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REAL ESTATE MONITOR

NEW LAW RESTRICTS TAX-FREE REIT SPINOFFS

By Randy Schwartzman, Patricia Brandstetter

In recent years, tax-free spinoffs under Sec. 355 involving REITs became popular among corporations with real estate holdings.

The essence of REIT spinoffs is that valuable real estate leaves the corporation and moves tax-free into the favorable REIT tax regime. New tax legislation that took effect December 7, 2015, severely curbs this tax planning strategy.

THE REIT SPINOFF TRANSACTION

The recent legislation targets the following type of transaction: a corporation conducting the core operating business (OpCo) contributes its real estate assets to a controlled subsidiary (SpinCo) in exchange for 100 percent of the SpinCo stock. OpCo then distributes the SpinCo stock to the OpCo shareholders in a tax-free spinoff transaction under Sec. 355, whereby neither OpCo nor its shareholders recognize any income or gain.

Shortly after the spinoff, SpinCo elects REIT status, and OpCo then leases the real estate from the REIT. OpCo thus makes deductible rent payments to the REIT, and the rental income passes through to the REIT investors free of corporate-level taxes. The REIT pays dividends funded by the rental income received from OpCo. Under the REIT tax regime, these dividend payments are deductible from the REIT's taxable income. Moreover, depreciation deductions for the real property held by the REIT reduce its taxable income enough to allow it to make

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TAX-FREE REIT SPINOFFS

distributions equal to, or in excess of, the REIT's taxable income to maintain REIT status. As a result, no tax is incurred at the REIT level, while taxable income is reduced at the OpCo level.

The dividends are subject to ordinary income tax rates at the shareholder level. From the shareholders' perspective, steady dividend payments from the REIT and higher valuation multiples applicable to real estate could mean that their REIT shares are potentially valued higher than they would be on a stand-alone basis without the separation.

The increasing use of REIT spinoffs by large publicly traded companies as a tax reduction strategy raised policy questions under Sec. 355 as well as concerns that these transactions were eroding the corporate tax base.

IMPACT OF RECENT TAX LAW CHANGES

On December 18, 2015, the Consolidated Appropriations Act (the Act) was signed into law, which contains the provisions of the Protecting Americans from Tax Hikes (PATH) Act (P.L. 114-113, Div. Q). This new law includes several taxpayer favorable REIT provisions, including reforms of the Foreign Investment in Real Property Tax Act (FIRPTA) that make foreign investment in REITs more attractive, and making permanent the reduction of the recognition period for a REIT's built-in gains from 10 to five years. However, the most significant change comes in the form of the Act's restrictive provisions regarding tax-free REIT spinoffs, which make REITs generally ineligible to participate in a tax-free spinoff either as a distributing or a controlled corporation under Sec. 355.

Under the new law, tax-free treatment under Sec. 355 is not available where either the distributing or the controlled corporation is a REIT. There are two exceptions for existing REITs:

(1) Tax-free treatment is still available for the spinoff of a REIT by another REIT where, immediately after the distribution, both the distributing and the controlled corporation are REITs.

(2) A REIT may spin off its Taxable REIT Subsidiary (TRS) if (i) the distributing corporation has been a REIT at all times during the three-year period ending on the date of the distribution, (ii) the controlled corporation has been a TRS of the REIT at all times during such period, and (3) the REIT has had control of the TRS (defined in Sec. 368(c) as at least 80 percent voting power and 80 percent of the total number of shares, taking into account stock owned directly or indirectly, including through one or more partnerships) at all times during such period.

Moreover, under newly enacted Sec. 856(c)(8), if a non-REIT was a distributing or controlled corporation in a Sec. 355 transaction, that corporation (and any successor corporation) may not make a REIT election before the end of a 10-year period beginning on the date of the distribution.

These provisions took effect for distributions on or after December 7, 2015, but do not apply to transactions with a pending ruling request submitted to the IRS on or before that date. Several companies, among them Hilton Worldwide Holdings Inc. and Caesars Entertainment Corp., have requested a ruling prior to the Act's effective date to be granted IRS permission to spin off their real estate holdings.

