

M&A Academy

How can real estate become a
financing means for your company
today?

25 March 2010

Agenda

Section 1: Debt markets today

Section 2: Unlocking value / return from real estate

Section 3: Real estate markets today

Section 4: Tax consequences of unlocking value from real estate

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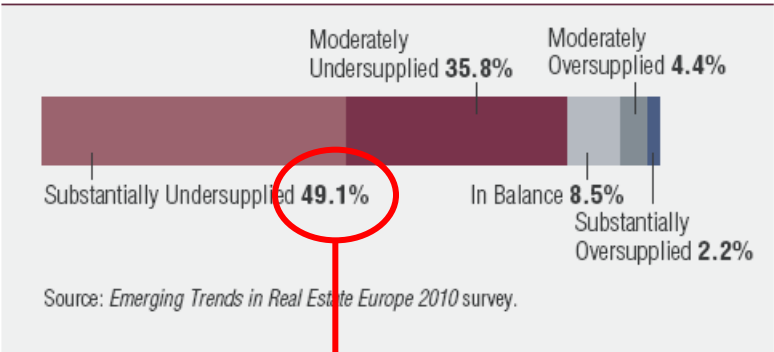
Debt vs. Equity in 2010

“There is a great deal of money out there that is feeling much more confident and looking for a home”. That may be true for equity, but for debt it is a different story. “Debt will be rationed for a long time and the price will be high”.

