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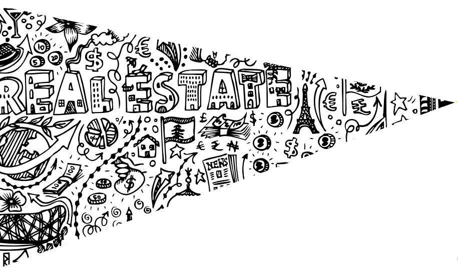
Real Estate,
Hospitality and
Construction

# Global Capital Confidence Barometer




## Sustainable growth

Opportunities arise for deal making as confidence improves

Global economic confidence continues to improve as credit availability expands, industry fundamentals strengthen and companies focus on growth.

There's no question that stubbornly high global unemployment, the ongoing crisis in Europe, decelerating growth in key emerging markets and fiscal challenges in the US are causing global real estate owners, investors and corporate occupiers to step back and re-evaluate. However, there are many positive developments worth highlighting as some real estate sectors start to show visible signs of improvement.

Global real estate transaction volume totaled US$214b in Q1 2013, up 23% from last year. The increase was across all property types. Across the global regions, EMEA results were the weakest, while transaction volumes in Asia were up 31% from last year. Impressively, China and the US accounted for approximately 63% of the total transaction volume.[1] As our survey points out, companies are looking to invest and their appetite for making acquisitions is increasing. Also, it shows that the gap between the price a buyer and seller are willing to transact is decreasing and that 71% of RHC respondents expect global M&A volume to improve in the next 12 months.

US housing markets continue to recover, with privately owned housing starts hitting a seasonally adjusted annual rate of 853,000 in April 2013, or 13.1% ahead of last year. Inventories of US new and existing homes remain historically low and that's helping to push up prices.[2] Additionally, the hospitality industry continues to improve with year-over-year (2012 vs. 2011) revenue per available room (RevPAR) increasing by 6.3%, 5.6% and 1.4% in the Americas, Middle East and Asia, respectively,[3] and between January and April 2013, RevPAR increased by 7.6% in the Middle East and 6.2% in the Americas, vs. the same period last year.[4] Apartments have been one of the best-performing property types. Although headwinds are building, apartments continue to be a favorite among global investors. In addition, industrial markets around the world are strengthening as global trade continues to be an important driver of logistics demand.

The bottom line — there are attractive opportunities, particularly for first-movers. It's important, however, to conduct thorough due diligence and select the right partner who understands the local market and regulatory environment. Now is the time to position your company for sustainable growth.

**Howard Roth,** *Global Real Estate Leader*

### Key findings

- 48% of respondents think the global economy is improving, up from 24% six months ago.
- 58% of companies are focusing on growth, up from 27% in October 2012.
- 51% view credit availability as improving.
- Developing nations top the list of countries where respondents plan to invest, with India and China leading the way.
- 71% expect global M&A volumes to improve, but only 34% expect to execute deals in the next 12 months.

### About this survey

The *Global Capital Confidence Barometer* is a periodic survey of senior executives from large companies around the world, conducted by the Economist Intelligence Unit (EIU). Our panel consists of select EY clients and contacts, and regular EIU contributors. This snapshot of our findings gauges corporate confidence in the economic outlook, and it identifies boardroom trends and practices in the way companies manage their capital agenda. The survey was conducted in April 2013.

EY's Real Estate, Hospitality and Construction practice performed an analysis of these survey results, specifically focusing on the 117 respondents from real estate, hospitality and construction companies.

### The Capital Agenda

Based around four dimensions, the Capital Agenda helps companies consider their issues and challenges, understand their options and make more informed capital decisions.

1. **Preserving capital:** reshaping the operational and capital base
2. **Optimizing capital:** driving cash and working capital and managing the portfolio of assets
3. **Raising capital:** assessing future capital requirements and evaluating funding sources
4. **Investing capital:** strengthening investment appraisal and transaction execution

1. Real Capital Analytics
2. "Housing Starts decline sharply in April to 853,000 SAAR," Calculated Risk, 16 May 2013
3. Smith Travel Research, December 2012
4. Smith Travel Research, April 2013

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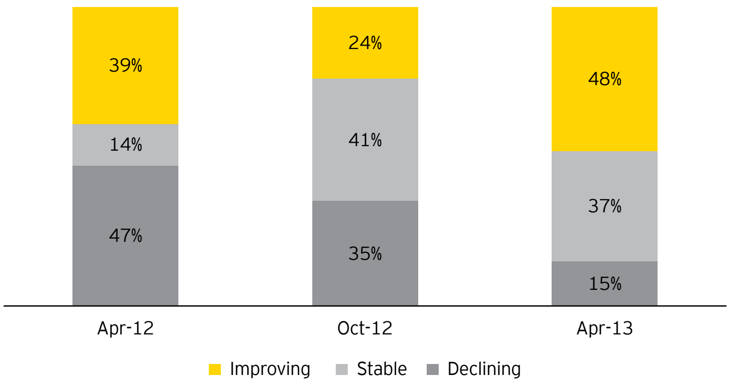
Building a better working world