Other companies have already started pursuing alternate strategies to monetize real estate value. Among them is publicly traded casino, hospitality and entertainment company MGM Resorts International, which has announced its plan to contribute some of its real estate assets to a newly formed REIT and to use a lease structure without a tax-free spinoff.

CONCLUSION

The recent legislation makes it almost impossible for an existing business to separate its operations from the ownership of real estate without incurring significant tax liability. While the restriction of tax-free REIT spinoffs marks a significant change to the restructuring environment for the real estate industry, its impact remains to be seen.

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How and where healthcare is being delivered is changing. Consumers are demanding even greater access and convenience. And while in the past consumers may have had to conform to the healthcare industry's rules, today it is healthcare that is conforming to the consumer. The healthcare industry is moving toward a more retail-focused model and no better example of this is the proposed Walgreens and Rite Aid merger, which was just approved by shareholders and is expected to be completed in the second half of this year, after it is passed by antitrust regulators. The following Chain Store Age article authored by Ted Vaughan, our consumer business practice leader, and Patrick Pilch, our healthcare advisory practice leader, dives further into what this merger means for the healthcare and retail industries.

WALGREENS AND RITE AID PROPOSED MERGER: THE BLURRING LINES BETWEEN RETAIL AND HEALTHCARE

By Ted Vaughan, Patrick Pilch

In October, Walgreens announced plans to acquire Rite Aid in a deal that had been widely anticipated.

The deal is most certainly going to reshape the retail market by creating a drugstore giant with nearly 13,000 stores in the United States; as well, it foretells of the significant changes occurring in the healthcare market.

The way healthcare is delivered in the United States is undergoing a significant transformation in the aftermath of the Affordable Care Act, which is putting increased pressure on hospitals, insurers and drugmakers to lower their costs. As a result, providers are looking to move delivery of care closer to the intended receiver — and out of the high-cost hospital environment. Meanwhile, consumers are taking more responsibility for their healthcare choices and looking for convenience, easy access, and better and more cost-efficient services.

And as the healthcare industry moves toward a more retail-focused model, one-stop solutions that provide healthcare, insurance and other related services and products are gaining popularity — and intensifying the competition — and in some cases "co-opetition" — between retailers and healthcare providers.

The Walgreens-Rite Aid deal comes amid a multitude of strategic partnerships drug and retail companies are forming in order to capture a bigger share of the healthcare market, which is expected to comprise 20 percent of the nation's GDP in 2021.

In late 2014, Wal-Mart announced that it would partner with DirectHealth.com to provide healthcare insurance advice to consumers at half of Wal-Mart's 4,300 stores. Separately, in June 2015, Target Corp., sold its in-store pharmacies to CVS in a deal that may lead to other supermarket chains with struggling pharmacies to look for drug store partners.

Moreover, drugstores are not only competing with each other and now with retailers, but also with hospitals. In fact, Walgreens' latest announcement to transition its Healthcare Clinics to the Epic electronic health records platform to achieve better coordination and interoperability with health systems is a direct example of the company's strong focus on growing its clinic business.

A deal between Walgreens and Rite Aid will enable the joint company to realize increased synergies by consolidating stores in close proximity and will, as a result, drive up revenues per square foot — a key metric in negotiations with retailers. By one estimate, Walgreens may be closing some 3,000 Rite Aid stores because of the proximity considerations. If this happens, the winner will likely be Walgreens itself, as the foot traffic is likely to be directed to the nearest Walgreens location.

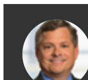
From a strategic perspective, achieving this kind of scale is likely to afford the combined company extra leverage in negotiations with suppliers that fill the front end of the store where the majority of revenues are generated. And by drawing consumers in by offering more competitive prices on the front end, Walgreens is naturally going to aim to lure them into buying other services while in the store.

Despite all the benefits outlined above, the merger will not be without its challenges. Even as consolidating real estate can drive cost efficiencies and increase leverage in negotiations, it also creates complexities. The new entity will have to decide what makes the most strategic sense from a real estate consolidation standpoint as well as determine and develop the brand identity of the merged stores.

Most importantly, combining the unique cultures (one—Rite Aid—with a bigger focus on smaller communities and the other — Walgreens — on large urban markets) of the nation's first and third largest drug stores will require a thought-out communications and marketing plan, as well as strong leadership that has its ears tuned to the needs of both employees and customers.

