By 2025, they could represent 75 percent of the workforce. But equally, rapidly changing expectations around employees' career lifespans sees the potential for up to "four generations" working side-by-side in the future workplace, driving an accelerating need to cater for a multi-generational workforce with an age range spanning up to five decades.

Deloitte research firmly points towards a material shift in employee motivations, suggesting that workers today have a new focus on purpose, mission, and work-life integration. The unrelenting pace of technology raises both expectations and potential performance by allowing people to work in different ways.

Five years ago, office space was all about cost reduction, hot-desking and ensuring resources were fully utilized. Now, it is increasingly about using space creatively for collaboration, teaming, learning, and socializing. And the demand for this new way of thinking is coming from employees. If employers want to attract talent, they have to evolve every aspect of their employee proposition; where people work, how they work, with what technology, how they are managed, developed and measured. Offices are moving away from "factory" functions where employees gather to carry out transactional roles. It is less of a place to go and do work and is moving towards being a place to collaborate, work as a team, socialize, and share knowledge. There are frankly a lot of jobs that could, and indeed should, be automated. The workplace and working practices have to evolve to reflect this.

When people think of innovative workspaces, it is often the “radical” or “quirky” that catches the imagination. But beyond the sleeping pods, the slides between floors, the in-house yoga space or the AstroTurf on the walls, it is actually the unseen intelligent use of the workplace—how the space is being used and the technology enabling it—that should be receiving the plaudits.

The future of work is far from being “just” about the workspace. Highlighting the supporting changes in corporate culture, attitudes, management models, and processes that will be necessary to succeed in this new world of work, Deloitte’s research also identified that fewer than one in ten organizations believe they currently have the performance management practices in place capable of managing a flexible workforce.

To add to the challenge, the pace of skills change appears to be accelerating. The Deloitte London Futures report showed that 84 percent of London-based employers anticipated some or significant changes in the required skill set of their employees in the next decade, with digital know-how heading the list of fast-emerging priority skills.

The future of work is far from being “just” about the workspace

Attracting this new talent is only the start of the challenge. Coupled with the need for a strong corporate culture to drive employee engagement, enable changing skill sets and adapt to the unrelenting pace of technology change and a “24/7 connected” work environment, Deloitte’s Global Human Capital Trends 2015 research concludes that: *“We have also identified a new human capital issue... the overwhelmed employee. Organizations face an imperative to find ways to absorb more technology while simultaneously making it simple.”* We are increasingly overwhelmed by the flood of data in our lives and the researchers observe that we are unfortunately saddled with an ancient computing architecture that has not seen a major upgrade in more than 50,000 years, the human brain!

Many of the positive intentions of tomorrow’s ways of working—technology, globalization, flexibility, mobility, the virtual workforce—are actually adding complexity to work. But technology and workplace design thinking can helpfully converge in a way that offers significant opportunities for businesses to get ahead of the curve.

Enabled by evolving technology in the workplace that could not have been envisaged a decade ago, and a generation of talent that is growing up with new expectations from the ever-lengthening portfolio careers ahead of them, the future of work presents a fascinating opportunity and challenge to every employer. How employers respond to this challenge and manage their interconnected strategies, processes and attitudes around their talent, technology, geographic locations, and physical workplace is going to be key to their winning this war for tomorrow’s talent.



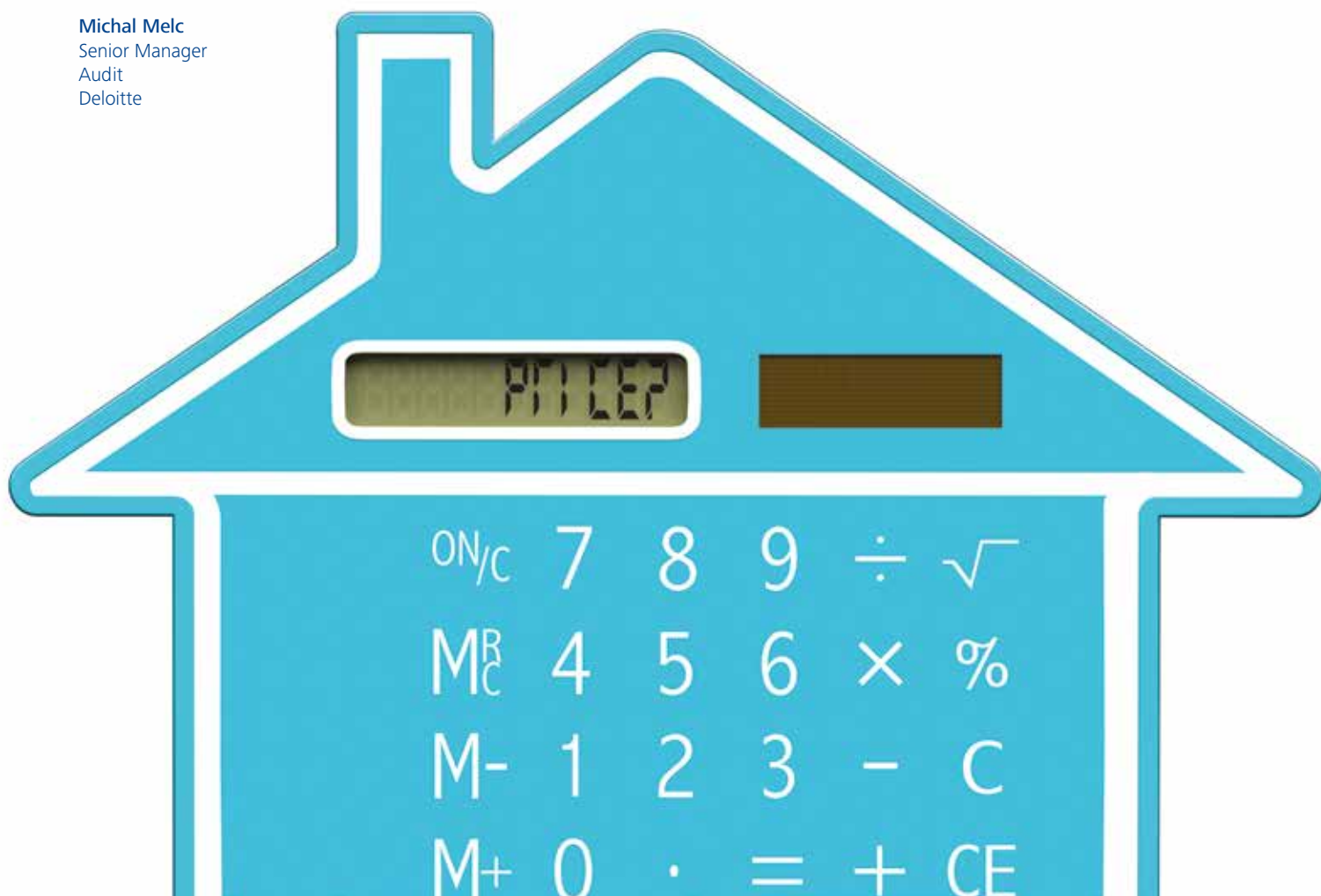
Real estate has the potential to be a key enabler of this success. Workplace design can inspire, attract, and support. Emerging locations can access and enable previously untapped pools of talent. But it will require a real estate profession that typically focuses on the physical asset to increasingly operate seamlessly with a rapidly evolving technology landscape and to recognize that what tomorrow's worker will expect from the workplace, and how it will need to serve them, is changing apace.

Workplace design can inspire, attract, and support. Emerging locations can access and enable previously untapped pools of talent

Deloitte Property Index 2015 - Overview of European residential markets

Residential property prices increase

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Deloitte's Property Index, an overview of European residential markets, reveals that the residential market is gaining momentum in Europe. Prices have grown in 12 markets in 2014, compared to only 5 in 2013.

The newly issued publication is the fourth edition of the annual Property Index, a comparative report on residential markets and housing across Europe. It analyzes factors influencing the development of residential markets and compares residential property prices in selected European countries and cities.

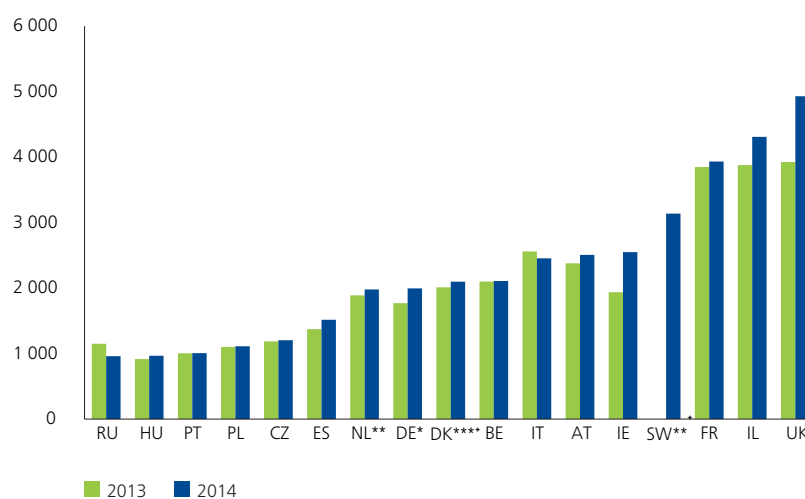
The average transaction price of a new dwelling rose in most countries

The highest prices per square meter can be observed in the United Kingdom, Israel, France, and Sweden. The cluster of post-Soviet economies falls on the other end of the price spectrum. Russia has the lowest dwelling prices among the countries surveyed, with a price slightly below €1,000 per square meter. Despite recent price growth, Hungary is the only country besides Russia with a price mark below €1,000 per square meter. The Czech Republic has the highest prices among post-Soviet states, reaching €1,200 per square meter. However, prices are still significantly below those of Western Europe. Prices in Spain and Portugal are on a similar level to those of the CEE countries due to their slump in recent years.