EXHIBIT 2-1
Real Estate Equity Capital Market Balance Prospects for 2010

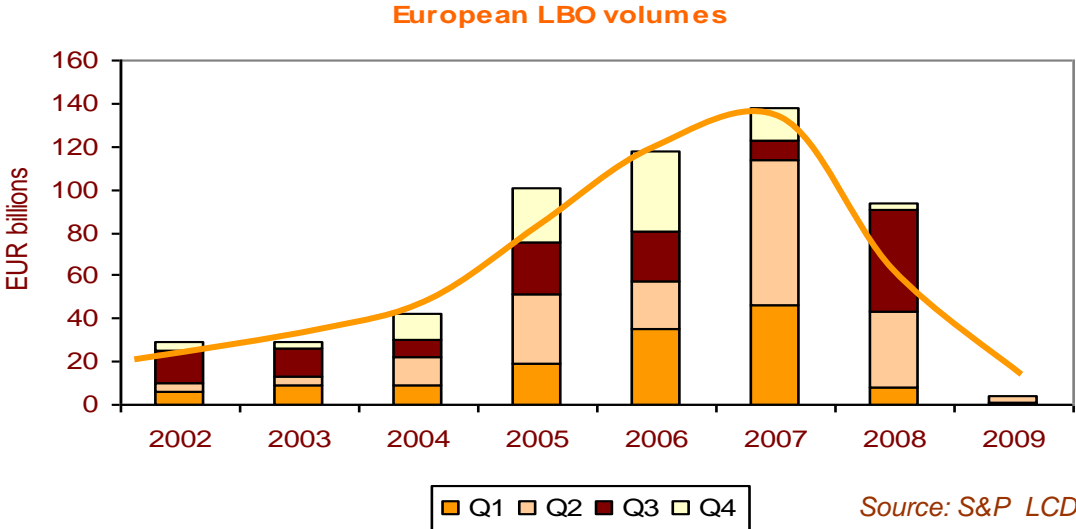


EXHIBIT 2-2
Real Estate Debt Capital Market Balance Prospects for 2010

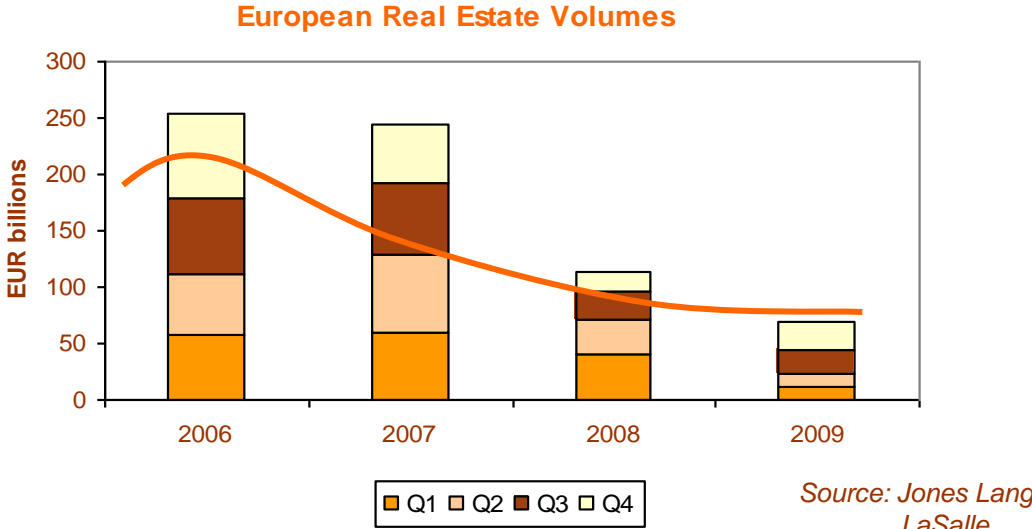


→ *There is still plenty of equity out here... at least for prime deals*

Deal volume: LBO vs. RE

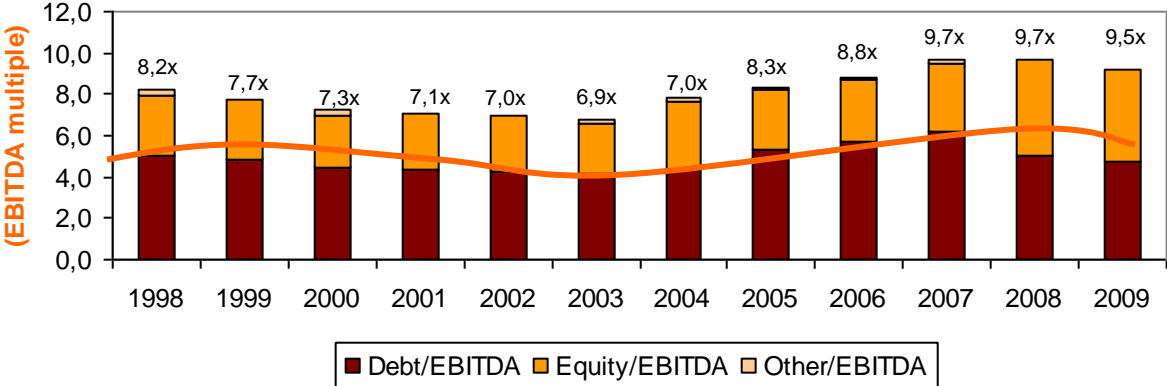


- Peak of transactions in 2007 (PE, RE)
- Both in volumes and numbers
- Step decrease since mid 2008-2009
- RE is peaking up since early 2009 – private equity is still flat



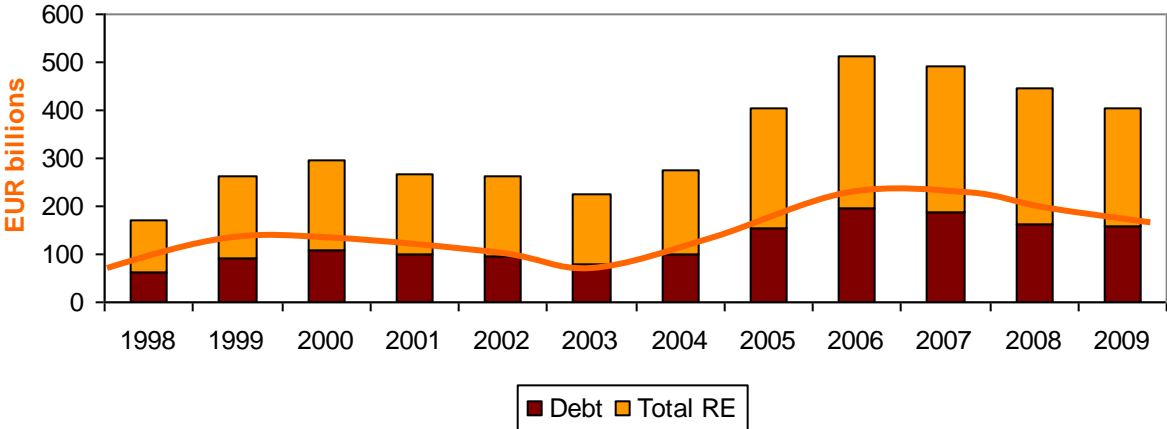
Debt vs. Equity in 2010

Sources of proceeds as a multiple of EBITDA of European LBOs



- Increase of multiple and debt to equity funding
- Peak of multiples in 2007
- Decrease of leverage since 2007
- Still no decrease of multiples since end of 2008 due to higher equity funding
- Prices start to decline since early 2009