All of this will have to happen as the merged entity works on building its position as a one-stop healthcare provider in multiple markets nationwide, defining relationships with insurers and healthcare provider networks and simultaneously attracting new customers.

Even with myriad challenges, the merger is a sound strategic step in an industry that is getting increasingly complex and multifaceted. And when all is said and done, the merger is bound to play a defining role in the evolution of the healthcare market and permanently alter the playing field in retail and healthcare industries.



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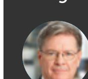

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ACHIEVING THE BEST TAX RESULTS FROM TENANT IMPROVEMENT ALLOWANCES

By Jeffrey J. Schragg

Tenants who meet certain conditions can get a tax break for Tenant Improvement (TI) allowances.

New lease agreements are typically viewed as routine business decisions rather than tax-saving opportunities. Ignorance of rules can prove costly to a tenant who is unaware of the potential tax implications. As an enticement to a new tenant, landlords commonly offer a TI allowance to help offset the tenant's cost of moving into the new space and fitting it to their unique needs. For leases with a term of 15 years or less, there are special tax treatments for these allowances.

FINANCIAL REPORTING VERSUS TAX TREATMENT

For financial reporting purposes, generally accepted accounting principles (GAAP) typically require that an allowance used for property improvements be amortized over the life of the lease. The allowance is also recorded by the tenant as a deferred rent liability and prorated over the life of the lease. For book purposes, then, the tenant is deemed the bona fide owner of the improvements.

If tax rules followed GAAP, the tenant would be required to use a 39-year proper tax life for nonresidential real property (or 15 years, if the improvements meet the definition of qualified leasehold improvement property). Moreover, the tenant would also have to recognize the full allowance in gross income when received. Therefore, from a tax perspective, it is far more advantageous for the tenant to have the landlord own the improvements.

Section 110 of the Taxpayer Relief Act of 1997 essentially created a safe harbor for tenants. A tenant no longer needs to include in its gross income any cash amount or rent reduction used for constructing or improving qualified long-term real property.

Although disclosure is required in the taxpayer's timely filed return (including extensions), if the criteria of the section are met, the exclusion of income is automatic. Unless notified by the tenant in writing to the contrary, the landlord must capitalize the improvements for tax purposes and depreciate them over 39 years (or 15 years, if applicable).

Example 1. Imagine that ABC Corp., a landscape design firm, leases space from XYZ LLC beginning in January 2016. The lease expires in December 2025. As an incentive to ABC (the tenant), XYZ (the landlord) includes in the lease an agreement to cover $1 million of improvements that ABC will make to the space within the first year of the lease. The lease specifies that at least some portion of the allowance will be used to improve long-term real property, and notes that any portion not used can be applied by ABC against rent payments within the year. ABC uses $800,000 of the allowance, $750,000 of which is spent on Section 1250 property (depreciable real property) and $50,000 on Section 1245 property (tangible personal property). ABC applies the remainder against its December 2016 rent.

On its 2016 federal income tax return, ABC would capitalize and depreciate the $50,000 of the allowance used to purchase tangible personal property. The company would also recognize $250,000 of gross income on its return for the $200,000 applied against the December rent payment and the $50,000 capitalized. However, the $750,000 would not be treated as income or as a capital investment on ABC's return. According to Section 110, XYZ would treat the $750,000 as a fixed asset and depreciate it on its return, unless ABC agrees in writing to a different treatment. Both ABC and XYZ would attach a statement to their timely filed returns pursuant to the regulations.

NEGOTIATIONS

When negotiating and executing a lease, tenants should be aware of Section 110 and should specify that at least some portion of their TI allowance will be used to construct or improve qualified long-term real property, in order to meet the purpose requirement. If this provision was missed in the master agreement, an ancillary agreement executed either with the lease or during the term of the lease is also acceptable. Although the lease agreement does not need to require the entire allowance to be used for this purpose, only the amount actually expended on qualified long-term real property will qualify under Section 110.

Example 2. Imagine that the facts are the same as in example 1, except that the lease did not specify that any portion of the TI allowance would need to be spent improving real property. In this instance, the treatment by ABC and XYZ should still be the same, but because there could be an issue under examination as to whether the purpose requirement was met, an ancillary agreement should be drawn up to cover this point.