As usual, the development of real estate prices in individual countries varied significantly in the year-on-year comparison. The highest growth was recorded in Ireland, where new-build prices rose by an astounding 31.7 percent, followed by the United Kingdom (21.6 percent). Prices in Germany and Austria have continued their growth from the last year, rising by 12.7 percent and 5.3 percent respectively. Meanwhile, prices in Italy and Russia continued their downward trend. Belgium saw residential property prices rise by approximately 0.5 percent.

The spread between the offered and final transaction price serves as an important indicator for the balance between dwelling demand and supply. The highest discount was seen in Spain, where buyers receive a 20 percent discount on average when buying an apartment or house. However, the discount is lower than last year, which indicates improving conditions on the housing market. Other markets show a typical discount of under 10 percent.

Average transaction price of a new dwelling (EUR/square meter)



Source: National Statistical Authorities, Deloitte data calculations

* bid price, ** older dwellings, *** all dwellings (older and new),

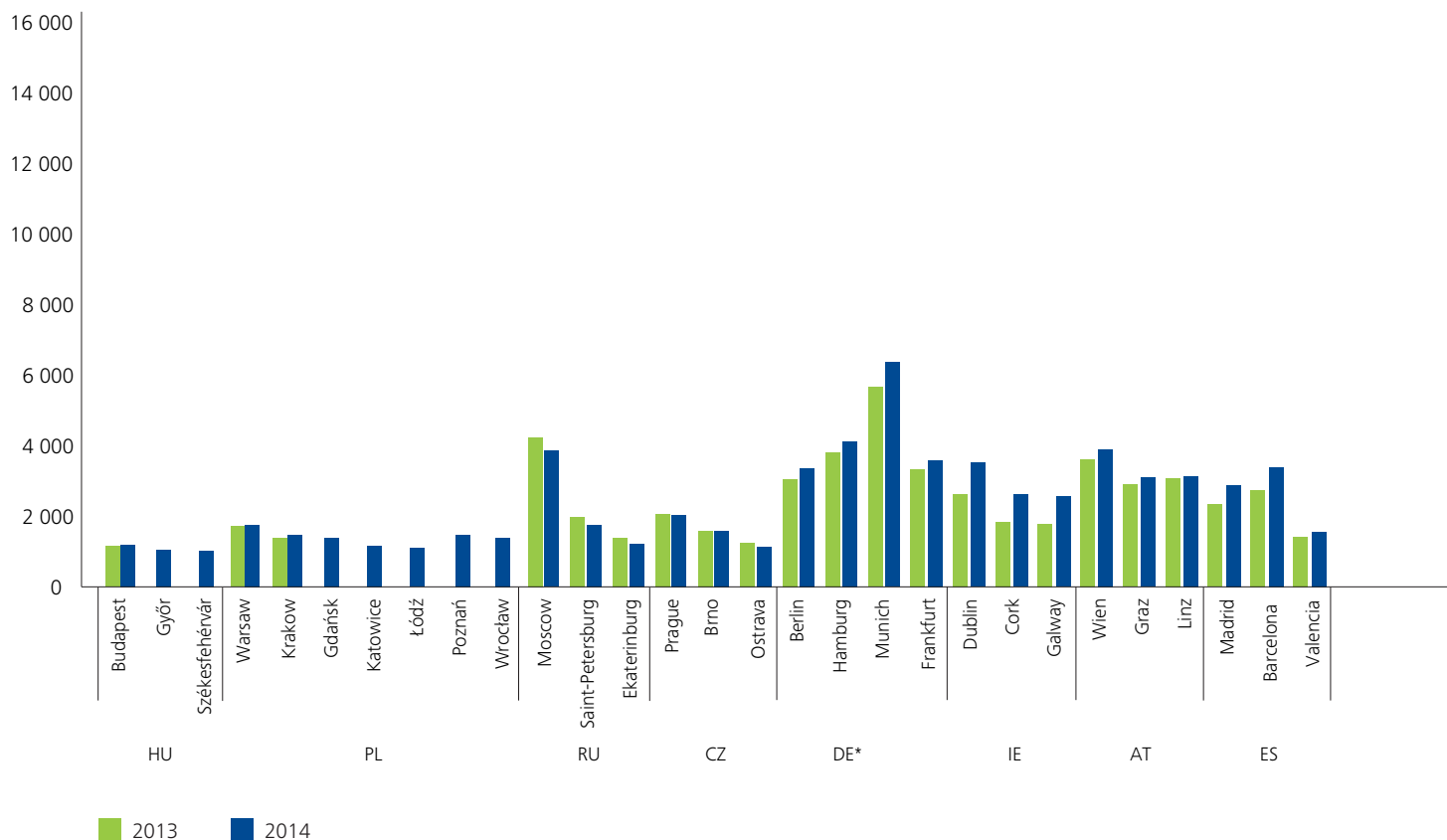
* average of apartments and houses

London and Paris are the most expensive cities in Europe

At a city level, Inner London was the most expensive city with a price tag reaching an astonishing €14,089 per square meter. Living outside Inner London is much cheaper. In comparison, new dwellings in Outer London cost on average €7,879 per square meter. The second most expensive city after London was Inner Paris, with a price of €10,266 per square meter.

It is often the case that the capital is the most expensive city in a country. However, this is not true for some countries. For example, Munich, Milan, and Tel-Aviv are more expensive than Berlin, Rome, and Jerusalem. If you are looking for good value, Porto might be the place for you. With a price tag of only €860 per square meter, it is the least expensive city in the survey. The second cheapest city in 2014 was Székesfehérvár in Hungary. With €1,026 per square meter, it is 20 percent more expensive than Porto.

Average transaction price of a new dwelling (EUR/square meter)



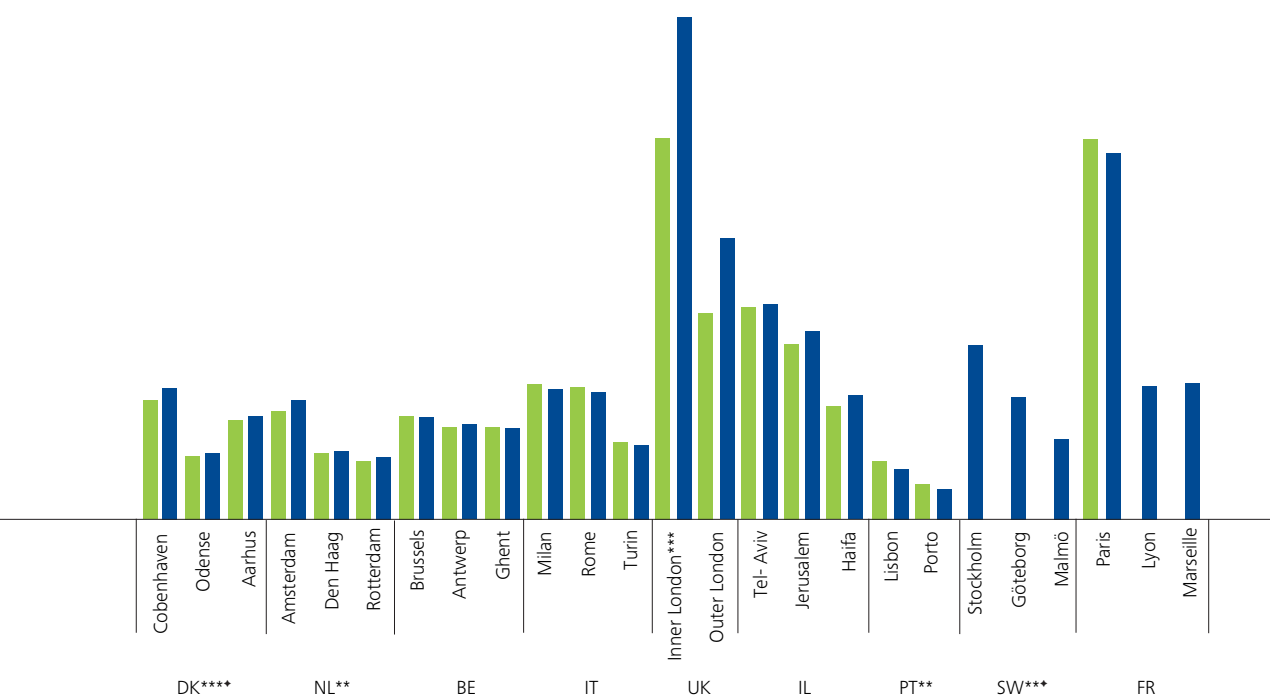
Source: National Statistical Authorities, Deloitte data calculations
 * bid price, ** older dwellings, *** all dwellings (older and new),
 ♦ average of apartments and houses



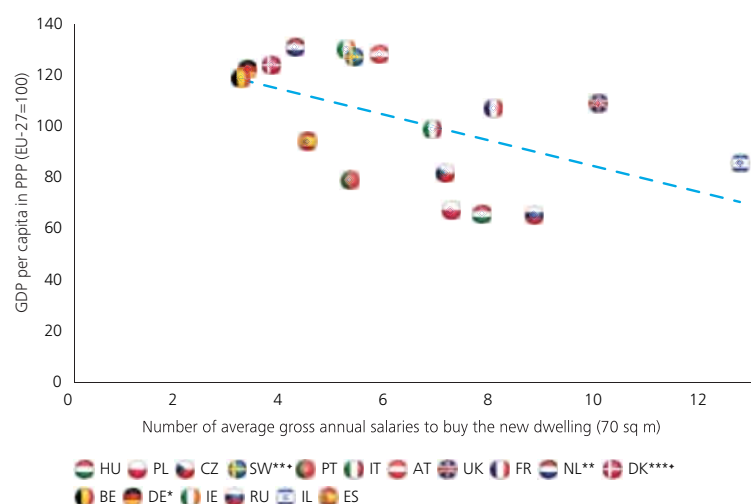
Cities situated in Eastern Europe were generally the least expensive in the survey. An exception to the rule is Moscow, which with €3,840 per square meter is at a similar price level as Vienna or Milan.