# Economic outlook

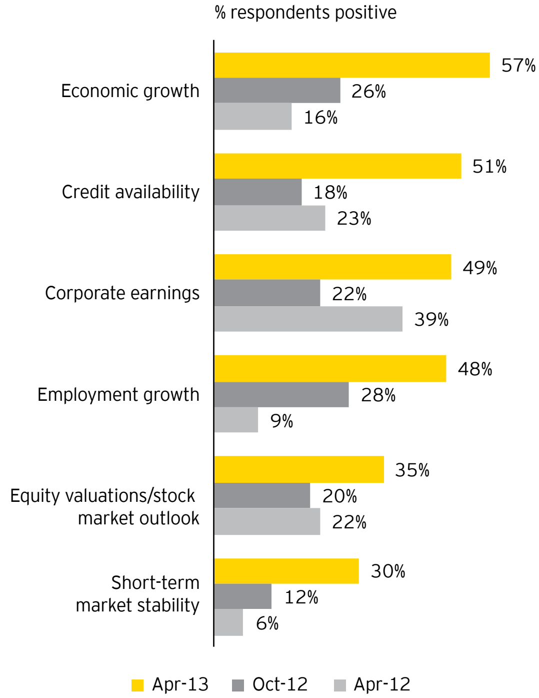
## Optimism in the global economy has increased

Global economic confidence has significantly rebounded, as indicated by 85% of RHC respondents saying that the economy is either improving or stable, compared with 53% a year ago. This confidence is attributable to positive sentiments surrounding economic growth, credit availability, employment growth and short-term market stability. Nonetheless, industry participants will likely continue to monitor a number of global economic factors that may limit momentum, such as waning emerging market growth; dampening economic indicators in key eurozone countries, particularly Germany; the prolonged eurozone crisis, including the Cyprus bailout; and uncertainty regarding the long-term impact of the United States sequester. Will global optimism gain momentum, or will psychology start to shift back toward the economic problems we face, as it did in the second halves of 2011 and 2012.

**What is your perspective on the state of the global economy today?**




**What is your level of confidence in?**

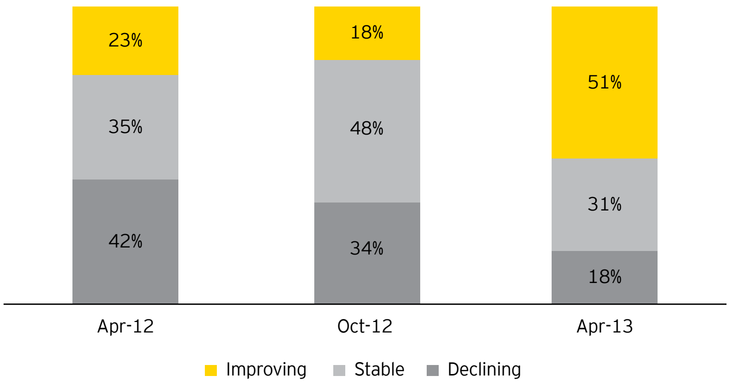



# Credit availability

## Credit increasingly available

In addition to their improved outlook on the economy, RHC respondents are more confident than ever about their ability to access the global credit markets. When asked about credit availability at the global level, 51% of the respondents see improvements and only 18% reported a decline, both strong improvements from April 2012.

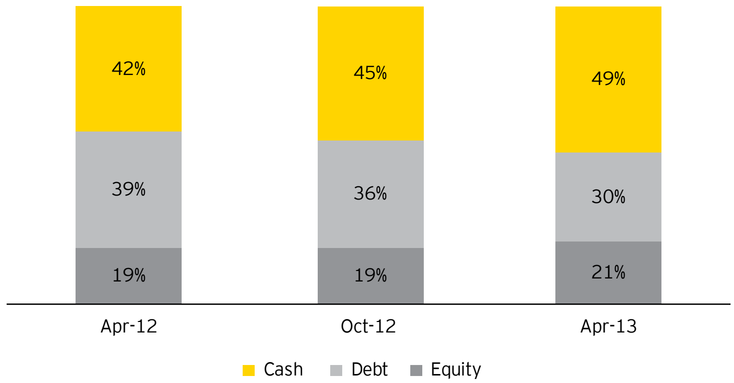
**Please indicate your level of confidence in credit availability at the global level.**

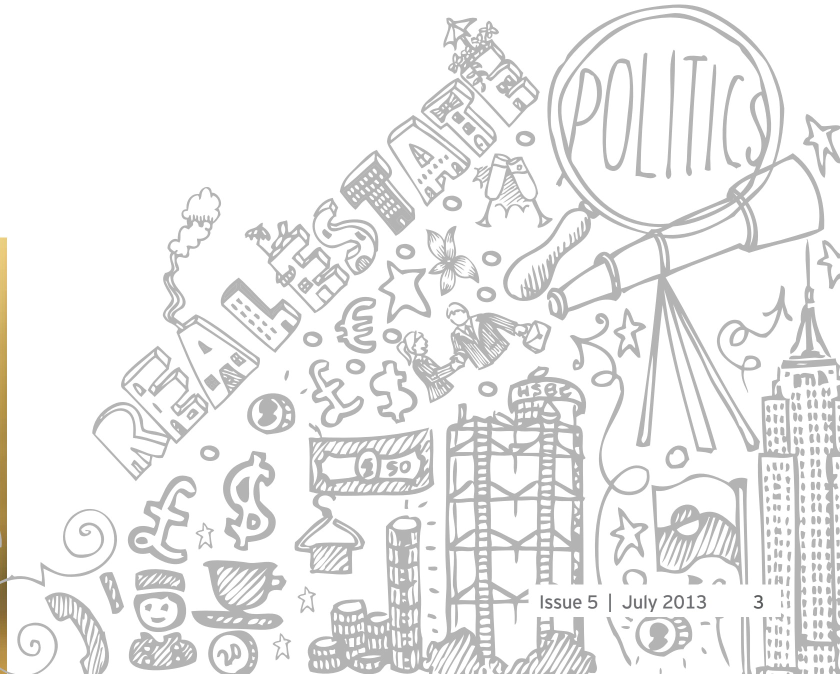



## Cash dominates near-term deal financing

Forty-nine percent of the RHC respondents point to cash as their primary source of deal financing over the next 12 months. Only 30% indicated that they plan to use debt as their primary source of deal financing, despite many reporting improved credit availability. The predominant use of cash to finance deals may be indicative of companies' ongoing cautionary mindset, and evidence of their need to deploy cash, which is currently earning a low return.