EXCESS ALLOWANCE

Any portion of the allowance that the tenant does not use within eight and a half months after the close of the tax year in which it was received, or that the tenant does not apply as a rent reduction — including amounts used to acquire Section 1245 property — will not be included under Section 110 and will be recognized as gross income.

Example 3. Again, using the same scenario as in examples 1 and 2, suppose that ABC uses the entirety of its allowance on qualifying properties by the end of the 2016 tax year, but only spends $650,000 by September 15, 2016 — eight and a half months after the year in which the proceeds were received. In this case, ABC would recognize $350,000 of gross income on its 2016 federal income tax return, as

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TENANT IMPROVEMENT ALLOWANCES

this remainder of the allowance no longer qualifies under Section 110. Tenants should be aware of this clause and should ensure that intended improvements are made within the proper time frame.

REPORTING REQUIREMENTS

Section 110 requires both tenant and landlord to attach a statement to their timely filed federal income tax returns, including extensions, generally providing details of the parties to the lease agreement and the allowance. Given the detailed information required in the statement, tenants should request this from the landlord at the time the agreement is signed.

WHAT ARE QUALIFIED IMPROVEMENTS?

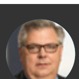
A landlord may be entitled to use the shorter life of 15 years (rather than 39 years) for some leasehold improvements they are required to depreciate under Section 110. Improvements to building interiors are considered qualified leasehold improvements if all three of the following conditions are met:

1) The landlord and tenant are not related parties.
2) The leased space is occupied exclusively by the tenant.
3) The building has been in service for more than three years.

In this case, the TI allowance could not be used to:

- Enlarge the building.
- Install an elevator or escalator.
- Construct a structural component in a common area.
- Alter the internal structural framework.

This piece originally appeared in NAIOP's Developments Magazine.



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PErspective in REAL ESTATE

The $7.6 trillion hospitality industry is in the grips of a merger frenzy, with players from hotels to online bookings to car rentals and cruise liners seeking to increase their share of a fragmented, increasingly competitive and globalized market.

Room rates and occupancy levels are at all-time highs, but the rise of home-sharing platforms like Airbnb is putting pressure on lower-priced and leisure brands. Many firms view scale as the best way to compete, according to *MarketWatch*.

There have been several major deals in the last six months. Marriot International acquired the much sought-after Starwood Hotels & Resorts Worldwide for $12.2 billion, and the Blackstone Group paid $6 billion for real estate investment trust (REIT) Strategic Hotels and Resorts. Expedia has also gotten into the M&A game, purchasing vacation home rentals company HomeAway for $4 billion.

Most of the major hospitality companies are no longer in the business of hotel ownership, preferring instead to collect fees from management contracts or franchise their brands. This enables them to offer more global exposure and a larger customer base to entice new hotel owners to their brands, according to *MarketWatch*. Strategic buyers have also revised their consolidation strategies to compete with the rise of the sharing economy. For example, Wyndham Worldwide recently invested $7.5 million in home exchange company Love Home Swap, and Enterprise Holdings bought several ride-sharing companies in addition to launching its own.

Ratings agency Fitch expects hospitality M&A activity to remain high in the near term, as firms fight for control of the market in an evolving competitive landscape and navigate the rapid growth in alternative lodging accommodations like Airbnb, reports *Private Equity Wire*. While megadeals grab headlines, mid-size hotel companies are attractive targets for private equity firms that might not be able to swallow such massive deals.

Private equity firms are expected to favor investments in hotel REITs, as they did during the last wave of hotel consolidation a decade ago, betting that real estate holdings are more valuable than the market values of the companies themselves. The last cycle peaked with the privatization of Hilton in 2007, when–in the biggest hotel deal ever–Blackstone paid more than $18 billion plus $7 billion in assumed debt. Some analysts believe this dynamic has returned and could fuel further consolidation and privatization of hotel REITs in the near term, *MarketWatch* reports.

