Hogan Lovells

Deal Dynamics
Insights on cross-border M&A

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Asian interest in international assets propels real estate M&A to its highest value quarter in 2018

- Quarterly cross-border M&A activity in the real estate sector hit US$18.4bn in Q3 2018
- This was an increase of 118% over the average quarterly deal value since 2010
- Deal volume slipped from 26 deals in Q3 2017 to 18 deals this quarter – a year-on-year fall of 31%

Cross-border M&A deal activity in the real estate sector peaked in Q3, achieving its highest quarterly deal value of 2018 at US$18.4bn – a 118% increase over the average quarterly deal value since 2010. Meanwhile, a slight decrease in deal volume, from 24 deals to 18 deals, highlights a shift in activity towards the top end of the market.

Asian appetite for deals grows

Strong Asian interest in international property assets has continued to be a key driver of deal flow, with Asian investors conducting three of the six largest cross-border deals of the quarter. Since 2015, Asian capital markets have matured rapidly. In China, South Korea and Japan, restrictions on insurers, pension funds, and sovereign wealth funds have loosened and it has been easier for institutions in these countries to invest in real estate abroad.

Notable Q3 transactions include Malaysia’s Hong Leong Company acquiring Hong Kong real estate investor Guoco Group in a US$1.6bn deal; a US$438m take private of Singapore-listed Wheelock Properties by its Hong Kong parent Wheelock & Company Limited; and ESR Cayman, the real estate investment vehicle of Asian logistics group ESR, acquiring a stake in Commercial and Industrial Property in Australia for US$39m.

This activity builds on a strong Q2 for Asian real estate dealmakers, when Hong Kong's CK Asset Holdings acquired 5 Broadgate, a prime London office, from British Land for US$1.35bn and Singapore's Ho Bee Land paid US$884m for Ropemaker Place, a similar high-profile site.

Chinese buyers flock to western markets

In addition, due to a relaxation of restrictions for Chinese investors holding offshore capital, Western real estate markets in the US and Europe have become attractive destinations, with many investors looking to hedge against economic volatility at home.

An escalating trade war with the US and a fall in economic growth to its weakest level in two years has seen dealmakers in China flock to real estate in the West, which is viewed as a safe haven.

They have been investing heavily in London property, despite the uncertainties of Brexit. Chinese buyers have been attracted by sterling's softening against yuan, which has brought down pricing, and have taken the long-term view that London will remain a key international finance hub post-Brexit.

Another trend that has pushed the real estate M&A needle is Chinese companies being forced to sell assets by the Chinese government – these include the announcement in July that conglomerate HNA has hired advisors to help sell its 29.5% stake in Spanish hotel group NA Hotels.

On the other hand, corporate outbound investment in real estate using *onshore capital* is almost at a standstill, as this is still subject to approval by the Chinese government. Since it was put on the 'restricted'/'sensitive' list, China has basically stopped approving such outbound investment projects.

Chinese individuals, meanwhile, have been trying to find ways around the currency controls when buying property outside China, largely in perceived safe havens and lifestyle-driven jurisdictions to safeguard their wealth against the background of a more challenged domestic economic environment.

However, there is still no official route that allows Chinese individuals to make purchases of real estate overseas, and China appears to be taking a tougher line on individual purchases of property involving capital outflows, with the window for Chinese individuals to shift assets overseas closing fast. The State Administration of Foreign Exchange, the Chinese regulator in charge of enforcing foreign exchange controls, has dramatically stepped up its policing of such cases.

Recently it started naming and shaming the individuals involved in overseas purchases (using a variety of 'workaround strategies', like using underground banks, aggregating the US$50,000 individual conversion quotas and the like), sending out a clear message not to challenge China's capital controls.

United States and Europe look to sell

Meanwhile, property groups in the US and Europe have been willing sellers of holdings in office, hotel, and retail properties. With interest rates on an upward curve in the US and the UK, and the European Union winding down its quantitative easing programme, many western property investors have taken the view that we are now late in the property cycle and that it is a good time to sell, as rising interest rates change the risk-reward dynamic in real estate.

The deep pool of Asian buyers, who are broadening their real estate strategies beyond the United States, where their hedging costs are high, have provided a key source of liquidity in the market and are expected to be active players in Europe, as well as branching out into adjacent markets in Asia-Pacific and Australia.

Fund frenzy

In addition to strong activity emanating out of Asia, cross-border real estate M&A has also been lifted by cash-rich private fund real estate investors. According to research firm Preqin, private equity real estate managers now have at least US$266bn of dry powder available for investment – a record high.

Mega-funds such as Blackstone and Starwood Capital have secured the bulk of the proceeds – raising close to US$15bn between them this year – and as they have a global focus they will seek to diversify their investments across jurisdictions.

In Q3, Starwood Capital announced a US$882m investment in one of Austria's largest real estate groups, CA Immobilien. This is the latest example of a fund leading a cross-border real estate deal. It follows similar international transactions secured earlier this year, such as Blackstone's acquisitions of Investa Office Fund in Australia and Indiabulls Properties in India, and Apollo's move for Fair Value REIT in Germany.

Fund and strategic real estate dealmakers have also been scanning global stock markets for bargain deals, as many real estate investment trusts have been trading at discounts to net asset value. This provides investors with opportunities to offer shareholders attractive premiums to stock prices but still secure a valuation at fair value or below.

In the previously mentioned Wheelock deal, for example, the offer from Wheelock's Hong Kong parent priced shares in the Singapore-listed property company at their highest level since 2010 and a 20.7% premium to the price before the bid was announced. Toronto-based asset manager Brookfield's US$9.5bn move for US real estate company Forest City Realty, the largest cross-border real estate deal in Q3, offered shareholders a similar upside, valuing the property group at a 26% premium to its valuation before the parties entered talks.

Positive outlook

Although there is a growing consensus that the real estate cycle may be peaking, the outlook for cross-border real estate remains robust. Asia's increased appetite for deals means that there is a larger group of investors on the hunt for real estate targets than ever. Even if activity from US and European dealmakers cools, Asian appetite is expected to maintain at current levels, with a CBRE survey of cross-border real estate investors showing that 92% of respondents plan to increase their investment activity in Asia-Pacific over the course of 2018.

Demographic trends are also expected to sustain high levels of overseas deals, with JLL forecasting that global cross-border real estate M&A could break the US$1tn threshold by as early as 2020. An ageing population will be the main driver of this uplift, with international investors investing increasing amounts in real estate, which offers diversification – a hedge against inflation and income – in order to meet the investment requirements of retirees.

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