**What is the likely primary source of your company's deal financing in the next 12 months?**



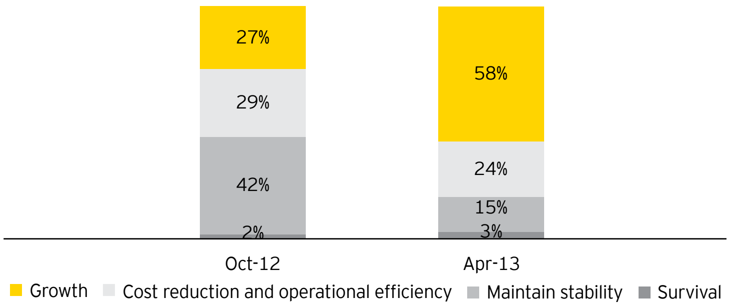



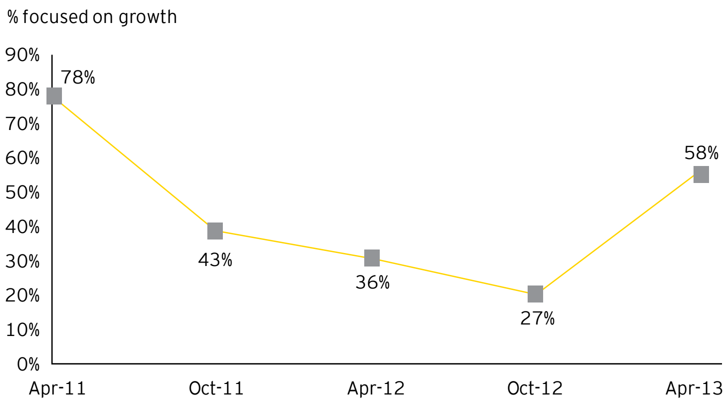
# Growth

## Focus shifts from the basics toward growth

Many companies that had previously focused their efforts on the basics — maintaining stability, and operational efficiency and cost-reduction initiatives — are now shifting gears by increasing their presence in new and existing markets. When asked about their companies' focus over the next 12 months, 58% of RHC respondents cited growth, a major rebound from 27% in October 2012. However, even amid this heightened optimism, 24% of respondents still remain focused on cost reduction and operational efficiency.

**Which best describes your organization's focus over the next 12 months?**




# Viewpoint

**Investors in search of yield look to REITs**

Companies have been largely focused on lower-risk, lower-yielding growth strategies and more cautious approaches than one would expect, given increased confidence and better credit availability. Additionally, because interest rates have been low for an extended period of time, global investors are in search of higher yields, stronger valuations and inflation protection for income stocks. One result of this is that a number of companies have recently announced that they are exploring converting to real estate investment trusts (REITs).

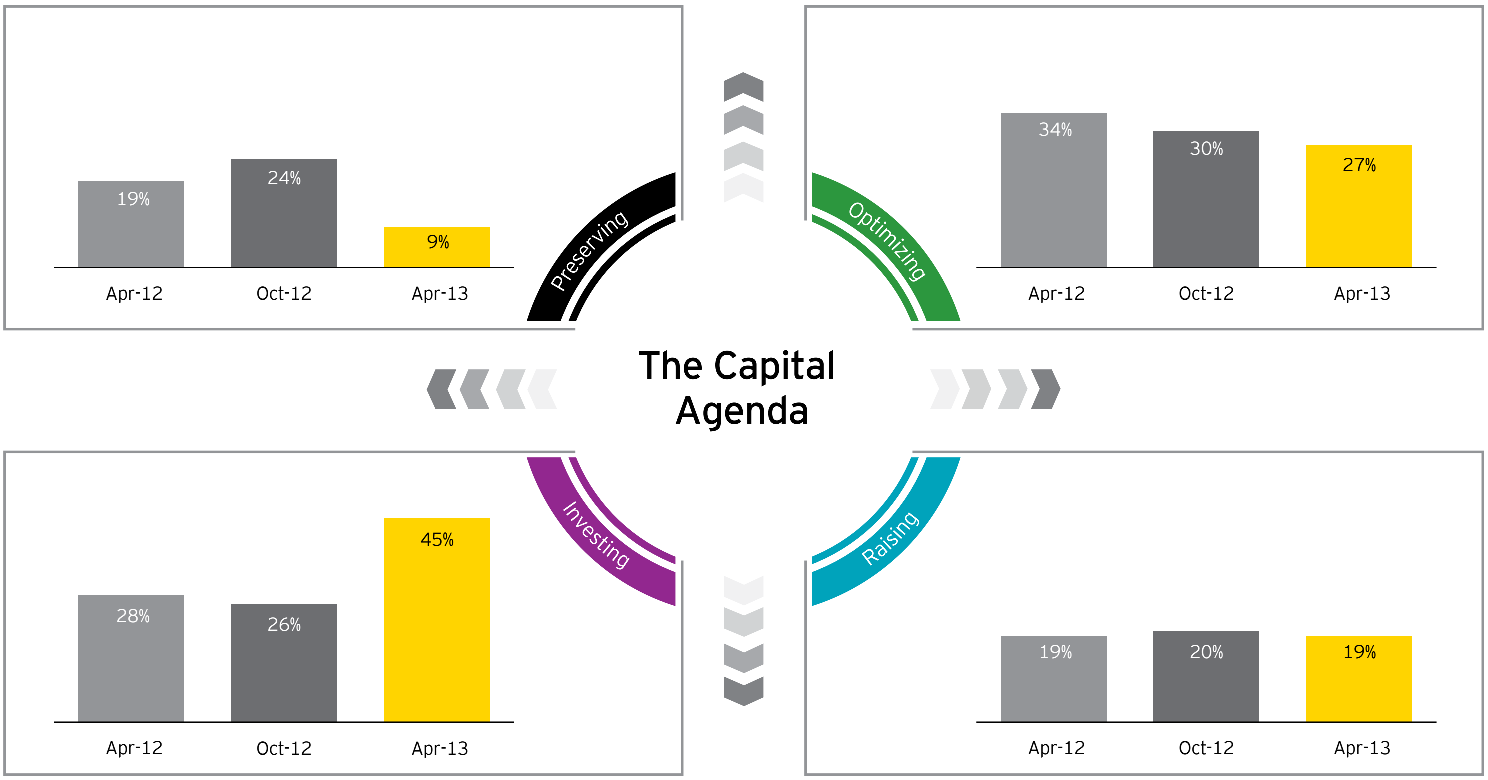
REITs, which invest in mortgages and properties from shopping malls to office buildings, are hedges against inflation because property owners can raise rents when the economy heats up. Moreover, since REITs are required to distribute 90% of their income as dividends to shareholders, they are attractive to income-oriented investors seeking capital appreciation. In 2012, equity REITs yielded 3.5% on average,[5] and since the worst of the financial crisis in early 2009, REITs returned more than 220%.[6]