REITs make attractive PE targets because they have better access than corporates to low-cost debt and valuations are generally at a discount compared with net asset values, according to *Private Equity Wire*. With record amounts of capital raised for commercial real estate platforms in recent years, many buyout shops are now looking to put it to work, including through REIT privatizations, *Private Equity Wire* reports.

Sources: Private Equity Wire, MarketWatch, Financial Times, Travel Daily News, Huffington Post, JLL Real Views

PErspective in Real Estate is a feature examining the role of private equity in the real estate industry

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COULD A LACK OF SKILLED LABOR SLOW THE RESHORING WAVE FOR U.S. MANUFACTURERS?

By Tom Stringer, Michelle Cammarata

U.S. manufacturing is on the rebound, having added more than 730,000 jobs since the end of 2010.

And industry analysts expect the sector to create at least another 700,000 jobs by the end of the decade, according to the Manufacturing Institute.

Many of these jobs are the result of the return of operations to the U.S. from abroad, also known as reshoring. Companies are exhibiting a strong commitment to reshoring, and a December 2015 study by The Boston Consulting Group found that:

- 54 percent of companies with more than $1 billion in revenue are considering reshoring
- The share of executives saying that their companies are actively reshoring production increased by 9 percent since 2014 and by almost 250 percent since 2012
- Of manufacturers planning to add production capacity over the next five years for goods consumed in the U.S., more plan to add that capacity in the U.S. than in any other country

Perhaps no company has had a bigger impact on the reshoring trend than Walmart. The retailer has committed $250 billion for U.S.-made goods over the next decade and reshored 4,444 jobs between 2010 and 2014, according to the Reshoring Initiative. This has set in motion a chain reaction, as suppliers are reshoring their own operations to serve the retail giant.

U.S. automakers are also making significant investments. Ford, second only to Walmart in reshoring over the past five years, brought 3,250 jobs from Mexico to Michigan and Ohio and moved 1,800 jobs to Tennessee. General Motors also brought 1,800 jobs from Mexico to U.S. plants, according to analysts at the Reshoring Initiative.

Reshoring is strongest in the southeast and Texas. Companies building new facilities frequently choose right-to-work states with comparatively lower wages and business taxes. Companies that move operations to other regions typically choose existing factories with excess capacity. For example, in 2014 Whirlpool announced it would relocate production of KitchenAid small appliances from China to an existing facility in Greenville, Ohio, adding 400 workers.

JOBS RESHORED BY INDUSTRY

(January 2013–June 2015)

Transportation Equipment	13,823 jobs
Machinery	2,860 jobs
Computers and electronics	3,483 job
Clothing and textiles	2,154 jobs
Food industry	1,628 jobs
Fabricated metal producers	1,721 jobs
Wood products	1,028 jobs

Source: Reshoring Initiative

WHY BUSINESSES RESHORE JOBS

Costs: Two major costs–labor and energy–are dramatically reduced for many companies when they reshore. The cost of labor in China has increased 320 percent since 2000, according to the Reshoring Initiative. Gas and oil prices, volatile in other countries, have been lower and more stable here in the United States, and few predict that will change in the near term.

Logistics: Reshoring shortens the supply chain and cuts time to market, helping companies be nimbler.

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RESHORING WAVE

Brand Building: Businesses boost their brands when they can market their products as "Made in America." Companies enjoy better quality control and access to skilled labor, which can improve the product, further strengthening their brands.

WHO WILL FILL THE JOBS?

Add existing manufacturing sector growth, plus reshoring, plus the pending retirement of the baby boomers, and U.S. manufacturers say there will be as many as 3.5 million job openings over the next 10 years, according to a 2015 GE Reports study by General Electric. Meanwhile, according to the Reshoring Initiative, there are still 3-4 million manufacturing jobs abroad, offering a chance for enormous economic growth if reshoring continues.

The U.S. might not have enough skilled manufacturing labor–today or in the pipeline–to meet this demand. Several factors contribute to the gap:

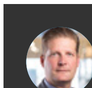
- **Perception:** After years of layoffs, plant closings and relocations to emerging markets like China and Mexico, the industry has struggled to attract younger talent. While initiatives like Manufacturing Day are making strides to cultivate a new generation of manufacturers, a 2015 study from the Manufacturing Institute reports that just 37 percent of parents would encourage their children to pursue careers in manufacturing.