Property prices grew on most of the markets in 2014. Out of the 15 cities shown, only 5 have seen a decrease in price compared to 2013.

Copenhagen, Berlin, Amsterdam, Jerusalem, Madrid, Inner London, and Dublin saw double-digit growth. The best performing market in 2014 was Dublin with astonishing growth of 34 percent. Inner London came second with 32 percent. However, prices in the UK were influenced by a stronger pound. Madrid was third with 24 percent. Fourth place was taken by Jerusalem with 18 percent. The worst performing market was Lisbon with a price decrease of 14 percent.

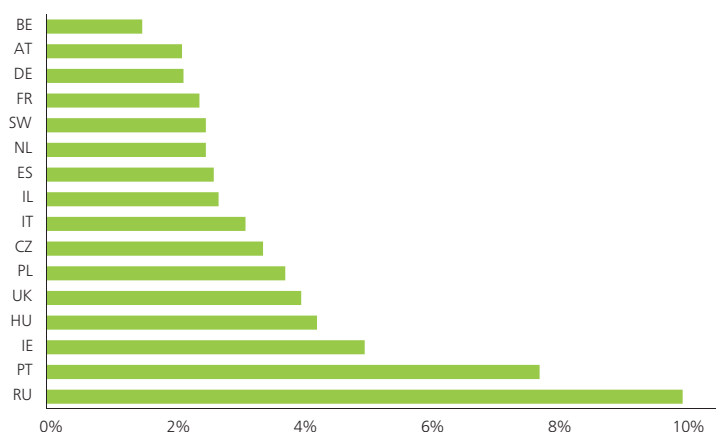


Affordability of own housing and the economic level



Source: National Statistical Authorities, Eurostat, Deloitte data calculations
 * bid price, ** older dwellings, *** all dwellings (older and new),
 * average of apartments and houses

Typical loan interest premium applied by banks for the financing of residential development projects (margin over 3M Euribor, % p.a.)



Source: Deloitte analysis

Belgium has the most affordable housing

Our study measures the affordability of housing in each country in terms of number of gross annual salaries needed to buy a standard new dwelling (70 square meter).

The most affordable housing can be found in Belgium, where a person needs to save for only 3.2 years on average to buy a new dwelling. Belgium is closely followed by Germany with a ratio of 3.3. Relatively affordable housing can be found in the Netherlands (4.2), Spain (4.4), Ireland (5.2), Sweden (5.3), and Austria (5.8). The least affordable housing is found in France (8.0), Russia (8.8), the United Kingdom (10.0), and Israel (12.7).

Accessibility of dwelling ownership generally depends on the economic advancement of a country. The higher the country's economic level is, the more accessible dwelling ownership becomes. The United Kingdom is the exception that proves the rule. The high real estate prices in the United Kingdom result from the great interest of foreign investors in this market.

Household indebtedness rises

Household indebtedness (i.e., the proportion of residential debt to household disposable income) is one of the determinants of house price growth. The lowest level of household indebtedness can be found in Russia with 6.5 percent of residential debt to household disposable income. Countries with a low level of indebtedness are the Czech Republic, Hungary, Poland, Italy, Israel, and Austria, with residential debt to household disposable income of under 50 percent. Consequently, these countries have the highest potential for house price increases as a result of better overall financing conditions and following increases in mortgage lending. The highest level of indebtedness can be found in Sweden, Denmark, and the Netherlands with residential debt to household disposable income of above 150 percent.

Good financing conditions for residential projects are important for the stability and health of the residential real estate market

This year, the Property Index includes a special topic on the financing of residential real estate development projects. The lowest interest premiums advanced by banks for the financing of residential development projects can generally be seen in Belgium, Austria, Germany, France, Sweden, and the Netherlands owing to their low risk profile and well established real estate markets. Pre-sales vary significantly among the surveyed countries, with the lowest figure seen in Portugal (10 percent) and the highest in Italy (60 percent). Debt-service coverage ratio (DSCR) of between 1.1 and 1.4 is typical. The highest DSCR can be found in France and the lowest in Italy.

Average interest rate premiums in the surveyed countries—which cover the majority of Europe—is 3.32 percent, the average loan-to-value is 68 percent, the average pre-sales requirements are 39 percent, and the average DSCR is 1.27.

Residential on the rise

Europe's residential markets have become its strongest performing real estate sectors over the last decade, even though there have been significant differences in return and the drivers of performance between countries and local markets over this period. Each residential market has its own specific market structures and fundamentals as well as historic trends. On the one hand, there are common conditions affecting the whole of Europe, especially in the eurozone, such as European Central Bank (ECB) policy on key interest rates. On the other hand, specific factors drive economic fundamentals in each country and thus its residential markets.

Geopolitical risks are still present and the global outlook is clouded by the possibility of macroeconomic trends diverging further. Financial market volatility is also a threat to European economies. Europe could be facing an era of low growth, low investment, low inflation, and volatile financial markets. The ECB is attempting to combat this scenario and has supported the economy by starting quantitative easing early in 2015. The ECB buys bonds worth €60 billion each month. The latest data seems to indicate that financing institutions have reacted positively with a decrease in credit standards. This should help companies and investors to grow further.

The entire Property Index report is available via the link below:

<http://www2.deloitte.com/cz/en/pages/real-estate/articles/cze-index-nemovitosti.html>

Europe's residential markets have become its strongest performing real estate sectors over the last decade





BEPS implications for the real estate investment industry

What is on the horizon?

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On 5 October 2015, the OECD published the 13 final BEPS reports, which confirmed most of the recommendations discussed in the past. A significant part of these recommendations are either subject to further discussions in 2016/2017 or left to individual taxing authorities' own initiative. Whilst BEPS could generally have an impact on all sorts of businesses, it is clear that only some of the recommendations raised would directly target real estate investment structures.

The 2015 Final Reports recommend changes to domestic laws, the OECD Model Tax Convention (the OECD Model), and the OECD Transfer Pricing Guidelines (TPG). They propose to accelerate the incorporation of recommended changes into existing bilateral treaties through a multilateral convention to be entered into by interested countries.

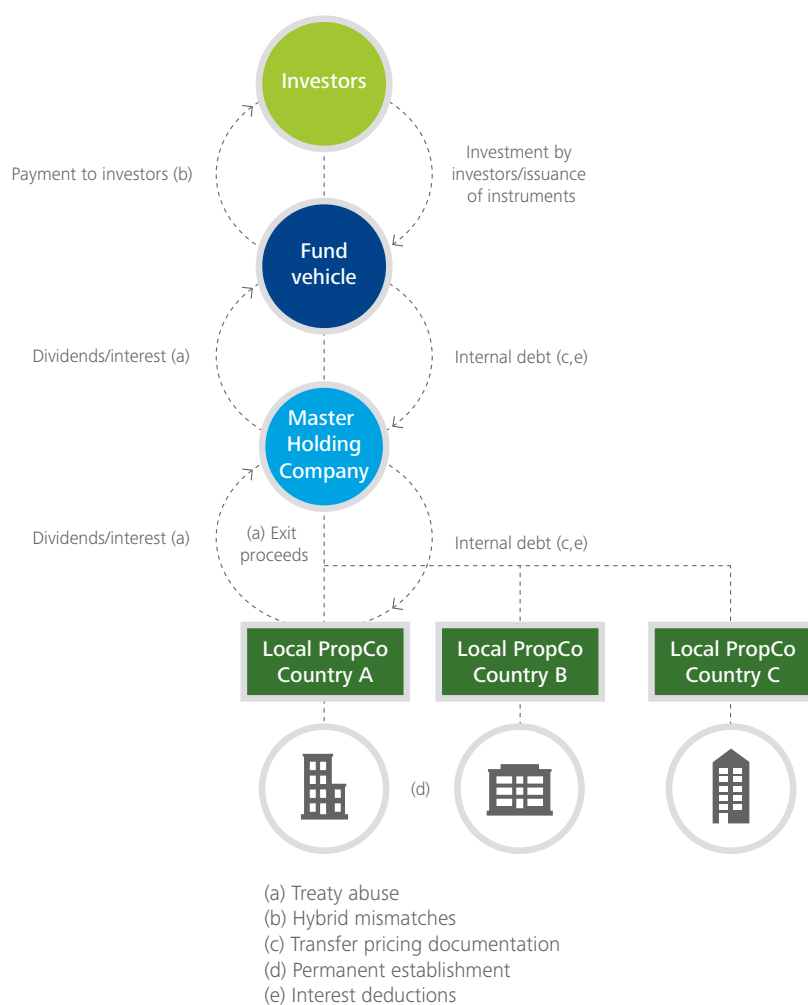
Given the significant volume of real estate transactions, particularly cross-border investments, and the strategic importance of real estate for the global economy, the impact that these final reports may have on the tax structuring and associated treatment of real estate investment structures may have real economic consequences for investors and managers. That being said, it is important to emphasize that real estate investments are not the main drivers of these BEPS Actions—as they are heavily focused on multinational corporations—and there is consequently limited information to share at this stage within the industry. The real impact will be felt as the Actions are implemented at national level.