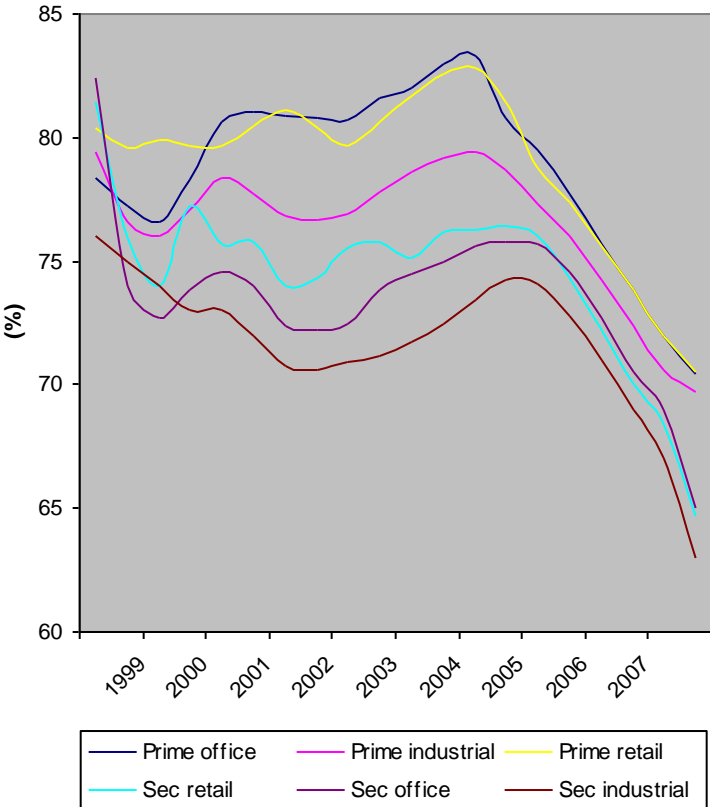
Commercial Real Estate Capital Flows



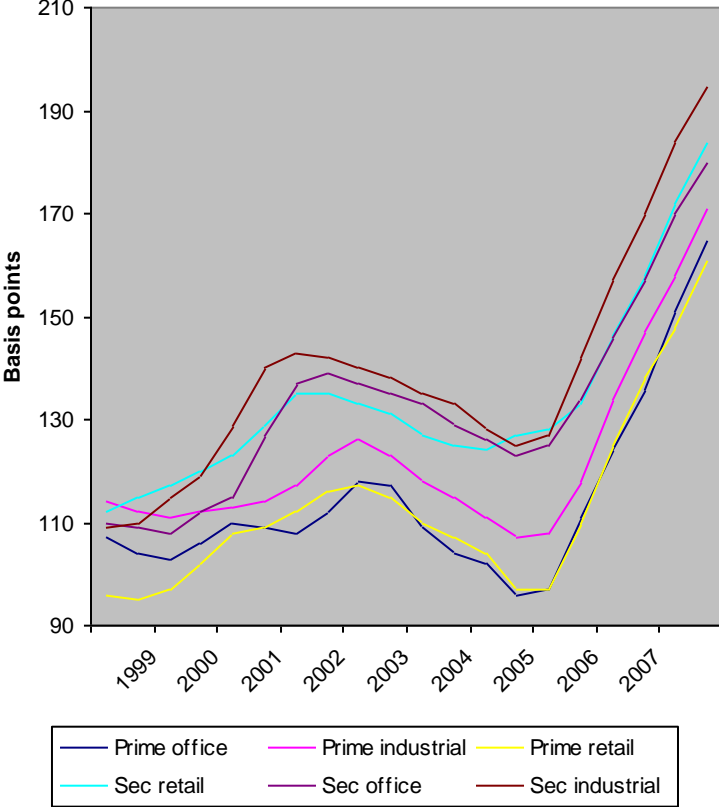
Source: DTZ Property Survey

LTV's – Yields: More debt = Higher prices