- **Demand for technical skill:** U.S.-based manufacturing jobs today focus on operating, maintaining and programming high-tech machines. Employers need problem solvers with strong technical skills. Unfortunately, inadequate investment in manufacturing education, vocational schools and community colleges, along with a decline in apprenticeship programs, have contributed to the skills gap.

- **Wages:** Concerns about wages may push otherwise qualified workers away from a manufacturing career. While automakers have reshored jobs, for example, some have moved to areas where wages and benefits are lower. Increases in manufacturing pay are struggling to keep pace with the influx of jobs to fill.

Company	Location	Product	Jobs	Reasons for Reshoring
General Electric	China *to* Louisville, KY	Water heaters and appliances	1,300	• Tax incentives • Reduce intellectual property risk • Ease of design collaboration with workers • Reduce costs through improved inventory and delivery management
Farouk Systems	China *to* Houston, TX	Appliances	1,200	• Increased control over manufacturing inventory and distribution • Quality • Image • Spent too much money fighting counterfeits • Local suppliers
Heinz	Canada *to* Massillon, OH	Processed frozen food	699	• Government incentives • Lean process implementation
Element Electronics	China *to* Winnsboro, SC	Flat screen LCD TVs	500 over five years	• Customer responsiveness improvement • Patriotism • Lower tariffs • Production cost equivalency/improvement • Freight cost • Image/ brand
Whirlpool	China *to* Greenville, OH	Small appliances	400	• Skilled workforce • Government incentives • Capacity at existing factory
General Electric	Mexico *to* Louisville, KY	Refrigerators	300	• Labor concessions • Government incentives • Total costs lower • Customer responsiveness • Lean improvements
NEF	China *to* Stratham, NH	Athletic shoes	200	• Automation/technology • Total cost • Image/brand
General Electric	China *to* Bucyrus and Circleville, OH and Mattoon, IL	Energy-efficient light bulbs	150	• Walmart
Creative Things, Inc.	Asia *to* Lowell, AR	Consumer Plastic products	104	• Delivery • Freight cost • Political instability • Customs uncertainty • Government incentives • Image/ Brand • Lean Improvments
Hessaire	China *to* Holly Pond, AL	Industrial and commercial fans	100	• Wages • Shipping costs • Quality
Master Lock	China *to* Milwaukee, WI	Locks	100	• Cost structure • Productivity gains • Control • Customer service

Experts note that these hurdles are not insurmountable, and several strategies are already yielding progress. As the cost of doing business abroad continues to rise, manufacturers are heading home to take advantage of lower costs, more efficient logistics, stronger protections for intellectual property and a boost to their brands. Job opportunities abound for employees with the technical skills and problem-solving ability to operate and maintain high-tech equipment and engineer new products. By collaborating to offer educational programs and apprenticeships, leaders in business and government can grow the skilled workforce to keep pace with the rapid growth projected for the manufacturing sector for years to come.



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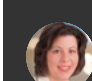

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DID YOU KNOW...

According to Dodge Data & Analytics, monthly construction starts increased 2 percent in January due to growth in the residential sector.

In 2015, foreign purchases of U.S. real estate assets rose to $62 billion over the 12 months ending in October, according to Real Capital Analytics, with Canada, Norway, Singapore and China all leading the wave.

The freestanding retail REIT sector is up more than 10 percent so far in 2016 and has outperformed the REIT industry overall, according to data from REIT Cafe.

According to a recent survey of construction industry professionals by HomeAdvisor, 93 percent of respondents believe the labor shortage is hampering their businesses from growth over the next 12 months.

The office sector benefitted from stronger employment growth at the close of 2015, with vacancy rates dropping by 20 basis points in Q4, according to NAREIT analysis.

Individuals in their 50s and 60s make up the largest portion of the increase in renters since 2005, according to a recent report from the Harvard Joint Center for Housing Studies.

ARE SUNNY SKIES AHEAD FOR TIMESHARES?

Q&A with Kevin Riley

Do you foresee an active year for M&A in the timeshare industry?