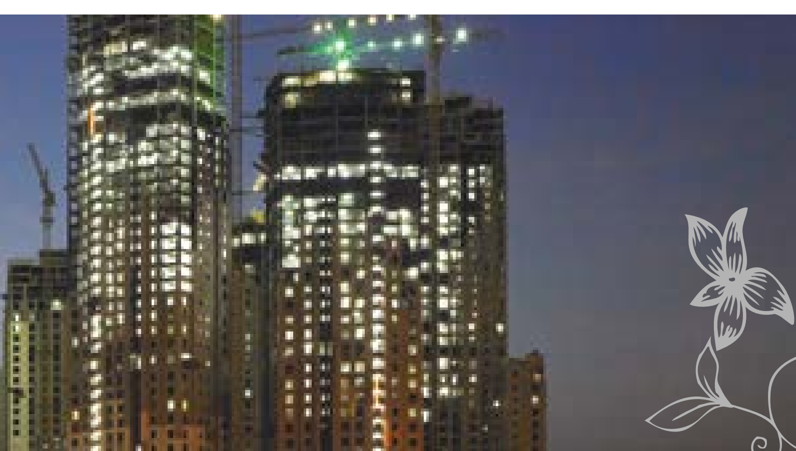
5. John Wasik, "Your Finance: REIT hedge against inflation, Reuters, 26 April 2013.
6. Brad Thomas, "REITs Boom As More Industries Discover This Tax-Friendly Structure," *Forbes*, December 2012.

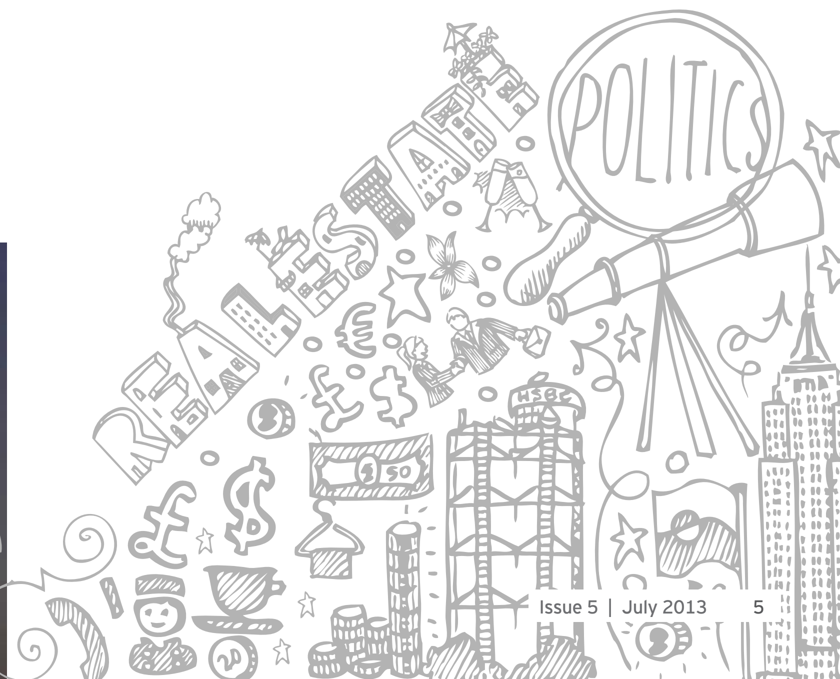
## Investing dominates the Capital Agenda

Companies expect their Capital Agenda priorities to continue to move toward investing over the next 12 months. Forty-five percent of the RHC respondents indicated that their focus has shifted toward investing, as compared with 28% in April 2012, while preserving and optimizing have declined over the same period, and raising has remained the same.