Lower Loan-to-Values

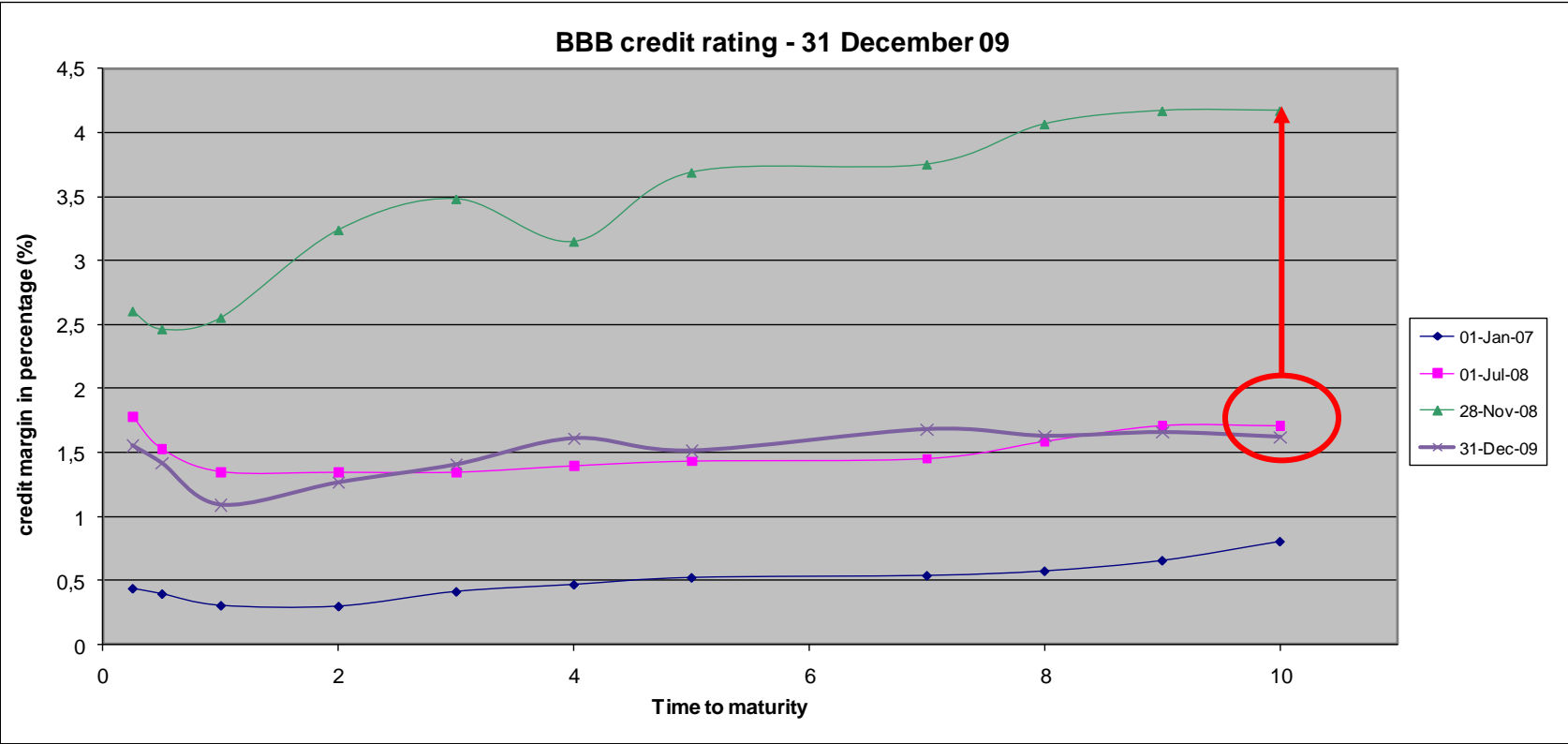


Higher Margins



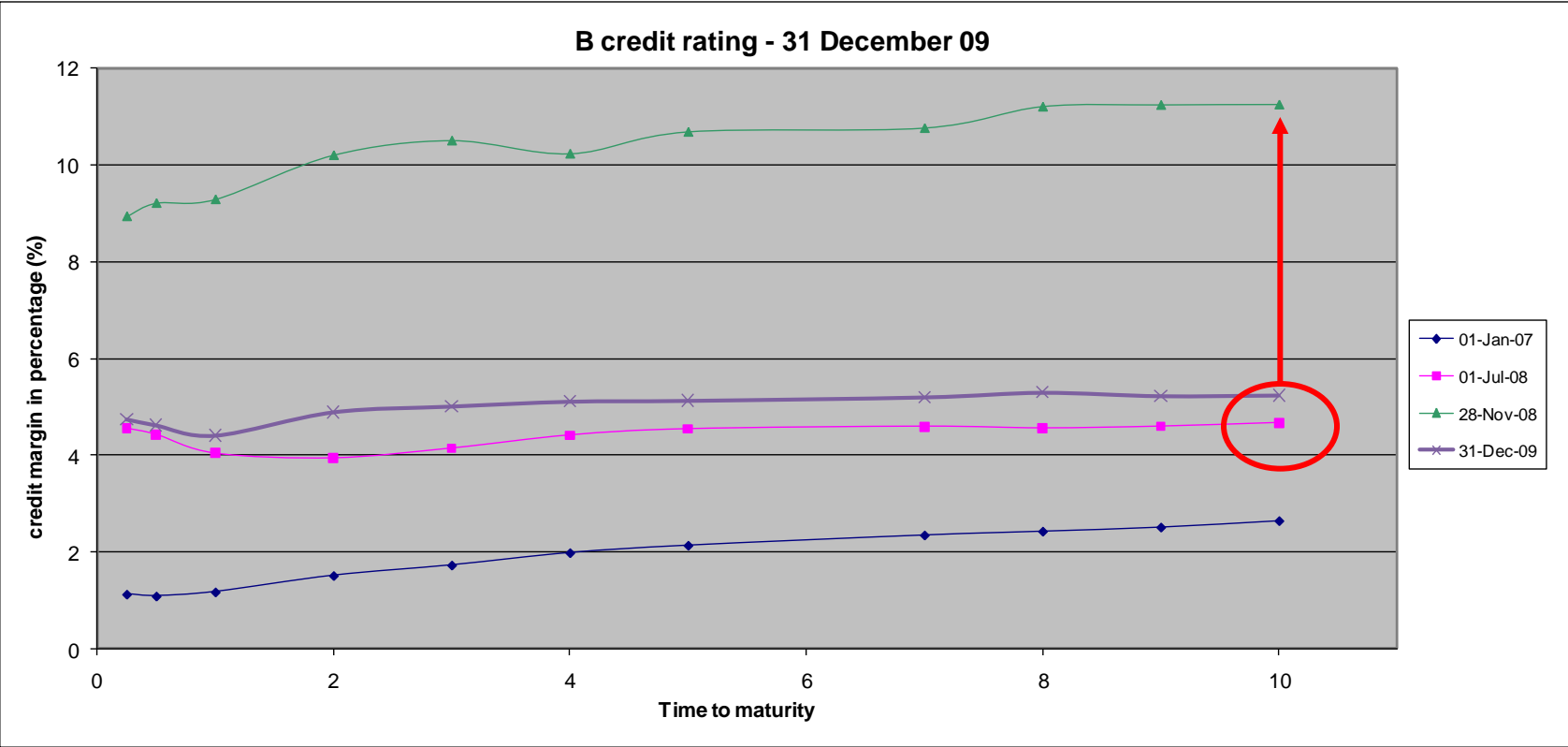
Spreads evolution in mid-crisis