Following the recession, many timeshare companies, like most luxury and consumer products, struggled as consumers pulled back. In that aftermath, we haven't seen many new entrants; however, we did see a significant amount of consolidation among some of the independent developers. Private equity firms took positions in several major companies and, as the industry begins to thrive again, private equity firms are reaching their exit points. The tide could be turning back toward M&A among some of the smaller legacy players in the industry.

How has the timeshare industry evolved to compete with the growing rental market, particularly as platforms like Airbnb continue to explode?

Airbnb is growing rapidly, but it's not a new entrant in the rental market. Platforms like Airbnb primarily provide additional touchpoints for consumers to reach their vacation destinations. In some ways, the timeshare industry is crossing over more and more into the rental market and taking pages out of Airbnb's playbook, by way of expanding its network of destinations through strategic partnerships with major hotel chains and offering travelers greater flexibility.

Millennials represent one-quarter of the population and have an estimated $200 billion in buying power. How are timeshare companies adjusting their selling to target this demographic?

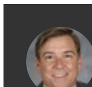
In the past, the rental side of timeshare business was used as more of a sales and marketing tool to draw in potential buyers to "try-then-buy." However, there was a pivotal shift in that business model after the recession. The robust building activity that took place before the recession and the consumers that walked away during the late 2000s left companies sitting on inventory. They adjusted and, while they are still emphasizing the traditional "lifetime product," they are now more focused on the short-term rental side of the hospitality industry. Major brands have learned that to target millennials who do not want to buy, they must offer a more flexible product. All of the brands and independents are looking at a short-term product to address that pivotal shift in demand.

What do you expect to see in funding this year?

That's one area that's remaining consistent right now. Traditional lenders, including private equity, that have long dominated the space are not showing signs of departing and, currently, we're not seeing signs of new entrants wanting to throw their hats in the ring. There are always eyes on the industry, but in the current landscape, I don't see any indications that new investors will enter the market.

2016: Sunny for timeshares?

The industry is unquestionably still thriving and coming back after a challenging few years. It was recently reported that timeshare sales have increased 25 percent since 2010. There are tougher regulations in place on the industry, and it's adjusting away from past perceptions and meeting new consumer demands. It's an exciting time as the industry looks away from its traditional "vacation for life" business model and toward the flexible short-term value consumers are craving.



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With the outcome of the March 15 Federal Reserve meeting being no change to the hike that was implemented during the December meeting, we thought our readers would benefit from our National Practice Leader Stuart Eisenberg's perspective on the outcome of the December 2015 meeting – a rise in the key interest rate from a range of 0 to 0.25 percent to a range of 0.25 to 0.5 percent. While market fundamentals, like low unemployment and energy prices, are encouraging signs the economy is re-energizing and could support another minimal hike, because of increasing global market volatility the Federal Reserve is reportedly "already signaling why it might lower forecasts for growth, inflation and the path of future interest rates when it meets next month."

NO ALARM BELLS AFTER MINIMAL INTEREST RATE HIKE

By Stuart Eisenberg

News and predictions surrounding interest rates have dominated industry headlines for quite some time.

The Federal Reserve's first interest rate hike since 2006, which arrived in mid-December after months of speculation, should act less as a cause for alarm than as a bellwether of even better things to come for the economy as a whole, as well as the CRE industry.

Because the hike is largely symbolic and indicative of the Fed's view of strengthening market fundamentals, it is not expected to hinder CRE activity. While some in the industry may be disappointed to see the end of historically low rates that helped the CRE industry recover from the Great Recession, the economy's increasingly stable footing should only help propel the industry and will outweigh any potential negative effects of the quarter-percent interest rate hike.

Though longer-term concerns could bubble up, it's unlikely that the increase will negatively or greatly impact the sector, or cause a slowdown in development or investment activity in the near term.

Unemployment is falling, oil prices are expected to remain low through 2016 and housing prices have recovered in many markets, bolstering economic stability for consumers and tenants alike. Greater consumer confidence also presents the opportunity to command higher rental rates, generating better cash flow for REITs.

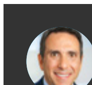
The potential short-term impact of the hike might have been overblown primarily because it had been top-of-mind among REITs, and industry players were well prepared for the adjustment. Many REITs have likely already factored the potential risks associated with a rate increase into their strategies, and some have already done much of the heavy lifting by preparing for a more dramatic increase than the quarter percentage point.