**Investing dominates the Capital Agenda over the next 12 months**



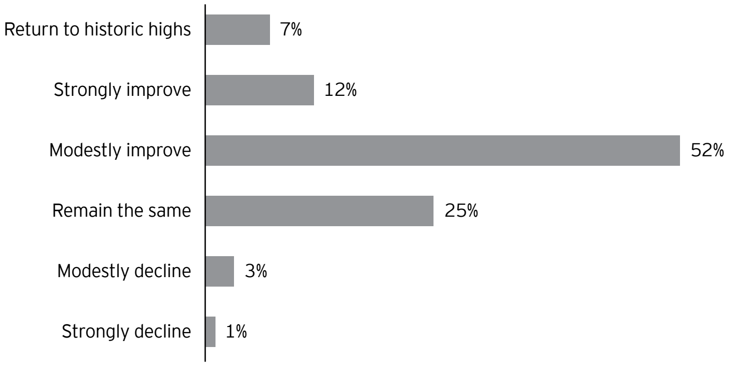


# M&A activity

## Appetite for acquisitions increases and valuation gap decreases

Due to strong fundamentals and growing confidence in the global economy, the appetite for acquisitions has increased. Seventy-one percent of RHC respondents expect improvement in global M&A and deal volumes over the next 12 months.

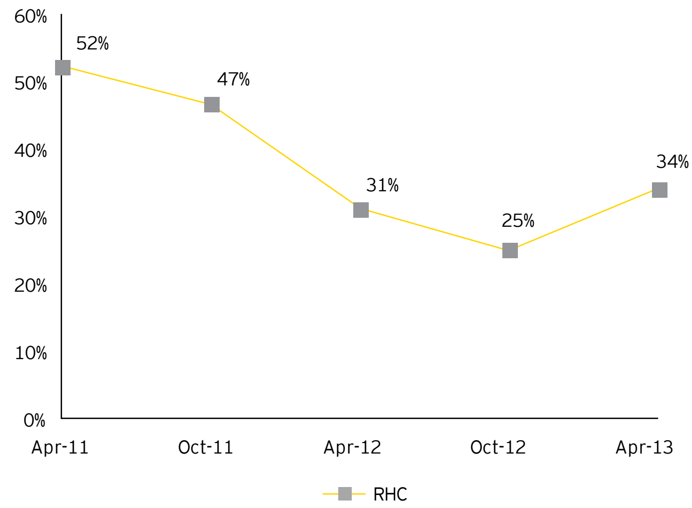
**What is your expectation for global M&A and deal volumes in the next 12 months?**



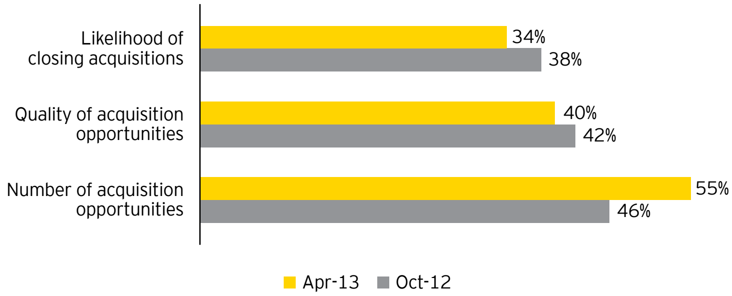

Thirty-four percent of RHC respondents expect their company will pursue an acquisition in the next 12 months, an improvement from 25% in October 2012. The improvement in acquisition plans is partially driven by an increasing number of opportunities (55%) vs. 46% in October 2012.

**What are your expectations to pursue an acquisition in the next 12 months?**

Expectations to pursue an acquisition

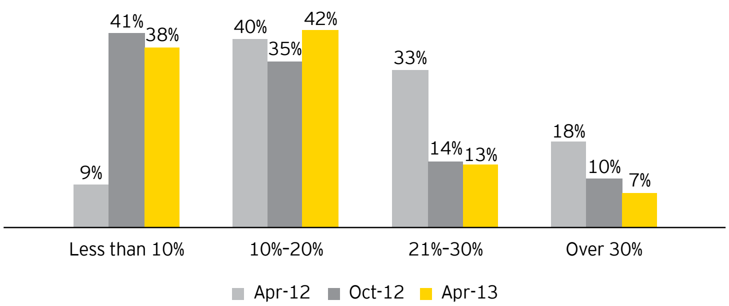



**What is your level of confidence in deals at the global level in the next 12 months?**

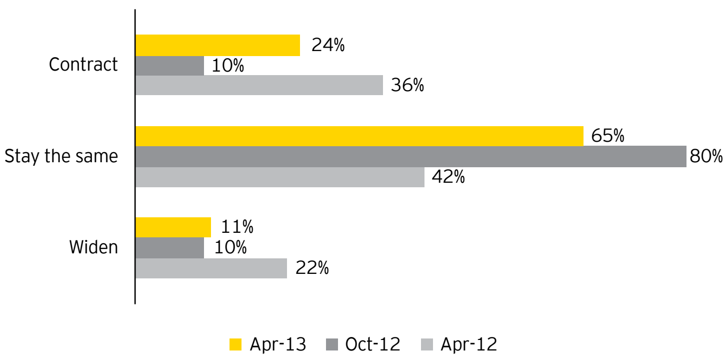



Additionally, RHC respondents surveyed indicate that the valuation gap has narrowed, with 80% of respondents stating that the gap is 20% or less, as opposed to only 49% saying this in April 2012. Further, 24% of respondents said that the valuation gap will contract over the next 12 months, compared with only 10% in October 2012.