Whilst BEPS potentially and theoretically brings change to all sorts of businesses, only a few Actions in the final BEPS report may directly have an impact on the real estate fund industry as depicted in the chart on the right, representing an example of widely used real estate investment structures.

In this publication, we will therefore focus on Action 2 “Hybrid Mismatch Arrangements”, Action 4 “Limit base erosion via interest deductions” and Action 6 “Preventing Treaty Abuse” which may directly affect the way real estate investments are structured.

Action 2 - Hybrid mismatch arrangements

A mismatch in the qualification of a financial instrument or an entity in two different jurisdictions might arise due to the fact that each country generally applies its own set of rules and characteristics. These so-called hybrid mismatch arrangements are directly targeted by Action 2, which aims at eliminating the possibility for taxpayers to benefit from an (unintended) double non-taxation and/or long-term tax deferral (i.e. a deduction in one country without equivalent income recognition in the other country).



The final BEPS report recommends the development of model treaty provisions and furthermore includes a long list of recommendations to countries when it comes to the design of domestic rules to neutralize the effect of hybrid instruments and entities. Based on the final recommendations, it should be sufficient to have one country enacting an anti-hybrid rule in its own legislation to neutralize hybrid arrangements. Hybrid mismatch arrangements (of the type targeted by BEPS) are relatively uncommon within the European real estate investment structures, although many funds will have entities treated as hybrids (as a result of check the box elections) and/or use hybrid instruments. Such arrangements have already been the subject of anti-avoidance rules.



For example, on 20 June 2014, the ECOFIN adopted a proposal to amend the Parent-Subsidiary Directive to prevent the use of hybrid financing instruments.¹ Some EU countries—such as Germany and Denmark—have already existing legislations in place targeting hybrids.

Notably, however, anti-hybrid rules may have an impact on some of the standard structures and financing instruments such as the so-called CPECs currently used particularly by U.S. investors to defer taxation. However, these instruments should not be specifically targeted by Action 2 (where for example there is no tax arising in the hands of the recipient as a result of its own status, e.g. as an exempt pension fund).

Subject to a review of the final implementation of this Action at a local level, the impacts on real estate structures should be rather limited and alternative solutions should be available.

Action 4 - Limit base erosion via interest deductions

Action 4 focuses on the design of rules to prevent base erosion and profit shifting using deductions for interest expenses and other financial payments economically equivalent to interest, and is therefore relevant for the real estate industry. The recommendations for interest restrictions provide firm guidance that countries should limit interest deductions to a fixed percentage of earnings before interest, tax and depreciation (EBITDA). The cap should be in the range of 10 to 30 percent.

The Action also anticipates that local implementation of this rule may include a softening of the EBITDA cap by allowing interest deductions in excess of the 10-30 percent ratio where the group was able to demonstrate a higher level of interest deductions at a consolidated level. Each taxpayer would be allowed to deduct the highest result of the two tests, the principle being that genuine third party interest should typically be considered as deductible.

This level may, however, be very much below that typically seen in a real estate investment structure where interest deductions may be at 70 percent of EBITDA or more.

Critically, this Action is billed by the OECD as a “best practice”, leaving national tax authorities with greater latitude as to how to implement it into local law. Major European economies have upgraded their legislations in the recent years by introducing various “earnings-stripping” limitations to interest deduction (and also on the level of tax losses to be carried forward in some instances). Hence, some jurisdictions may consider that their existing rules now broadly satisfy the Action. A *de minimis* threshold could also be an option for contracting states (as it is currently under legislation in Germany for example).

The UK has, however, already launched a consultation following the publication of the final BEPS report on this Action and it may be expected that other jurisdictions will follow suit.

As a result, the outcome of Action 4 may have a significant impact on the real estate investment structures, and funds could expect additional interest restrictions in some countries that would ultimately affect the internal rate of return to investors. Whilst it is too soon to say exactly what will change in each jurisdiction, now is the time to start considering the levels of taxation that may be suffered if a hard cap on interest deductions is introduced.

Action 6 - “Preventing the Granting of Treaty Benefits in Inappropriate Circumstances”

Action 6 could be of particular relevance for the real estate industry. Its main objective is to limit the access to the benefits of the treaty via notably the insertion of a so-called “Limitation Of Benefits” (LOB) clause and/or a “Principal Purpose Test” (PPT).

¹ As a result of this amendment, the participation exemption may only be applied insofar as the payment is non-deductible in the country of payment (i.e. not tax deductible in the subsidiary).

These rules are to be introduced into all treaties either via a multinational agreement (to be completed by the end of 2016) or via domestic law or a renegotiation of treaties, albeit the latter option may be impractical/time consuming. If the motive test is not respected or the LOB applies, treaty benefits would be denied. The final BEPS recommendations remain therefore broadly unchanged compared to the earlier drafts. In particular, the ability of real estate funds to meet the LOB requirements as proposed remains very limited (as they bear little resemblance to the types of entities, typically multinational listed corporations, considered by the existing drafting of the LOB test). REITs that are listed in their headquarter's jurisdiction should, however, have a greater prospect of retaining entitlement to treaty benefits under this provision.

Given the specific nature of real estate investments, it is common for investors to gain exposure to real estate assets via different types of Collective Investments Vehicles (CIV). These gather funds from investors of different types (e.g. pension funds, family offices, SWF, corporates, individuals, etc.) and in multiple jurisdictions to invest into assets located in distinct jurisdictions so as to diversify their investments (e.g. different asset classes and geographical areas to ensure risk spreading). Therefore, a key concern of real estate players and institutions relates to treaty entitlement of such funds:

- There is a general support by the OECD to consider that CIVs (broadly those funds investing in securities) should be able to qualify for treaty benefits but under circumstances which remains left to each contracting state. Based on the final BEPS report, the access to double tax treaties for CIV funds will depend on how these funds are treated under the respective conventions in each contracting state. In a nutshell, the treaty entitlement of CIV funds is not automatic and, depending on the options chosen by contracting states, subject to conditions which could limit in practice the ability to rely on treaties.
- The situation of non-CIV funds—which includes REITs, real estate and pension funds—are not yet fully addressed and will be subject to further work being undertaken in 2016. Recently, asset managers have become more and more attracted to domestic REIT regimes that are promoted by major investment jurisdictions to attract foreign investors. Whilst these regimes are not targeted by BEPS, since it is mainly focusing on cross-border

tax optimization schemes, the ability to access tax treaties is also critical to maximizing returns by cross-border investors into such local structures. As a result, the further work on the OECD on this topic is likely to be highly relevant and closely watched.

- Specific investment and financing structures (e.g. intermediary companies such as Special Purpose Vehicles (SPVs)) are typically implemented below investment funds for genuine financial, pro-business, operational and regulatory reasons. The use of intermediate SPVs should be analyzed in the light of the “active trade or business” test or the “derivative benefits” test proposed (or in concert with the position of the fund in the follow-up work on non-CIVs).

The effectiveness of these recommendations will depend on how they are implemented in each country. Similarly to the other Actions, a significant number of jurisdictions already have existing rules that are aligned with these OECD recommendations.

Based on the current OECD treaty model, real estate income is always taxable in the jurisdiction where the property is located. Dividends or interest distributions by a property company located in a country with a favorable domestic regime (i.e. no withholding tax under local law) will not be targeted by Action 6 since there is no reliance on treaty provisions. Where there is local WHT, however, the impact may again be negative unless the recipient holding company or fund is able to meet the relevant tests.

Finally, the indirect disposal of real estate through share deals is increasingly being addressed by the renegotiation of existing double tax treaties and the insertion of “land rich” provisions into the “capital gains” article. There may therefore be few benefits left to lose on this point.

Conclusion

Our view is that the final BEPS report is likely to have an impact on the return offered to investors as the interest deduction Action, in particular, may lead to more effective restrictions on cross-border debt financing structures than we have seen to date.

The upcoming work on Action 6 will hopefully recognize the importance of fund vehicles (or non-CIVs) in encouraging cross-border investment and these entities will therefore hopefully remain eligible for treaty benefits.



Deloitte 2015 European real estate investment management survey

Forecast? Mostly sunny, with scattered clouds

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Changes in technology, taxation, or the market segment, and particularly regulatory developments, are forces keeping the real estate market in constant transformation. While this leads to new opportunities, it also creates road blocks for real estate players. Both real estate investment managers and investment servicers need to face these changes and adapt their business models accordingly.

What are the key priorities of their business today? How do they prepare their business for future growth and development? How do they deal with regulatory requirements? Deloitte sought answers and took the current temperature of pan-European investment managers and asset servicers in two distinct surveys recently conducted among major players of the industry.

Survey setup at a glance

Investment managers survey	Investment servicers survey
Survey period: January 2015–February 2015	Survey period: January 2015–February 2015
Participants: 20	Participants: 15
Aggregate net assets under management of participants: €200 billion, of which €116 billion are represented by Property Funds and €36 billion by segregated mandates	Aggregate assets under administration of participants: €197 billion under administration Aggregate assets under depository: €107 billion
Countries of operation: RE investment managers have established their operations in the United Kingdom, Germany (90 percent), France and Luxembourg (84 percent). Beside these four countries, the Nordics (including Sweden, Denmark, Finland and Norway), are among the most common European countries where RE investment managers have setup operations.	Countries in scope are: Luxembourg, Ireland, Channel Islands, the United Kingdom, Germany, France, and The Netherlands. Respondents have operations in at least three of the above listed countries, with 86 percent of them being present in Luxembourg and 50 percent in the Channel Islands and Ireland.