Assuming future hikes follow the gradual pattern discussed by the Fed of four small increases throughout 2016, the higher interest costs should be offset by increases in rental rates. This would be helped along by both inflation and strengthening economic fundamentals. If the increases in rent are greater than the incremental increases in interest costs, this would generate excess cash flow and allow REITs to pay greater dividends in the coming years.

Looking further ahead, once rates increase by another 50 or 75 basis points, REITs' risk-adjusted returns may not be as attractive to investors, and they may need to revisit their distributions. If rates were to climb higher than expected or the pace were to pick up, interest costs would be more likely to hamper REITs' valuations, distributions to shareholders and ability to finance new properties.

All things considered, one prediction to remain absolutely certain of is that the fate of rates will continue to be subject to widespread speculation and will be a key market driver for REITs in the year ahead.

This piece originally appeared in Commercial Property Executive.



Stuart Eisenberg is a partner and the national leader of the Real Estate and Construction practice and may be reached at seisenberg@bdo.com.

Read more ▶

WHAT'S TRENDING IN REAL ESTATE AROUND THE WORLD?

Canada

Salmaan Alvi
BDO Canada

Each quarter, *Real Estate Monitor* will feature the top trends impacting real estate in an increasingly global market, as reported by our international colleagues. For this issue, we sat down with **Salmaan Alvi, BDO Canada's National Real Estate and Construction practice leader**, to discuss the four leading trends he says are influencing the Canadian real estate market today.

Consumers are Pulling Back on the Purse Strings

Consumer debt in Canada has surpassed that of the United States. Spending on the lower end has dropped as consumers have shied away from the excess they may have embraced a few years back. That said, there is a prevailing wind of cautious optimism, mirroring what's being seen in the U.S. economy.

Foreign Investors Capitalize on the Deflated Loonie

Despite concerns that Canada could be facing a real estate bubble, foreign buyers are willing to pay a premium for in-demand properties, and we could continue to see more inbound money. China remains the top player, but we're also seeing significant investment from the Middle East.

Millennial Preferences are Reshaping Real Estate

Millennials' growing preference for multi-family urban living that caters to the live-work-play mindset is leaving its mark on Canada's residential real estate market. It is also impacting office space: as more people gravitate back toward urban markets, so do the employers that once inhabited suburban office parks.

How Low Can They Go? Oil Prices Bring Mixed Impact

In major markets like Toronto and Vancouver, low global oil prices are creating ripple effects reaching across the broader economy. But overall, low oil prices are benefitting most industries, as is the case in the United States. Also similar to the U.S. is the effect of low prices on boom towns that over-constructed to accommodate the influx in oil sands workers before prices crashed. For example, Alberta, historically heavily oil-driven, is experiencing double-digit vacancies.

For more information on the real estate landscape in Canada, contact Salmaan Alvi, partner in BDO Canada's accounting and auditing, business valuations practice, at salvi@bdo.ca.

Read more ▶

MARK YOUR CALENDARS

The following is a list of upcoming conferences and seminars of interest for Real Estate and Construction executives:

APRIL

April 3-5
World Built Environment Forum at the Summit of the Americas
Ronald Reagan Building and International Trade Center
Washington, D.C.

April 11
ANHD 2016 Conference: Building the Equitable City
Grand Hyatt New York
New York

April 28
BISNOW's Lodging and Innovation Series
Sheraton
Los Angeles

MAY

May 1-5
ARDA World*
The Diplomat Resort & Spa
Hollywood, Fla.

May 3-5
Medical Office Buildings + Healthcare Real Estate Conference
Hilton
Orlando

May 10-11
Commercial Real Estate Finance Summit (West)
Fairmont Miramar Hotel & Bungalows
Santa Monica, Calif.

JUNE

June 5-7
NYU International Hospitality Industry Investment Conference*
New York Marriott Marquis
New York

June 7-9
REITWeek: NAREIT's Investor Forum
Waldorf Astoria
New York

June 29-30
Non-traded REIT & Retail Alternative Investment Symposium
Marriott
New York

** indicates BDO is hosting or attending this event*

For more information on BDO USA's service offerings to this industry, please contact one of the following regional practice leaders:

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