**What is the current valuation gap between buyers and sellers?**



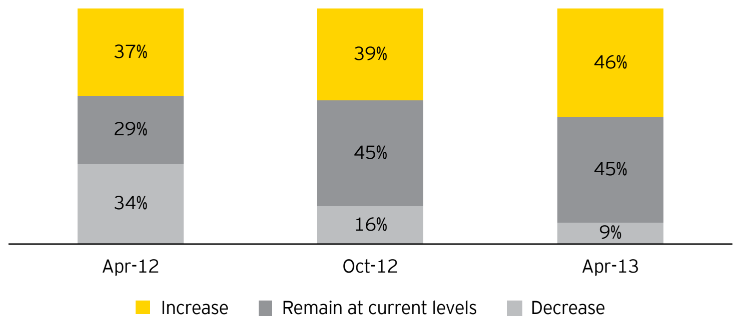

**Do you expect the valuation gap between buyers and sellers in the next 12 months to:**

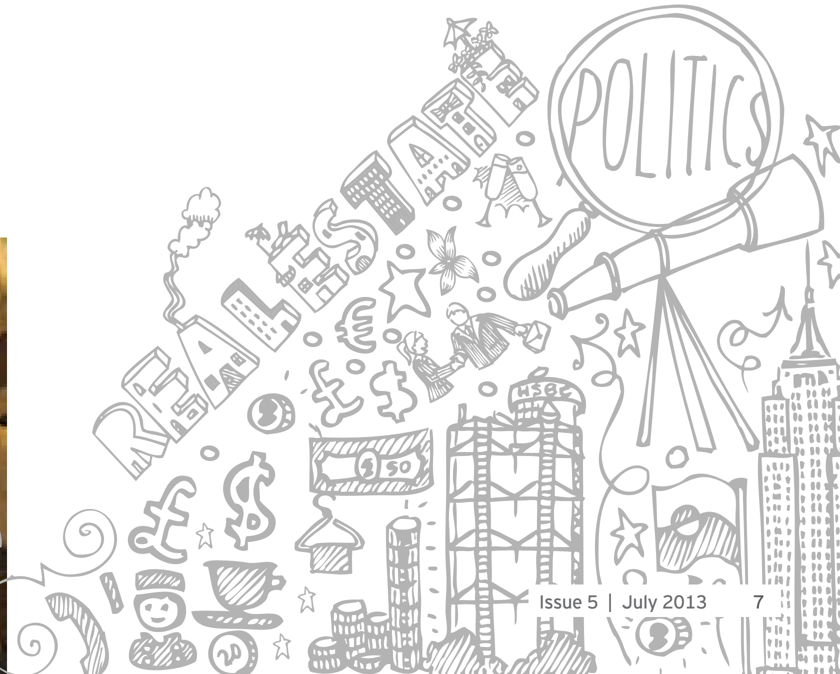



## Valuations increasing

Expectations for higher valuations are now at their highest level in the history of our *Global Capital Confidence Barometer*: 46% of RHC respondents expect prices/valuations to rise in the next year, up from 37% in April 2012. Only 9% expect valuations to decline, compared with 34% one year ago, indicating that the market has stabilized.

**What do you expect the price/valuation of M&A assets to do over the next 12 months?**



# Viewpoint

**A possible inflection point in asset valuations**

A contributing cause to the ongoing slowdown in deal making is a valuation gap between buyers and sellers. Sellers have been seeking high valuations, while potential buyers wanted discounts, and were reluctant to pay a premium.

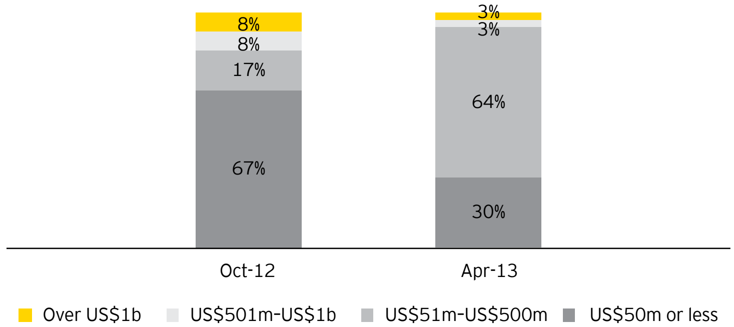
However, we may now be nearing equilibrium between what buyers will pay and what sellers will accept. This equilibrium should help spur additional transaction activity. The pendulum is primed to swing the other way — toward stronger valuations from buyers and more profitability for sellers. As market fundamentals improve and corporate financial conditions strengthen, the foundation for deal-making should become more stable.

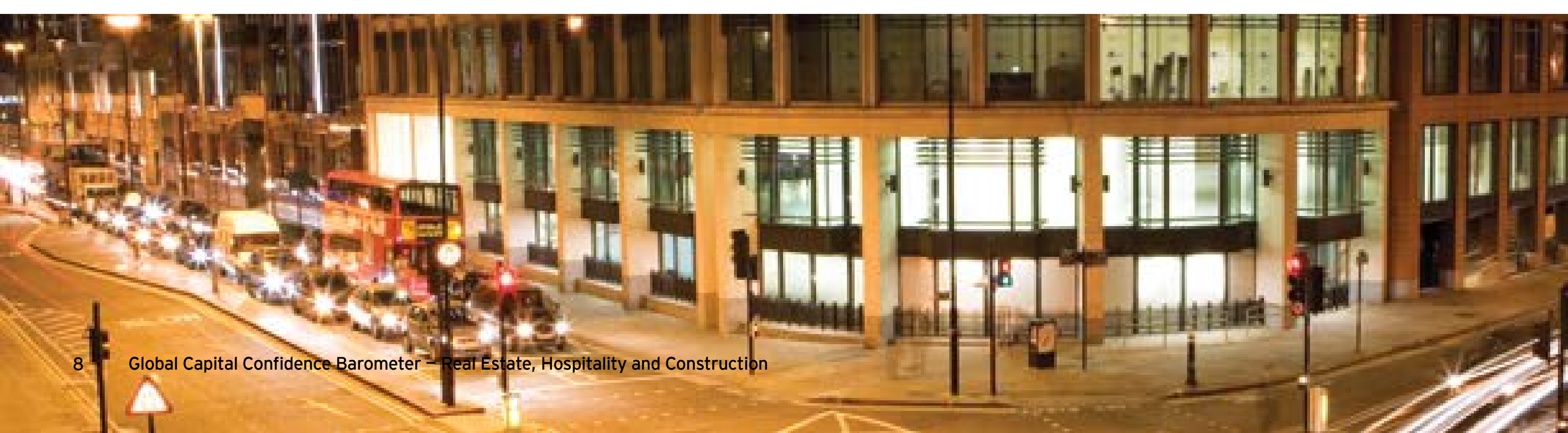
With 46% of the RHC respondents expecting M&A asset values to rise over the next 12 months (and only 9% expecting a decrease), companies should consider taking advantage of this opportunity.