The steep increase of investment grade spreads



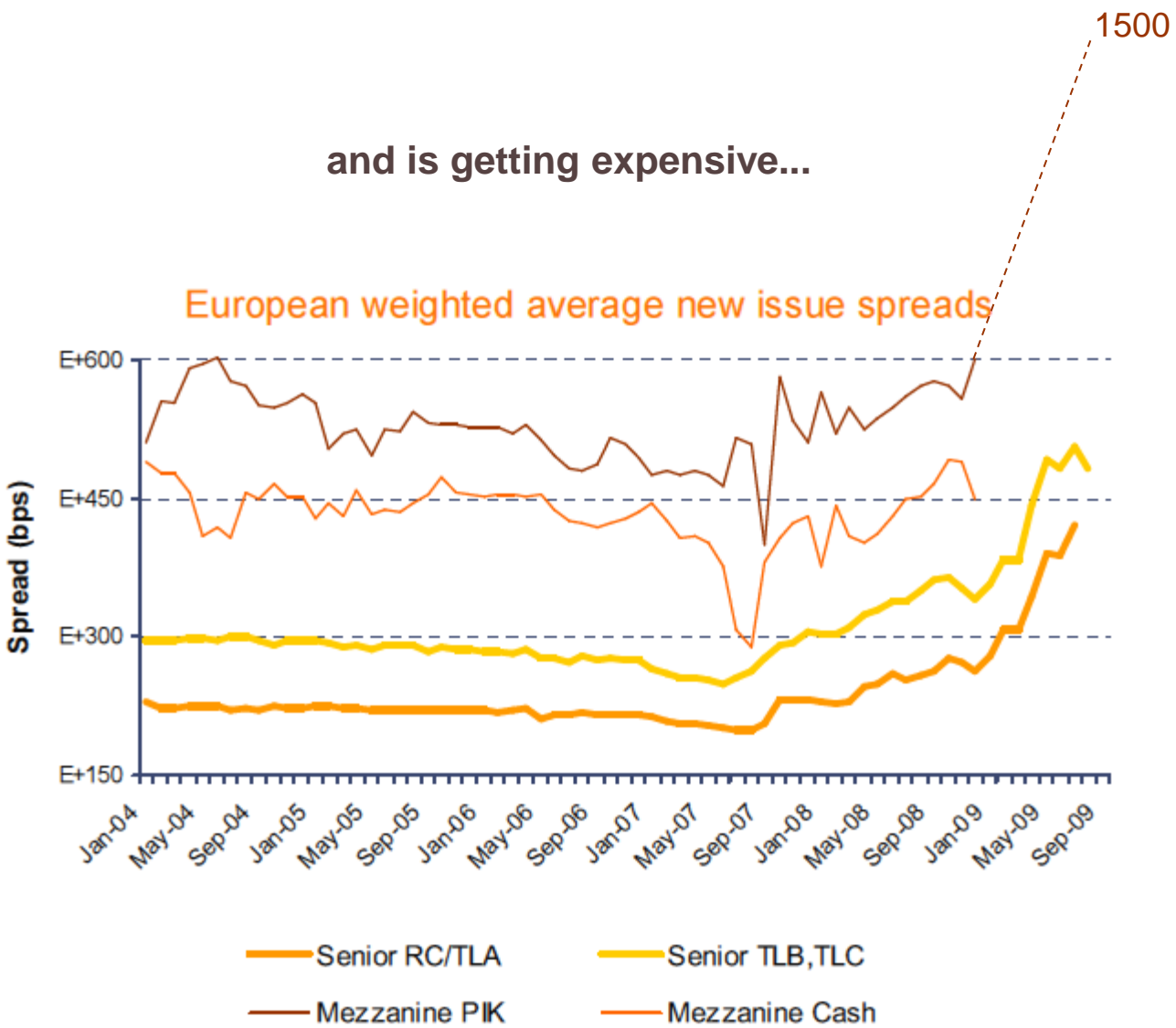
Spreads evolution in mid-crisis

Speculative grade spreads have gone through the roof !