Investment managers survey—key results

Easy access to capital with positive outlook for coming months

Access to capital does not seem to be difficult for real estate asset managers today and is expected to remain easy over the next two years, as confirmed by 50 percent of the respondents. Moreover, 66 percent of participants rating the access to capital in a neutral way today believe that it will become easier in the coming years.

Investors increased capital allocation to real estate but raised their level of requirements

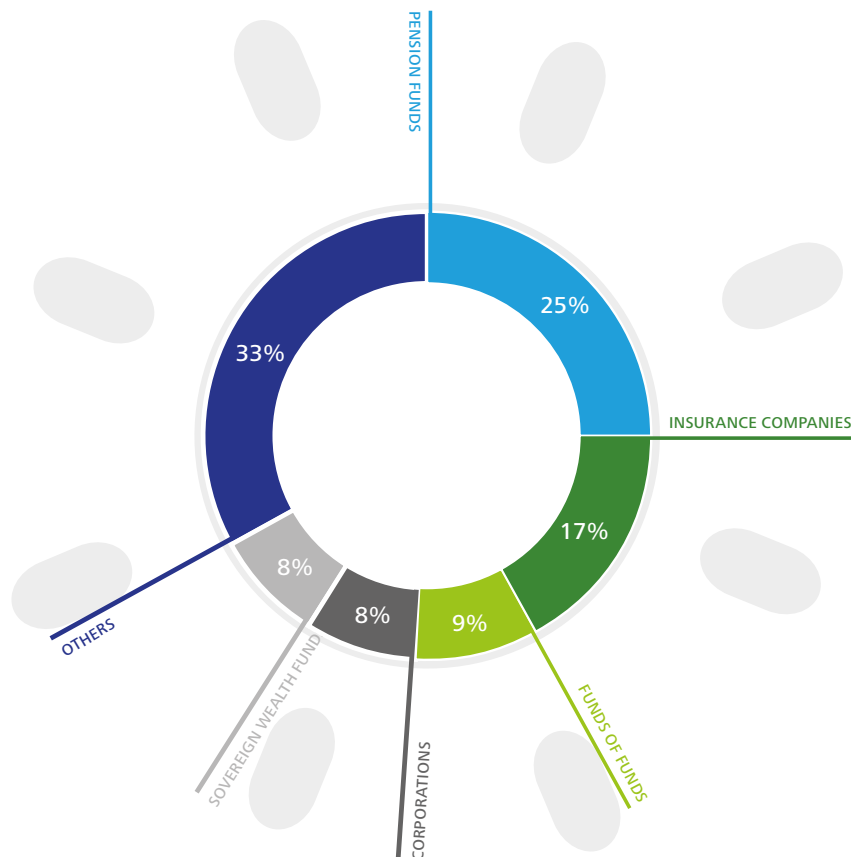
Not surprisingly, pension funds are the main business feeders of the real estate industry (25 percent), followed by insurance companies (17 percent) and funds of funds (9 percent). In recent years, investors

have increased their capital allocation to real estate, while at the same time increasing their requirements: IRR, management fee rate, and risk exposure are the most common requirements during the fundraising phase, whereas the size of the fund and length of the process have a very significant or significant impact, according to the vast majority of the respondents (74 percent and 79 percent respectively).

Specific or ad hoc reporting is the market standard:

89 percent of managers indicated that they receive a multitude of reporting requests from their investors; 53 percent of respondents provide INREV figures in addition to regulatory requirements. Overall, performances (94 percent), transparency (78 percent), and fees (44 percent) are the three key requirements for investors when assessing the managers they work with.

Figure 1: Main business feeders

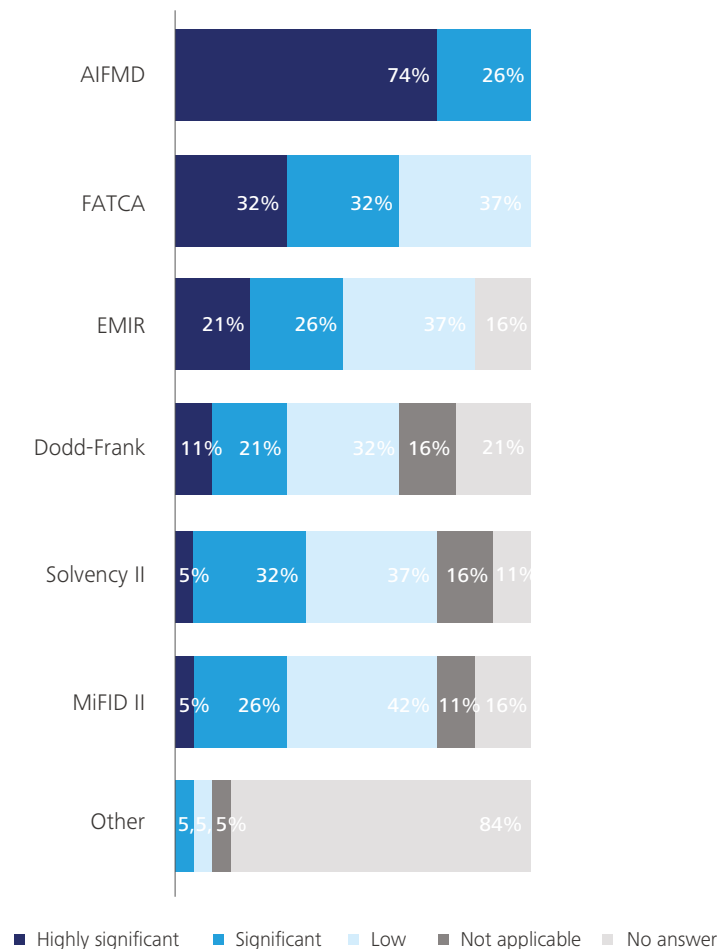


Regulation: AIFMD remains a key regulatory concern

Investors' aim for transparency goes along with the transparency imposed on managers by recent regulations: AIFMD, FATCA, and EMIR are the main regulatory concerns managers are currently facing. Among those, AIFMD is perceived as the regulation that most shapes the industry's landscape; respondents confirmed it had either very significant (74 percent) or significant (26 percent) impact. Not surprisingly, 72 percent of respondents stated that they need to review their operating model. Half of the participants confirmed that they had to increase their capital to comply with the Directive. The implementation of AIFMD is still ongoing. Reporting (74 percent), risk management (69 percent), and depositary (63 percent) have been identified to be the most challenging of all AIFMD requirements. For most of the respondents, these activities aim at the European passport (84 percent); however, for some managers, they are also driven by investor requirements and commercial reputation (68 percent and 58 percent, respectively).

In recent years, investors have increased their capital allocation to real estate, while at the same time increasing their requirements

Figure 2: Impact of regulatory changes on the organization





Capitalizing the investment of AIFMD and simplifications are priorities

With AIFMD being one of the factors leading real estate investment managers to review their operating model, 17 percent of survey respondents confirmed the need for operational improvements.

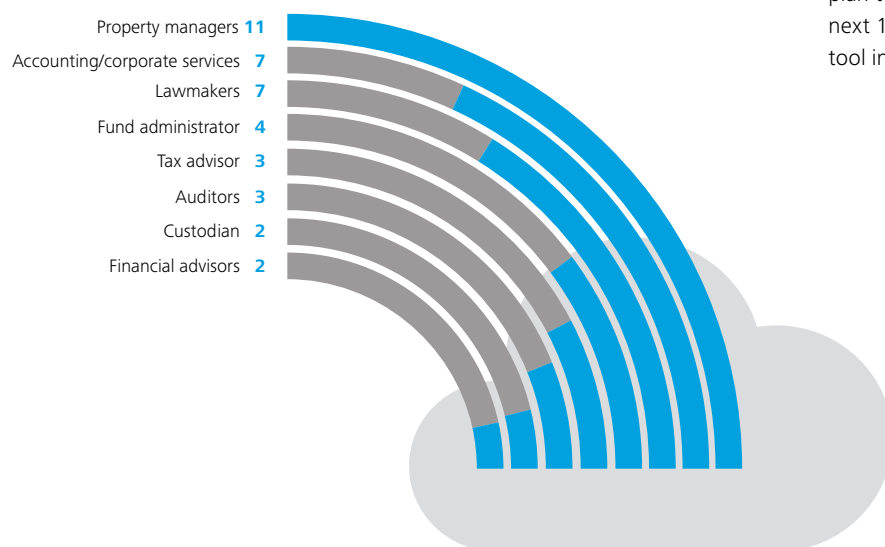
However, when being asked about their operational priorities for the next two years, simplification is on top of the agenda, alongside the improvement of efficiency and the increase in size of middle and back office functions to comply with regulatory requirements. The majority aims to turn AIFMD into a business opportunity rather than considering it as only a regulatory obligation, for instance, by increasing the number of mandates a single AIFM will manage or by developing a leaner structure via consolidating group entities.

The operational complexity real estate managers are facing is, first of all, driven by the large number of service providers involved in the fund administration (39 on average). More than 60 percent of respondents believe the number of service providers will even increase further.

The number of external parties involved is especially high at the level of property managers, accounting and corporate services and lawyers, which confirms that real estate is essentially a local business that requires local expertise and knowledge. At the portfolio level, the industry is using a variety of IT systems and tools for portfolio monitoring, while at the fund level, where standardization and efficiencies are achievable, asset managers heavily rely on MS Excel for consolidation, rather than using specific softwares.

