

THE NEWSLETTER OF THE BDO REAL ESTATE AND CONSTRUCTION INDUSTRY PRACTICE

REAL ESTATE MONITOR



A NEW SPIN ON REIT SPIN-OFF DEALS

By **Stuart Eisenberg**

Soaring property values have investors putting the pressure on retailers, including Macy's, to cash in on the value of their real estate by entering into lease-back deals or hybrid joint ventures, say analysts at [The Wall Street Journal](#).

In fact, the July announcement of Starboard Value's investment plan to spin off Macy's real estate into a REIT [spurred a 4 percent increase](#) in the company's shares.

Proponents of the move say using it to extract value from real estate can generate a boost in shares, as is the case of Hudson's Bay Co., which entered into a joint venture with mall operator Simon Properties and experienced a 24 percent boost to its shares since the deal

was announced in February. Critics say leasing the property back from the buyer saddles the retailer with higher long-term costs that could hamper its ability to adapt to market changes and may not be worth the short-term gain.

When taking this approach, two main avenues are commonly discussed: a business can sell part or all of its real estate to a third party, taking the proceeds and leasing the property back under a long-term rental agreement; alternatively, some retailers have chosen to spin off (through transfer or sale) the real estate to a newly formed REIT. Taking the latter approach hands control of the property over to the REIT, with the retailer then leasing back the property.

As major retail chains, Macy's included, continue to make adjustments to their retail spaces to accommodate for the market forces

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REIT SPIN-OFF DEALS

generated by the rise of e-commerce and shifting consumer preferences, deals like these are gaining more traction as a way to take advantage of a booming real estate market and extract value from a business' non-cash flowing assets.

Specifically, in what areas could retailers benefit by taking this approach?

LIQUIDITY

In the short term, spinning off real estate can be an effective value add and can generate an immediate influx in cash for the retailer. The funds can then be used to pay down debt and lower interest, invest in improvements or expand. If a retailer is performing well, it can be more practical to rent rather than own, as funds aren't tied up in a long-term asset, but rather are available to invest in the operating business. For some retailers, this can be an important consideration and one that justifies entering into a lease agreement with the buyer and committing to increased costs in the long term.

ASSET MANAGEMENT

Spinning off real estate effectively shifts responsibility for property management onto the buyer, which can benefit retailers by reducing costs associated with property maintenance and capital projects, as well as reducing payroll expenses and/or third-party management costs.

INVESTOR BENEFIT

It's important to note that a major driving force behind the uptick in lease-back deals has been a push from the investment community to take advantage of the current real estate market. Investor satisfaction is an essential consideration for retailers, especially as they weather disruption in the consumer business space. Some retailers could be subject to lower valuations if investors underestimate the value of the real estate held by the retailer, so spinning all or part of the real estate off can increase valuation and share prices, adding value from an investment perspective.

Historically, retailers direct their focus more on operating stores and generating revenue than on extracting value. With real estate values holding strong at a high level, Macy's CEO explained in a [recent CNBC segment](#) the importance of the company approaching new real estate deal structures with an open mind, while also taking care to consider implications, such as shifting tax burdens. If Macy's valuation grows as investors have modeled, some predict that a new model for retailers could emerge as a way to stimulate growth, generate liquidity and boost valuation.

This article first appeared in *Commercial Property Executive*.



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DID YOU KNOW...

According to **Urban Land Institute's Center for Capital Markets and Real Estate's** three-year economic forecast, commercial real estate transaction volumes are expected to increase for the next two years and level off at around \$500 billion in 2017.

Commercial Property Executive's latest **CPE 100 Quarterly Sentiment Survey** found that more than half of respondents believe industrial properties offer the strongest developmental growth potential.

Amid uncertainty around when – and if – the Fed plans to raise interest rates, 97 percent of REITs cited interest rates as a top concern this year, according to the **2015 BDO RiskFactor Report for REITs**.

According to the **U.S. Green Building Council**, the green building sector is outpacing overall construction growth in the U.S. and will account for more than 2.3 million American jobs this year.

Nearly half of respondents named wireless technology as one of the most critical value-add opportunities in the commercial real estate industry, according to a new **GlobeSt.com and Partner Engineering Science, Inc. study**.

According to mid-year data from the **U.S. Census Bureau**, the national rental vacancy rate fell to 6.8 percent, marking the first time it has fallen below 7 percent since 1985.



EVOLVING PORTFOLIO AND REAL ESTATE STRATEGIES IN U.S. HEALTHCARE SYSTEMS: The Rise of Outpatient and Ambulatory Care

By Patrick Pilch and Rachel Lauren



The future of healthcare delivery in the U.S. is shifting dramatically, and its real estate footprint will follow suit.