## Smaller deals are expected to dominate

A majority of the RHC respondents (64%) indicate that the most common deal size in the next 12 months will range from US$51m to US$500m. This is consistent with what we saw earlier this year. For example, from January to April 2013, all single-asset transactions within the hotel sector were under US$500m, with an average sale price of US$60m. Furthermore, during the same time period, 97% of all single assets that transacted within the commercial real estate sector were under US$500m, with an average sale price of US$136m.

**What is the expected deal size in the next 12 months?**

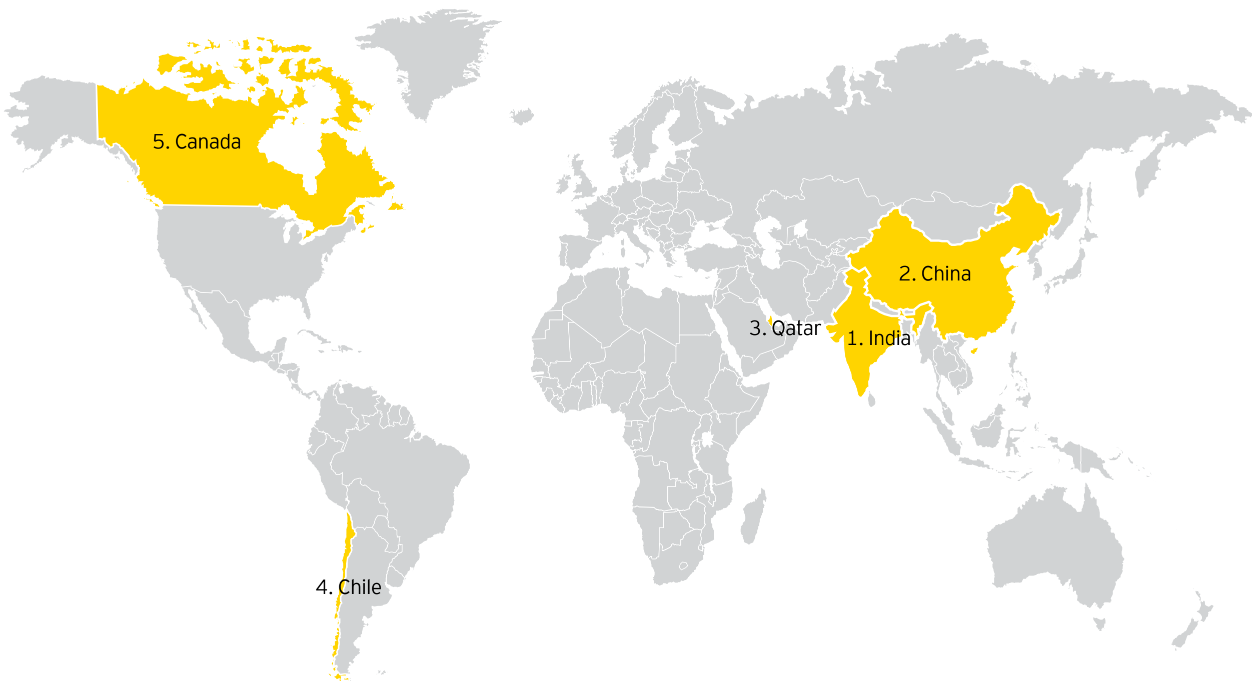


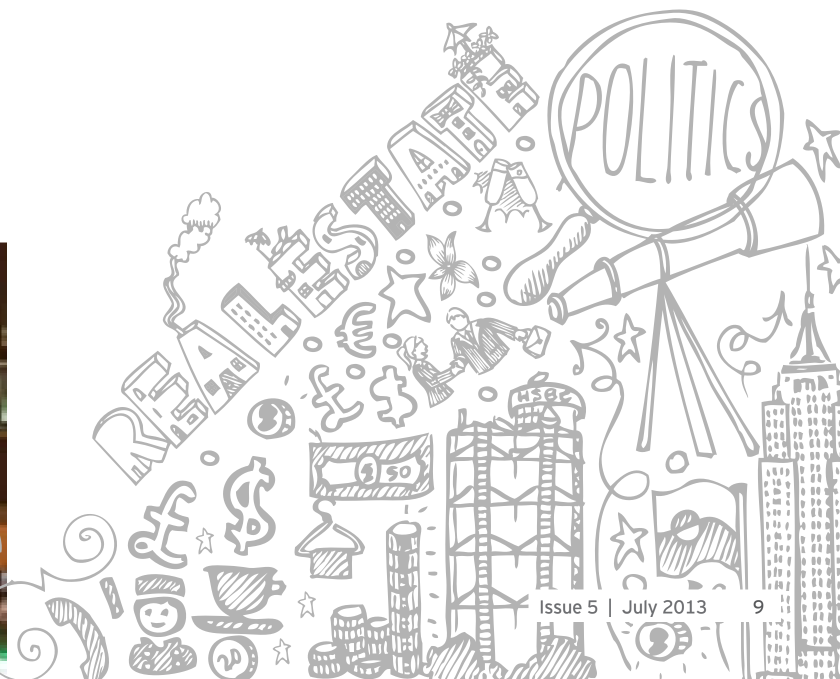



## India and China top the list of countries poised for investment

Investment destinations continue to evolve as companies challenge their growth strategies and underlying risk tolerance. The top five countries where RHC respondents stated they are planning to invest outside of their local market are India, China, Qatar, Chile and Canada. Except for Canada, this indicates a preference among RHC respondents to invest in emerging markets. Additionally, European countries were notably absent from the top 15 countries, with only Germany (ranked 15th) present in that list.

**Which are the top five countries (outside your local market) in which your company is most likely to invest?**

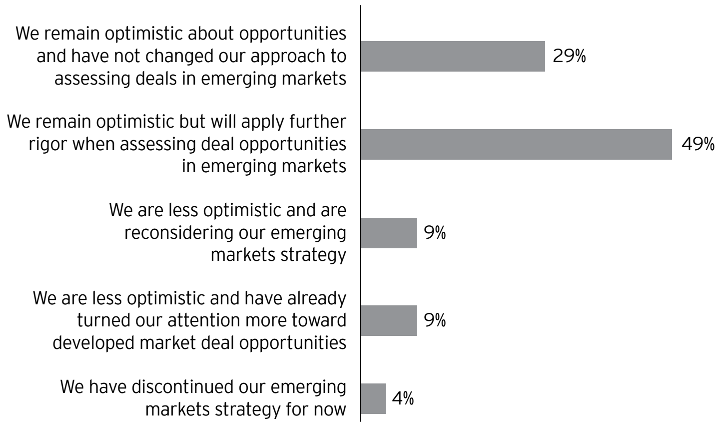


## Emerging markets strategy

RHC companies remain optimistic about deals in emerging markets, but are exercising more caution when investing there. Seventy-eight percent of RHC respondents have remained optimistic and have not changed their approach, or have remained optimistic but will apply further rigor when assessing deals in emerging markets.

**Which statement best describes your approach to M&A in those emerging markets which are experiencing slowing growth?**

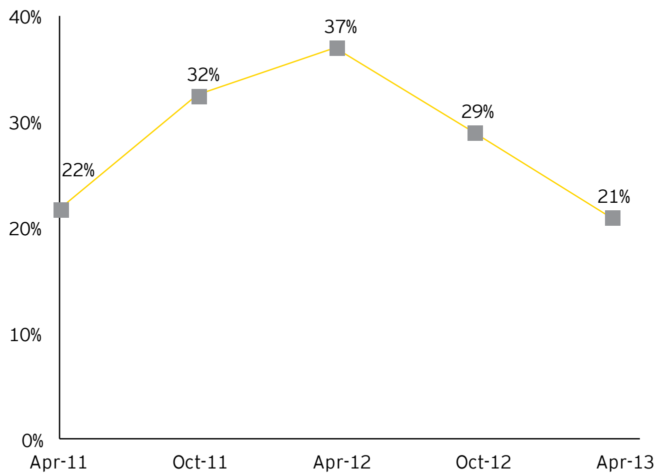