In this respect, the outcome of the survey is not very promising: only 37 percent of managers are satisfied with their current RE systems, whereas only 16 percent are not. However, almost half of the asset managers plan to have to change or upgrade their systems in the next 12-24 months, turning the search for the right tool into an operational priority in the coming months.

Figure 3: Average number of service providers used



Tax landscape

79 percent of managers have outsourced tax matters since they require local knowledge, which is difficult to centralize in a single pan-European team. This team is often in charge of monitoring and coordinating with local advisors that play a key role in setting up structures.

Three quarters of respondents confirm that the tax regime has an influence when looking for investments, while 88 percent stated they consider fiscal neutrality as a key driver for investment decisions. Moreover, local governments raising tax pressure to feed their balances, in addition to international initiatives such as BEPS, are changing the tax scene in which real estate managers operate.

According to respondents, France (78 percent) and Germany (67 percent) appeared to be the two countries where tax authorities have increasingly challenged cross-border tax benefits, followed by Luxembourg and the United Kingdom (22 percent). To meet potential BEPS requirements, the industry seems to agree on an increase in “substance” in most holding company jurisdictions.

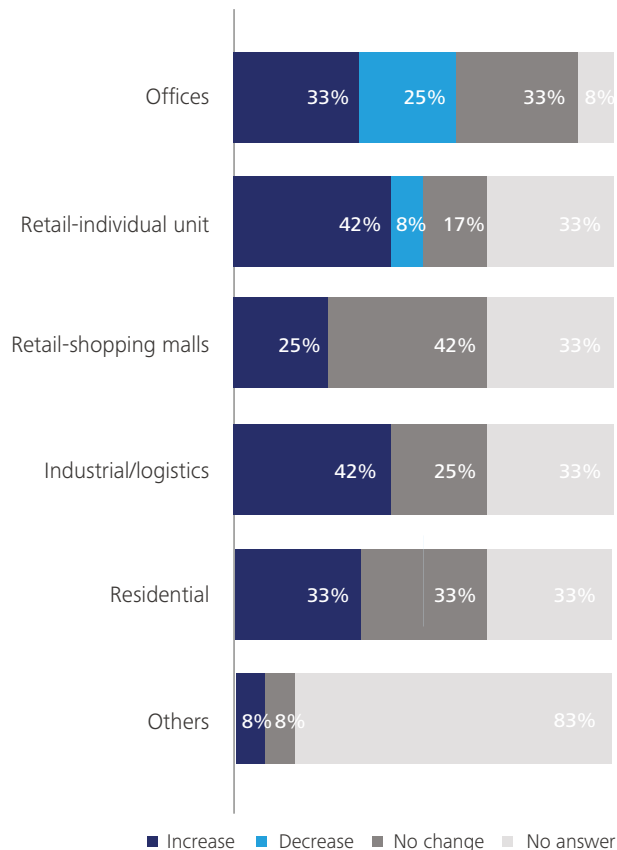
What is on the horizon?

Allocation to real estate is expected to grow across Europe mainly through capital flows from pension funds (+6 percent to 31 percent), insurance companies and sovereign wealth funds (both +7 percent to 19 percent), according to the survey asset managers. This seems to be in line with INREV’s Capital Raising Survey 2015 confirming that pension funds have the highest allocations to real estate, followed by the insurance industry.

In terms of target investments, the market is split into two different classes: Germany, the United Kingdom, and France are by far the top three countries where managers plan to deploy capital, confirming a well-established trend that does not seem to change (first class).

The Nordic countries and Spain rank fourth, followed by Poland and Ireland, all with modest appreciation rates compared to the leading three (second class).

Figure 4: Allocation of assets





For real estate asset servicers, reinforcing staff and investing in technology are on top of the agenda

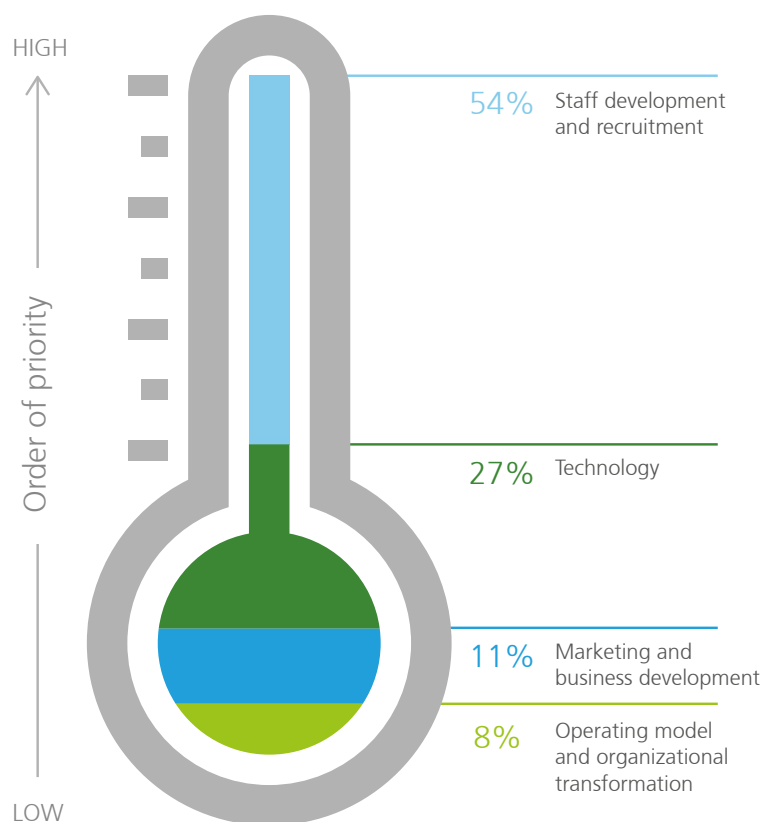
Asset servicers survey—key results

For real estate asset servicers, reinforcing staff and investing in technology are on top of the agenda, driven by a sustained and anticipated growth of the industry.

Investment in talent

Real estate asset servicers have already directed their efforts toward recruiting the right profiles as well as creating learning and development opportunities for existing staff, as confirmed by 54 percent of respondents.

Figure 5: Future investments



IT upgrades to be tackled in coming years

In contrast to investment managers, asset servicers rely on specialized software for their daily operations, with e-FrontFrontInvest and Multifonds being the most commonly used IT systems (36 percent). Over 50 percent of respondents indicated that they use more than one system for their activities to respond to the variety of requirements, including investors and portfolio reporting, transaction processing, accounting and financial reporting, regulatory reporting, and cash monitoring.

While the minority of respondents is unsatisfied with its current system, the vast majority is satisfied. However, there is a great willingness to upgrade current system versions within the next 12 to 24 months, as confirmed by 75 percent of participants.

Figure 6: Systems used

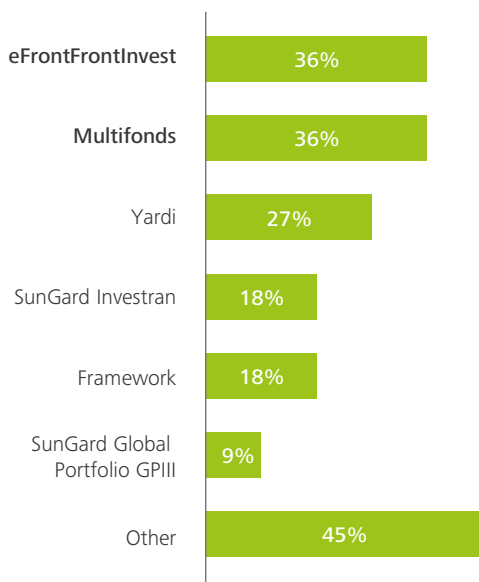
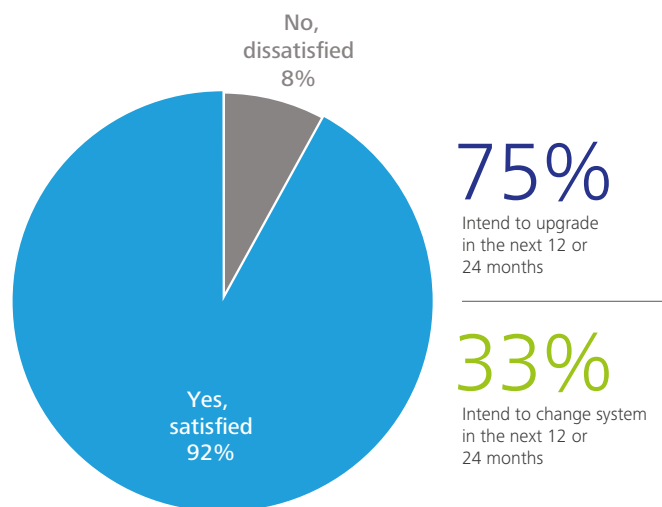


Figure 7: Level of satisfaction with RE systems used



Preparing for growth

Real estate asset servicers strongly believe that their business growth will be fuelled mainly by new clients. Extending their activities with existing clients only comes second. Value-added services are considered as growth opportunities as well as key differentiators. It is of paramount importance for asset servicers to invest in technology as well as to focus on operating models and organizational transformation to be in a position to develop and concentrate on value-added products.

Real estate asset servicers are bullish with regards to client growth, in respect of both the two-year and five-year horizon: 58 percent of respondents anticipated an increase of their client base by 11-20 percent in the next two years, whereas 42 percent forecasted their five-year growth to be in the region of 21-30 percent. These predictions are in line with the investment managers' views and the observed trends, in particular on the Luxembourg marketplace.