Hospitals and healthcare systems have shifted their focus away from building up hospital infrastructure, as they seek out alternative ways to keep costs low for patients. What does that look like? More outpatient and ambulatory facilities.

In the last four years, the number of stand-alone outpatient and ambulatory care clinics has risen dramatically as health systems across the country move relatively healthy patients from inpatient/hospital settings to lower-cost ambulatory settings. Outpatient services [account for](#) approximately 60 percent of all U.S. hospital revenues today, compared to 10 percent to 15 percent in the early 1990s.

Tenet, the \$16.6 billion Texas-based health system, announced two deals earlier this year that will make it the nation's largest operator of ambulatory surgery providers.

The organization has achieved strong results in part due to its thrust into outpatient and ambulatory care – a smart way of driving down real estate and facility costs while ramping up patient volume.

TAILWINDS DRIVING THE RISE OF AMBULATORY AND OUTPATIENT CARE

Advances in health technology are accelerating the shift to ambulatory settings. Physicians have begun to establish groups of their own capable of providing urgent care, diagnostic imaging and preadmission testing services in convenient and accessible settings for patients. From City MD to OrthoNow, new metropolitan stand-alone clinics [have also taken hold](#).

To counteract competitive ambulatory care facilities, hospitals and health systems are investing heavily in the development of their own ambulatory care and surgery models. New York Presbyterian Hospital, a Manhattan-based hospital with \$3.7 billion in annual

revenue, is [building a large-scale ambulatory facility](#) with an expected total cost of close to \$1 billion. The new facility will provide surgery, primary care and infusion therapy services, radiology and MRIs. It is also expected to offer comprehensive preventive and specialty services in an ambulatory setting. New York City leads the U.S. in new ambulatory space construction with an estimated \$2.2 billion under construction or in late planning stages; 75 percent of those projects will be built off campus, according to healthcare real estate analytics firm Revista.

In early September, [Healthcare Finance News reported](#) that Cleveland Clinic is investing \$320 million into its Florida healthcare business, including the launch of a new ambulatory center and clinic, complete with 40 exam rooms and an ambulatory surgical wing. Other health systems, like Tenet, are rapidly buying surgery centers, given the high margins for such procedures. The transition can be perilous, as inpatient hospital processes do not necessarily translate seamlessly to ambulatory care models and surgery centers; this requires re-examination of best practices in the new setting.

THE FUTURE EVOLUTION OF HEALTH SYSTEM PORTFOLIOS

Moving forward, ambulatory clinics and facilities will continue to increase as a percentage of U.S. health system portfolio assets. This offers opportunity for health systems and real estate investors.

Stand-alone rural or nonprofit hospitals – particularly those with higher portions of Medicaid patients – must analyze their portfolios of services sooner rather than later. Additional pressures to transform are arising from newly issued 1115 Medicaid waivers designed to reduce avoidable hospitalizations and unnecessary ER visits by double-digit percentages. Analytics should inform local communities' health needs to eliminate

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THE RISE OF OUTPATIENT AND AMBULATORY CARE

duplicative services and help articulate the future-state model of care. The right portfolio mix of services and asset strategies, including real estate, optimizes the value of these high-cost and high-value assets. Hospitals may [consider partnering](#) with healthcare REITs or other private capital sources.

In addition, hospitals must consider how strategic M&A activity and appropriate clinical alignment with larger systems will enhance their portfolios. The right M&A strategies will provide such hospitals access to the partners and capital they need to build their own ambulatory capabilities.

In summary, value will be created many ways in the transformational period of healthcare reform. Understanding the implications of synthesizing and aligning capital with the movement to outcomes-based reimbursement and delivery models, and with total cost of care, can create tremendous value for patients, investors, lenders and regulators.

This article first appeared on the BDO Knows Healthcare blog and may be viewed [here](#).



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PErspective in REAL ESTATE



Real estate private equity funds are having a prosperous 2015, with purchasing power and capital distributions at record highs.

At the midyear point of 2015, private equity real estate funds had amassed [\\$254 billion in dry powder](#), a 37 percent increase over the end of 2014. In addition, Preqin reported that real estate-focused funds have steadily increased their distributions since 2009, returning a record \$187 billion to investors in 2014 alone. With opportunities proliferating for both profitable exits and reinvestment, PE real estate funds are well-positioned to close out the fund cycle they began between 2006 and 2008 – before the Great Recession – and begin anew.

High property valuations appear to be the primary driver of recent real estate exit activity. *The Wall Street Journal* reports that commercial real estate prices [have reached some of their highest points](#) since the market collapsed in 2008, thanks to continued low interest rates and rising demand from buyers for high-performing assets. According to Real Capital, New York City's average commercial real estate capitalization has reached 5.7 percent, more than double the yield on a 10-year Treasury bond.