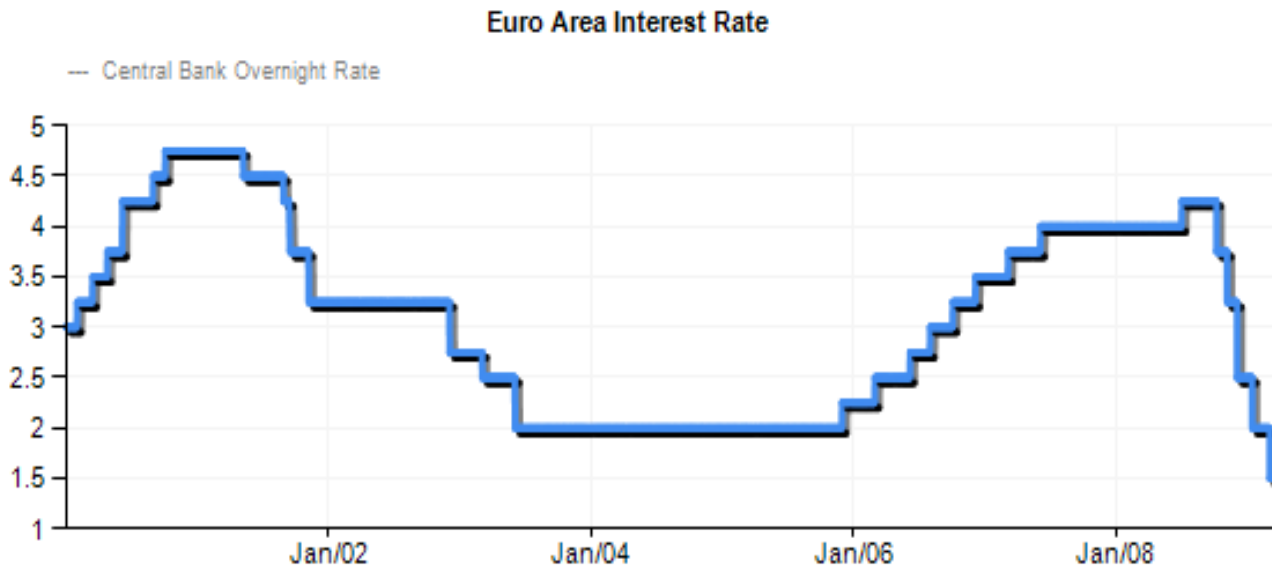
Explosion of risk premium

and is getting expensive...



ECB rates

... and yet central bank rates are the lowest in history



source: European Central Bank

www.tradingeconomics.com

- European central bank rates lowest in history
- We are reaching negative interest rates
- But bank pricing takes into account:
 - Operational costs
 - Cost of Credit risk
 - Cost of Liquidity
 - Cost of Capital
- And they need to repay state guarantee and restore balance sheet

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Section 2: Unlocking value / return from real estate

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Section 4: Tax consequences of unlocking value from real estate

Introduction

Trends 30.000 & PricewaterhouseCoopers – Vastgoed Enquête (2007)

PERSBERICHT EDITIE 2007
TRENDS TOP
30.000 - 100.000

Commercieel vastgoed in België
De slapende miljarden van het Belgische bedrijfsleven
Een studie van Trends Top 30.000 en PricewaterhouseCoopers

49.931.694.812 euro
(tweeduizend miljard oude BEF)

Dat is de totale boekwaarde van alle bedrijfsgebouwen en terreinen van de 30.000 grootste ondernemingen in ons land.

Vastgoedschatten op zolder
Werkelijke waarde vastgoed minstens driemaal groter dan boekwaarde
Maar...
40% kent waarde eigen vastgoed niet
30% bepaalt waarde eigen vastgoed nooit
Slechts 20% waardeert vastgoed jaarlijks
Zie pagina 2

Vastgoed onder de hamer?
65% bedrijfsleiders ziet nut van verzeelandiging vastgoed niet in
Amper 10% verzelfstandigt esters
Over ondernemingsrisico's en 9 andere goede redenen om vastgoed te optimaliseren
Zie pagina 3

Conjunctuurbareometer Geert Noels
Koud: Belg werkt zich steeds meer in schuld
Warm: groei China op cruisecontint 10%
Economische verwachtingen wintsehrallig voor 2007
Zie pagina 8

VW Vorst: EXIT ondanks EBIT
47 miljoen in 2005
= hoogste exploitatieresultaat sinds 2000
De Post: werkgelegenheid non-prior
24 miljoen arbeidsuren minder op 2 jaar
Genoeg om VW Vorst 3 jaar te laten draaien
Zie pagina 27

www.trendstop.be
GeoTop — Benchmark — Quicksearch
Werkinstrument voor 344.000 directie- en kaderleden
5.000 unieke bezoekers per dag
3.000.000 pageviews per maand

Embargo tot woensdag 13 december om 11.00 uur
Persbericht online op www.trendstop.be
PricewaterhouseCoopers

Main findings:

- Annual accounts of companies do not reflect the correct value of real estate
- Companies pay little (or not enough) attention to the value of their real estate
- Most companies do not know the exact value of their real estate
- Real estate often constitutes a hidden treasure, the value of which can be crystallised through internal (intragroup) or external (third party investor) split off of real estate
- Different war stories of companies unlocking value from real estate published in press, e.g. Domo, Eldi and Accor and more recently DHL (2009)

Why unlocking value from real estate **today**?