Figure 8: Expected sources of growth

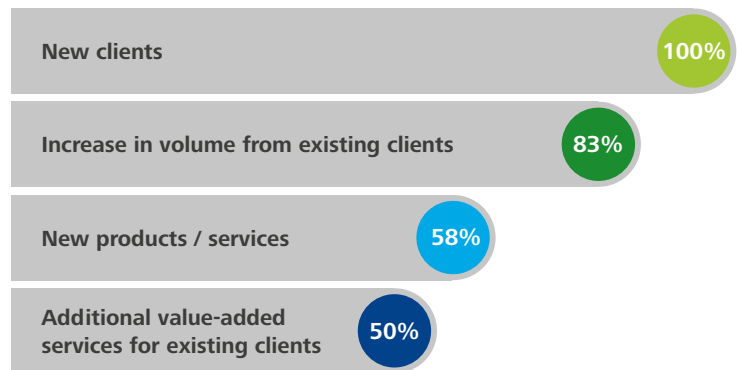
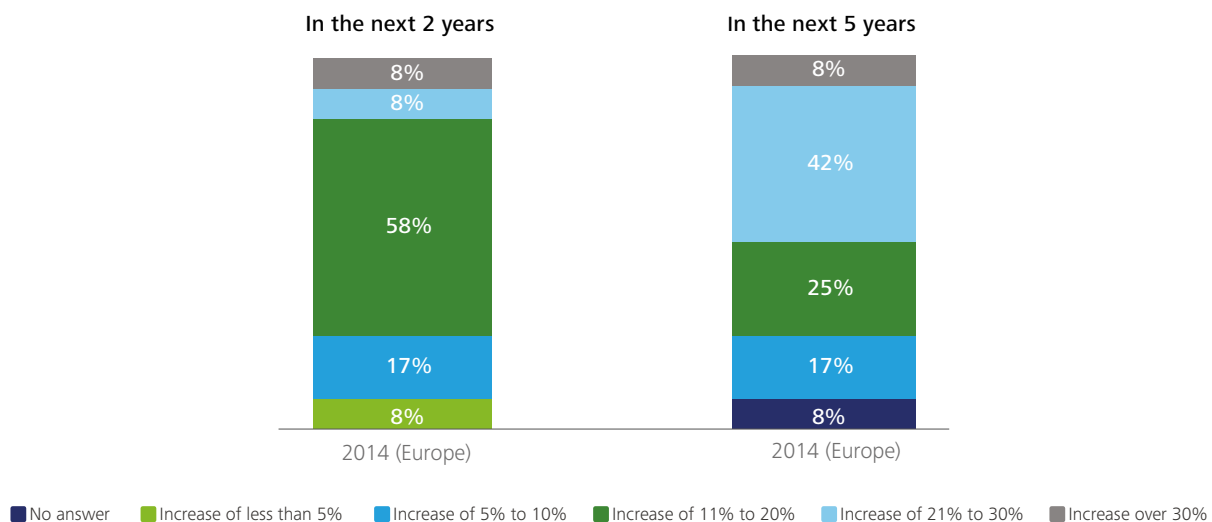


Figure 9: RE – clients' growth trends in the next 2-5 years



Conclusion: favorable winds, despite obligations

The survey shows a very positive outlook for the industry that is equally shared by investment managers and asset servicers, both of which have one common issue to tackle: the target operating model. How can we cope with new business, regulatory and investor pressure, and pan-European presence without costs being an obstacle to growth?





The Canadian perspective Retail landscape transformation

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The way that Canadians live, work and
shop is about to change profoundly

Rapid advances in technology are poised to disrupt many of the sectors that anchor today's economy. The impact will be felt across in Canada, which the following observations originate from and are exemplary showcased for. However, the same trends can also be found in other developed countries. Yet many businesses aren't ready for it – including the real estate industry.

Today, digital disruption is all-pervasive, with technology integrated into our everyday lives. Digital innovation is changing economies and markets, reinventing the way business is done in all industries across the globe. The level of technology advancement organizations are facing today is akin to the industrial revolution of the early 1900s – and it is accelerating our businesses and operating models. No industry is untouched. Some have been impacted immediately, and others, such as real estate, are just now feeling the profound influence of the digital transformation that has been taking place over the past two decades.

Digital disruption can, in fact, be a dynamic catalyst to transform operating businesses and advance productivity in Canada – if we embrace and invest wisely in change. Real estate can also itself become a catalyst for change, influencing organizations to invest in business infrastructure, redesign spaces and transform their business models to become more competitive within the global marketplace.

What are the implications for real estate?

Those that occupy real estate – whether office, retail, industrial, institutional or residential – have the opportunity to use a real estate event such as a lease expiry, property acquisition, refinancing or redevelopment to drive change within their organization. This opportunity is available for both private and public sector organizations that can re-think how and where they operate their real estate and business.

At the same time, real estate owners, investors, developers and managers need to take notice and adapt business models and delivery systems to embrace this change. This includes myriad real estate issues, such as building construction, sustainability, site selection, accessibility to infrastructure and amenities, branding, property management and a wide array of other issues specific to each real estate asset class.

Real estate can lead this change for Canada if industry participants truly embrace and drive this transformation





Canadian productivity remains challenged

The challenge facing the real estate industry stems from the fact that buildings are fixed and difficult to quickly or cost-effectively change in order to embrace technological advancements. A Harvard Business Review article noted that “the more difficult the barrier, or the more barriers a disrupter faces, the more likely it is that customers will remain with incumbents.¹” As such, many space occupiers are not motivated to change and will instead simply remain with the status quo. The problem with this decision is that these companies will face tremendous global competition, cost disadvantages and, most importantly, productivity challenges. Those that do not embrace change will inevitably fail to compete within the global marketplace.

The real estate industry has traditionally lagged behind other sectors, largely due to the nature of our buildings and infrastructure. Properties that are held by individuals, investors or owners remain unchanged for decades, with leases that extend from 5 to 20 years. As a result, with insufficient capital funds for improvements, some real estate market participants aren’t prepared for, and have been slow to react to technological transformation.

In addition to today’s overall uncertain economic environment, Canadian competitiveness and productivity have a huge impact on the real estate industry. According to Deloitte’s Future of Productivity reports, productivity in Canada still isn’t growing as fast as it is in the U.S. and many other countries.

Canada’s output per worker was 78% that of the U.S. in 2011.²

Canada’s 0.7% annualized labour productivity growth (2001–09) puts us in the bottom quartile of the Organization for Economic Co-operation and Development (OECD).³

An average U.S. worker generates \$13 more per hour than an average Canadian worker. An average Norwegian worker generates \$29 more per hour.⁴

Yet Canadian companies don’t make the innovation and productivity investments they need to thrive:

Private sector firms’ research and development (R&D) investments equal just 1% of Canada’s gross domestic product (GDP). That’s less than half of what U.S. companies spend on R&D.⁵

Per worker, Canadian companies invest 65% as much as U.S. firms on new machinery and equipment and 53% as much on information and communication technology (ICT).⁶

75% of new jobs are highly skilled, yet 40% of Canadian workers lack the necessary abilities.⁷

These statistics are borne out by the fact that Canada has fallen five places in terms of global economic competitiveness since 2009.

1 *Surviving Disruption*. Harvard Business Review, 2012.

2 *The Future of Productivity: Close the perception gap*. Deloitte, 2013.

3 *Ibid.*

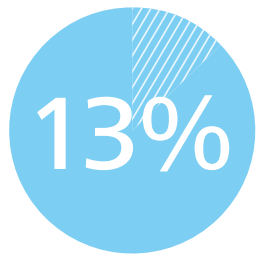
4 *Ibid.*

5 *Ibid.*

6 *Ibid.*

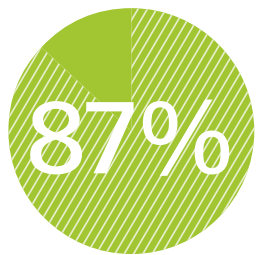
7 *Ibid.*

Canadian productivity remains challenged



Highly prepared

Deloitte survey found only 13% of Canadian businesses are highly prepared for new technologies



Not prepared

87% of Canadian businesses are not prepared for new technologies

Lagging productivity isn't the only challenge that Canadian companies face. As technologies continue to advance and further embed themselves into all industries, they widen the gap between Canada and other countries that are better positioned to take advantage of them.

Deloitte's Age of Disruption research found that, overall, Canadian companies are not prepared for the disruptive potential of new technologies, such as robotics, artificial intelligence, networks, advanced manufacturing and collaborative platforms. Only 13% of companies are highly prepared for these technologies, and yet 43% perceive themselves as more prepared than they truly are – a false perception not only of their readiness but also of the impact these factors will have on their growth.

⁸Clearly, it's time to change the way Canadian organizations do business. Previous studies have shown that despite a strong dollar, low interest rates and a stable investment environment, many of our businesses invest materially less in the R&D and machinery and equipment (M&E) – including Information and Communication Technology (ICT) – that are vital to improving productivity. Our research suggests that a significant portion of Canadian firms mistakenly believe they are making competitive levels of investment when they are not. And this is causing them to fall behind their peers.

But all is not lost. Investing in productivity improvement and developing both an awareness of technology advances and the ability to respond to them will be the hallmarks of tomorrow's leading companies.

Investing in productivity improvement and developing both an awareness of technology advances and the ability to respond to them will be the hallmarks of tomorrow's leading companies

⁸ Age of Disruption: Are Canadian firms prepared? Deloitte, 2015.