For PE firms evaluating real estate investment options for their current fund cycles, the retail sector may offer promising opportunities. As consumer demand increasingly moves toward omnichannel shopping experiences, many retailers are seeking to shrink their square footage and cash in on their real estate assets. According to *McClatchy News*, Sycamore Partners'

[\\$3 billion Belk buyout](#) may provide the firm the opportunity to quickly recoup part of its investment through a sale-leaseback arrangement – in which Belk would sell its real estate assets and then lease them back from the buyer. Other retailers, such as Macy's, are [exploring options](#) for spinning their real estate assets into other investment vehicles, including REITs and potentially private real estate funds (see our own Stuart Eisenberg's [recent column](#) in *Commercial Property Executive* for more information on these spinoff deals).

However, while opportunities abound, real estate fund managers face increasing regulatory scrutiny, with the SEC's Private Funds Unit undertaking a thematic review of the real estate fund industry in 2014. In a [May 2015 speech](#), Marc Wyatt, acting director of the SEC's Office of Compliance Inspections and Examinations, pointed to potential changes ahead: Fund managers who offer ancillary services, such as property management, construction management or leasing services, may be expected to justify their fees.

The trend of surging real estate exits – and subsequent reinvestment in new real estate funds and opportunities – could very well continue through the end of 2015. Amid recent stock market turmoil and global economic uncertainty, the Fed seems [disinclined to raise interest rates](#), making the higher returns of real estate private equity funds more attractive than ever. PE funds that can effectively navigate both the changing regulatory environment and the volatile economy may be poised to cash in again in five to seven years' time.

PErspective in Real Estate is a recurring feature exploring the role of private equity in the real estate industry.

WANT TO RAZE YOUR TAXES?

By Mark Carlie



In 2012, construction firms in the U.S. saved more than \$25 million in federal income taxes, saving on average \$100,000+ per firm, according to the IRS.

HOW DID THEY DO IT?

First, as part of their business, they attempted to develop or improve the functionality, performance, reliability or quality of items such as:

- Energy efficiency
- LEED certification
- Structural systems
- Mechanical systems
- Water systems
- Process design
- Flashing details
- Pilot plants
- Construction techniques
- Construction equipment
- Low-carbon technologies
- Plant performance or capacity
- Building materials, their combinations and uses

- Electrical and lighting systems
- Integration and constructability of building components
- Reclamation and remediation techniques
- Structural boring techniques
- Temporary structures used in construction processes
- Environmentally sustainable solutions
- Sanitary systems, including waste and wastewater treatment and disposal

Second, they identified and reported on their tax returns' "research tax credits" for these efforts.

Equal to up to 15 percent of qualified spending, these credits are available for wage and subcontractor expenses, as well as for some non-depreciable supply or material expenses, paid or incurred during all phases of a construction project, including:

- The preliminary bid-and-proposal stage, when design and technical specifications are being developed;
- Actual construction itself; and
- Plant commissioning or startup, when designs are being tested for performance.

To qualify, your firm must both:

- Retain rights to the attempted development or improvement, e.g., the improved construction technique can be used for other clients; and
- Be at economic risk for its development, i.e., if your efforts to develop or improve the technique failed, you would not be legally entitled to reimbursement from an unrelated third party for those efforts. For more information, click [here](#).

If you are entitled to reimbursement of your costs by your client, then your client might be entitled to the research credit. Informing them that your activities may help them qualify for the credit could benefit both of your bottom lines.

This first appeared on the AGC Missouri blog.



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MARK YOUR CALENDARS

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

OCTOBER

Oct. 20-21

iGlobal Forum Global Real Estate Private Equity Summit

New York Marriott East Side
New York

Oct. 20-24

REM Fall Leadership Conference

Grand America Hotel
Salt Lake City

Oct. 27-28

CCIM Thrive Conference

Hyatt Regency
Austin

NOVEMBER

Nov. 4-6

ACG/CFMA Construction Financial Management Conference

Caesars Palace
Las Vegas

Nov. 11-13

NCREIF Fall Conference*

Swan and Dolphin Hotel
Orlando

Nov. 12

BDO Construction Seminar*

DoubleTree by Hilton Pittsburgh
Pittsburgh

Nov. 17

REIT World: NAREIT's Annual Convention for All Things REIT®

Wynn Las Vegas
Las Vegas

DECEMBER

Dec. 2-3

RealShare Healthcare Real Estate 2015

Kierland Resort & Spa
Scottsdale

Dec. 3-5

AICPA Construction & Real Estate Conference*

ARIA Resort & Casino
Las Vegas

Dec. 7-8

2015 National New York Deal Making

Jacob K. Javits Convention Center
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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