- Alternative means of raising capital
- Cost efficient means of funding
- Maximise shareholder value through more efficient deployment of capital
- Align the real estate portfolio with the business' operational needs

Section 2: Unlocking value / return from real estate

How unlocking value from real estate helps maximise shareholder value

- Return from investing in the company's core business is generally greater than the return from holding the property
- Crystallise value not currently be recognised on a company's balance sheet
- A company can monetise its covenant and benefit from its strength
- Arbitrage gain between business and property valuations
- Example:

	EUR millions	Valuation multiple	Company value (EUR millions)
Status Quo			
EBITDA	60	7 (14% yield)	420
Post-transaction status			
EBITDA	60		
- Leaseback rent	-27	12 (8% yield)	324 (cash rec'd)
Post-transaction EBITDA	33	6 (16% yield)	198
		<i>Total</i>	522
Post-transaction value			522
Status quo value			-420
Increase in shareholder value		(16% yield)	<i>Total</i> 102
Increase in shareholder value (%)			24%

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Emerging Trends in Real Estate – Europe 2010



Main issues identified

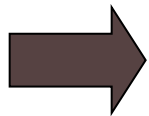
(1) Refinancing!

European CMBS Loan Maturities 2009 - 2018

Year	United Kingdom	Germany	France	Netherlands	Italy	Other
2009	1.56	0.05	0.42	0.00	0.00	0.05
2010	1.81	1.03	0.25	1.44	0.00	0.44
2011	4.20	6.91	1.10	0.35	0.00	0.67
2012	6.56	3.63	2.35	1.64	0.07	0.90
2013	3.92	13.55	1.57	0.46	0.50	1.32
2014	3.85	4.87	0.78	1.00	0.36	0.34
2015	2.34	0.29	0.11	0.09	0.21	0.24
2016	1.99	0.88	0.58	0.62	0.14	0.75
2017	1.19	0.54	0.00	0.00	0.42	0.17
2018	0.00	0.00	0.00	0.00	0.07	0.00

Source: Fitch Ratings, November 2009

Note: Billions of Euros

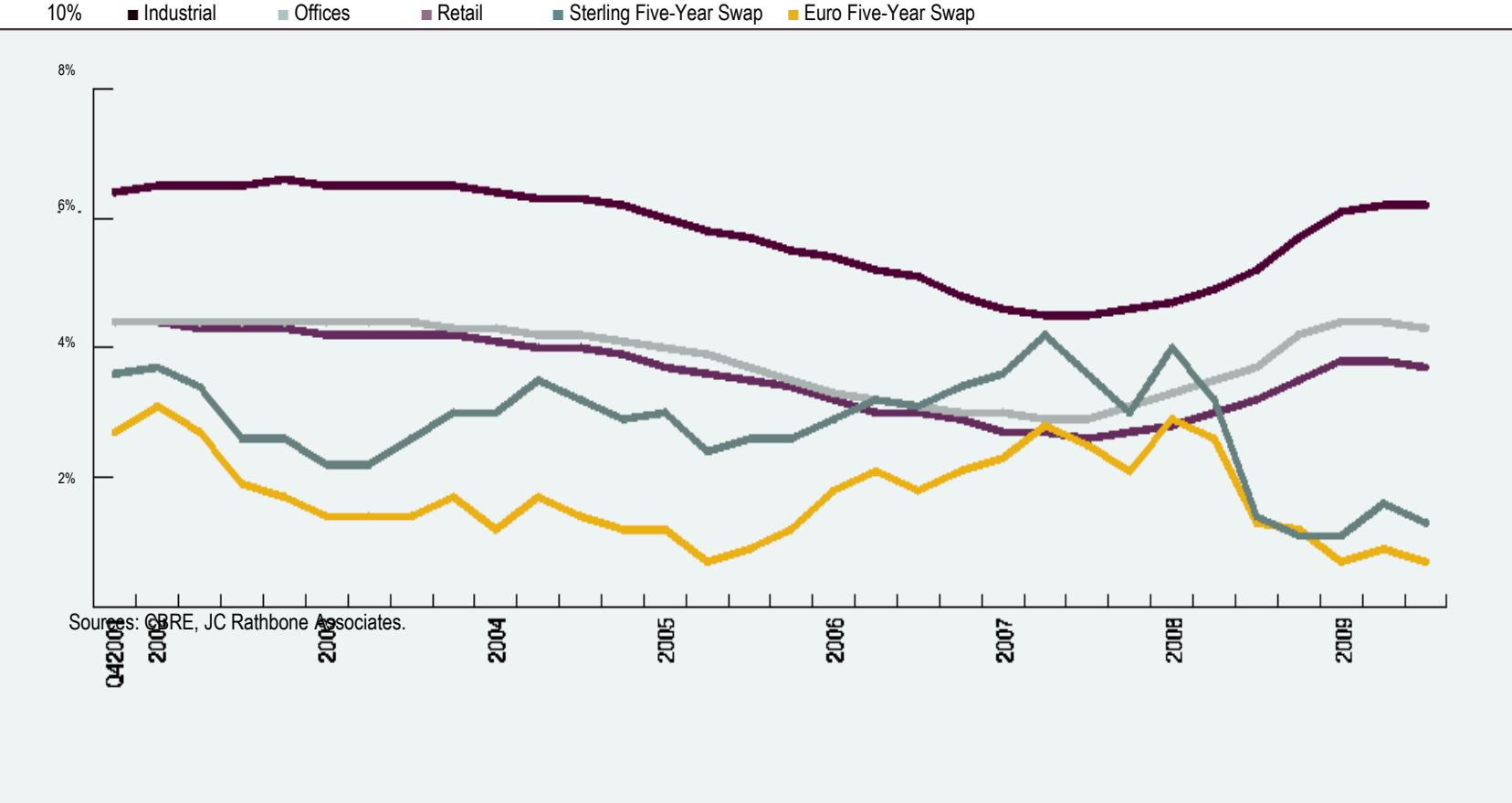


Banks must refinance or we have a huge problem...