## Divest for value

Currently, few companies are planning a divestment. Only 21% of RHC respondents believe that their companies are likely to undertake divestments in the next 12 months, the lowest number in the last two years.

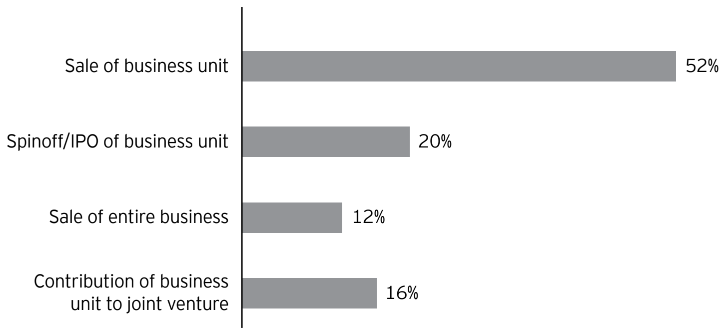
**Is your company likely to make an asset sale/divestment in the next 12 months?**

Expectations to pursue an asset sale




In total, 88% of the RHC respondents planning to divest indicated that those divestments will involve the carve-out of one or more business units, including a sale of a business unit, a spinoff/IPO of a business unit or a contribution of a business unit to a joint venture.

**What form do you expect your divestments to take?**




# Viewpoint

**Future growth**

There are a lot of positive things happening with respect to real estate. Global investor confidence is on the rise, credit markets are starting to open up and companies are shifting their focus toward growth and making investments. Although growth in emerging markets has slowed, companies remain optimistic about investing in these geographies. And as the pricing gap between buyers and sellers narrows, and valuations start to rise, that should form the foundation for more transaction activity.

Organizations in search of growth may need to take informed risks to achieve their strategic objectives and to outpace competitors. First-mover advantage is a constant, even in today's markets.

Leading companies are laying the groundwork for taking action when the time is right. This means honing their Capital Agenda, fine-tuning the capital structure, defining core businesses, executing divestments when necessary and putting in place proper risk management and governance. Most important, it means answering the questions, "Where do I want to grow?" and "What will it take?"

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