Digital disruption affects all real estate asset classes

It's clear that digital innovation will affect all real estate asset classes as space users and advanced technologies continue to transform workplaces, shopping centers, distribution centers, homes and so on. Mobile employees and consumers will transform how they work, shop and live. As a result, their associated real estate requirements will change.

Robotics and advanced manufacturing technologies suddenly question the viability and efficiency of factories across North America. The need to rethink traditional factory infrastructure, recognize decreased reliance on labour from emerging markets and identify potential re-shoring of workers certainly signal changes in job creation, design and overall operating models. Clearly, the real estate market is also facing seismic change.

The big picture for commercial real estate: more change than any time since the industrial revolution



Office

- Employees work anywhere, anytime
- Changing the space means more connected place
- Workplace is a business enabler to collaborate and drive productivity



Retail

- Consumers can shop anywhere, anytime
- Store networks are at the beginning of a major shift
- Empowered consumer driving new business models



Industrial

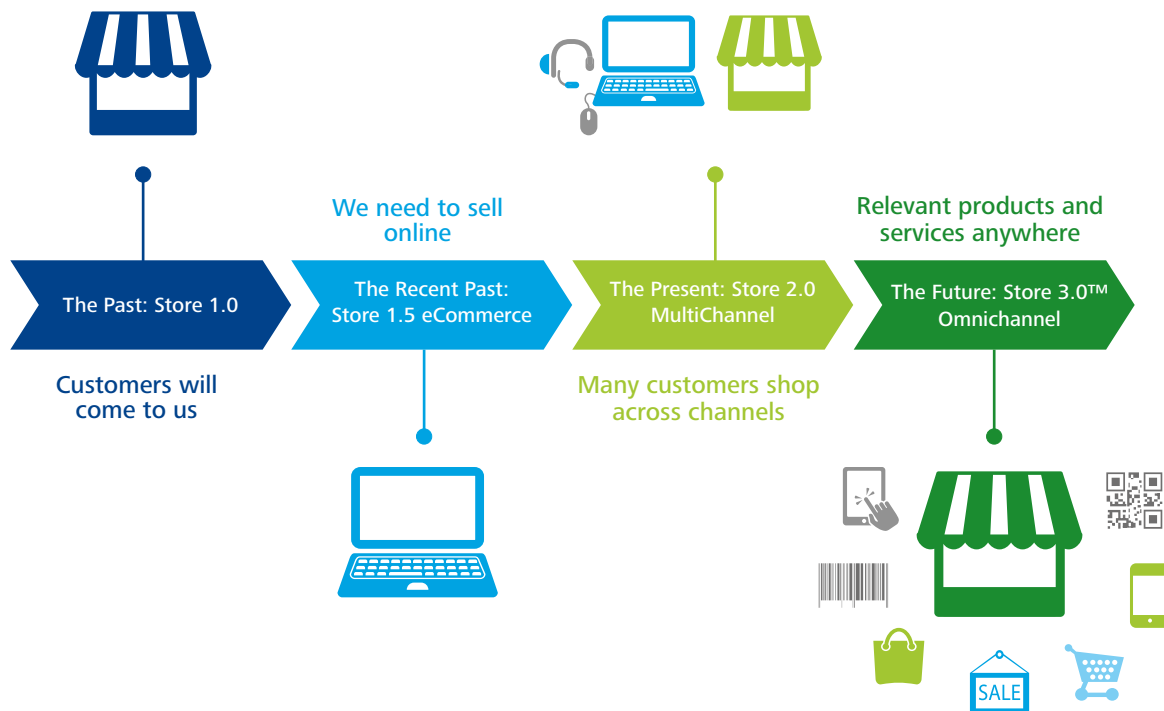
- North America becomes increasingly competitive
- Not everything is moving offshore, some re-shoring
- High tech and advanced manufacturing poised for a rebound

Focus on the retail landscape – driving factors of transformation

Specifically in the retail area, the effect of digital disruption is felt. Consumers are driving a sea-change in the retail industry due to the amount of information they now can access, thanks to technology. The power is shifting from retailers to consumers, and the implications for the real estate industry cannot be underestimated. The technology innovations impacting the office environment have also changed how, where and when we shop.

Over the past 15 years, online retailing has transformed the operating models of traditional brick-and-mortar retailers. This has resulted in the disappearance of some venerable retailers, the amalgamation of others and the need for others to look for other ways to survive the disruption. Retail continues to be a technological hotbed of entrepreneurship and innovation in both the storefront locations as well as the back office environment.

Omnichannel: the evolving path to purchase shifted the power from retailers to the consumer



Consumers are increasingly taking non-linear paths to purchase, combining both traditional store and Internet channels

This approach defines the omnichannel environment and has implications for retailers' real estate strategies in terms of store locations, footprint, warehousing, logistics and fulfillment.

Information asymmetries that favoured companies are being eroded, with consumers benefitting from more product and service choices as well as low switching costs. Consumers are doing their research and homework well before stepping foot into a physical location. This ability to be armed with competitive intelligence means buyers are better able to negotiate, demanding cheaper products and better service, and retailers have no choice but to respond.

Retailers need to quickly respond to consumer demands for online shopping "anywhere, anytime" by developing new channels and improving logistics and fulfillment strategies

Technology has significantly decreased the cost of entry for online retailers compared to new brick-and-mortar competitors

Online retailers can reach far more global customers than any retail location, no matter how many physical outlets the latter may have. Online sales are predicted to grow steadily to US\$370 billion in 2017, up from \$231 billion in 2012.⁹ No longer does the real estate mantra of "location, location, location" matter; a website's server can be located anywhere without affecting the site's ability to reach all target markets.

Accordingly, retail sector square footage has decreased due to changing retail buying patterns, the efficiency of omnichannel distribution and the changing behaviour of millennials. All these factors result in reduced store traffic in the U.S.¹³ and Canadian retailers need to take note and recognize that the physical store, although as important as ever, today plays a different role in the eyes of the consumer.

The Canadian retail marketplace is fundamentally strong, with the vacancy rate at only 3.5% in the International Council of Shopping Centres reported inventory. This stability is shored up by healthy retail sales, which are at their highest levels since 2010. But the retail industry has faced increased consolidation and competition from foreign retailers looking to expand their empires. As in the office sector, real estate is a significant driver of cost, accounting for anywhere from 5 - 20% of sales depending on the type of retail. The shift to online shopping and maturing retail markets has meant more focus on profitability and sales over growth. The ability for retailers to decrease the capital-intensive cost of real estate means those funds can be redeployed elsewhere, such as developing new channels to reach customers, improving logistics and developing warehousing and fulfillment strategies.

⁹ US Online Retail Forecast, 2012 To 2017. Forrester, 2013.

Physical locations still play a critical role, but role of the store is fundamentally changing

The conventional retail real estate approach is largely based on strategic locations; today, however, retail property owners need to continue evolving their “shopping experience” through the addition of food, entertainment and a wide array of retail offerings

Furthermore, real estate owners will be encouraged to partner with their retail tenants to better understand digital disruption and determine which specific tenant and customer technology needs should be included in overall shopping centre design and customer experience. And those technology needs extend to more than just the store front; the back office needs to be able to capture customer preferences and tap into data analytics to support and help drive sales. Understanding big data will be a key driver of long-term retailer prosperity.

From a real estate perspective, the retail industry is undergoing a profound change

Physical stores remain core to creating an innovative and long-lasting shopping experience, but they are no longer the sole touch point for a retail brand. Instead, stores are positioned as part of the omnichannel customer engagement model, combining physical inventory, online access and an environment that is customized to enhance the customer experience. Much of the real estate portfolio for retailers will not be expanding, but undergoing redevelopment as existing spaces are transformed to provide that unique store ambiance. It is a matter of not just reducing and reinvesting, but also reimagining and repurposing the retail space. Even here, the effect of digital disruption is felt. Consumers are driving a sea-change in the retail industry due to the amount of information they now can access, thanks to technology. The power is shifting from retailers to consumers, and the implications for the real estate industry cannot be underestimated. The technology innovations impacting the office environment have also changed how, where and when we shop.

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Property Index 2015: Overview of European residential markets

Property Index is a comparative report regarding residential markets and housing across Europe. It analyses factors influencing the development of residential markets and compares residential property prices in selected (not only) European countries and cities.

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Gaining Momentum: EPRA Annual Report Survey 2014/15

The annual survey conducted by Deloitte EMEA for the European Public Real Estate Association (EPRA) includes a review of 106 annual reports from leading listed real estate companies across Europe to assess compliance with EPRA's best practices recommendations (BPR), an industry disclosure guidance.

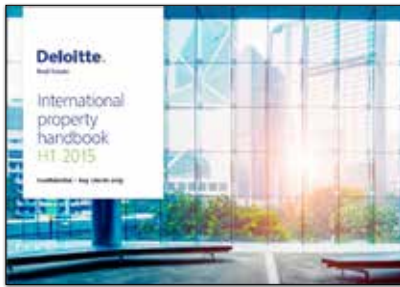
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European Powers of Construction (EPoC) 2014

The twelfth edition of European Powers of Construction examines the performance of the major listed European construction groups in terms of revenue, market capitalization, internationalization, diversification, indebtedness and other financial ratios.

<http://deloi.tt/1Mcvo3h>



The International Property Handbook: H1 2015

Drawing on expertise across Deloitte's global real estate network, the International Property Handbook tracks the flows of international real estate capital. It provides a succinct guide to investment trends on more than 50 of the top investment markets globally, spanning across 20 countries, as well as key country contacts for further information. The handbook is available in standard and interactive pdf versions, with the intention of it being shared directly with key clients, rather than being distributed widely.

Copies available upon request to James Griggs (jgriggs@deloitte.co.uk)

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