Main issues identified

(2) Interest rates / inflation / yields

European Property Yields vs. Five-Year Interest Rate Swaps



Main issues identified

(2) Interest rates / inflation / yields

- Central banks play a major role (inflation \Leftrightarrow growth)
- Commercial banks play a major role (spreads)
- If inflation goes up and / or spreads are too high

 Yields must go up

 Valuation goes down

Main issues identified

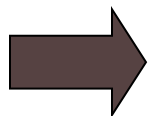
(3) Economic growth

European Economic Growth

	Percentage Real GDP Growth			
	2010*	2009*	2008	2007
Poland	2.2	1.0	4.9	6.8
Austria	2.1	0.8	2.0	3.1
Russia	1.5	-7.5	5.6	8.1
Czech Republic	1.3	-4.3	2.7	6.1
Sweden	1.2	-4.8	-0.2	2.6
Denmark	0.9	-2.4	-1.2	1.6
Finland	0.9	-6.4	1.0	4.2
France	0.9	-2.4	0.3	2.3
United Kingdom	0.9	-4.4	0.7	2.6
Netherlands	0.7	-4.2	2.0	3.6
Switzerland	0.5	-2.0	1.8	3.6
Turkey	0.5	-4.3	4.1	6.0
Portugal	0.4	-3.0	0.0	1.9
Germany	0.3	-5.3	1.2	2.5
Italy	0.2	-5.1	-1.0	1.6
Belgium	0.0	-3.2	1.0	2.6
Greece	-0.1	-0.8	2.9	4.0
Spain	-0.7	-3.8	0.9	3.6
Hungary	-0.9	-6.7	0.6	1.2
Ireland	-2.5	-7.5	-3.0	6.0

Sources: International Monetary Fund, Moody's (www.economy.com)

* Projections



Real estate needs higher growth to recover

Focus on 2010 - 2011

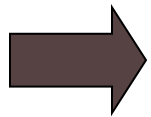
- Asset management
 - Keep your tenants
 - Get tenants
- Access to capital
 - Bank loans (but...)
 - Capital raising
 - Asset sales
 - Get a partner

Opportunities 2010 - 2015

- Fire sales will come – be ready!
 - If banks do not refinance
 - If real estate owners have no more alternatives but to sell assets
 - Bankruptcies
- Add value!
 - Get tenants
 - Keep tenants longer (longer contract = higher value)
 - Green energy
 - 2 – 3 € / m² for logistics
 - If energy efficiency increases, value will increase
 - Authorities will tax energy – again!

Conclusions

- Most challenging real estate market in many years
- Opportunities will be there – be ready
- Improve your portfolio
- Make sure your financing is under control



Only the strong will survive!

Agenda

Section 1: Debt markets today

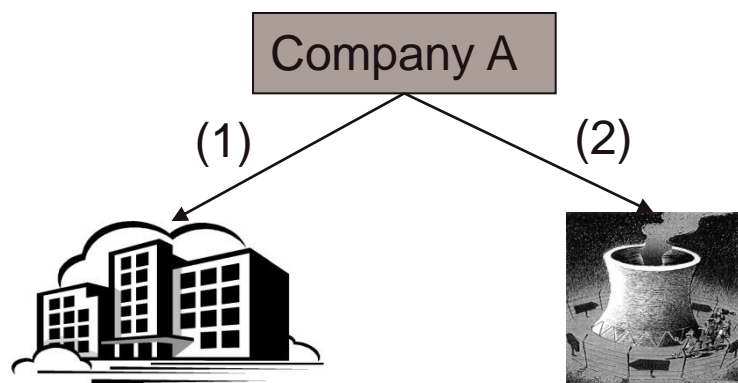
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Introduction

Typical investment structure of operating companies



Company A holds:

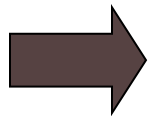
- (1) the full ownership of the construction
- (2) the operational activity

Why envisaging a sale and lease (rent) back operation?

- free up cash (to invest in core business or simply to survive)
- outsource real estate (such as other non core activities)
- tax reasons
- etc.

Introduction

- Debt market appears today to be still difficult and recovery will be slow.
- Alternatively, one may consider to go for alternative financing routes as sale-and-lease back operations.
- In order to achieve the envisaged result, 2 steps can be identified:
 - Preparatory step: OpCo – PropCo structure
 - Sale-and-lease back operation



Important tax consequences are to be analysed up-front in both steps!

Section 4: Tax consequences of unlocking value from real estate

Introduction

Sale and lease (rent) back transaction – OpCo/PropCo structure

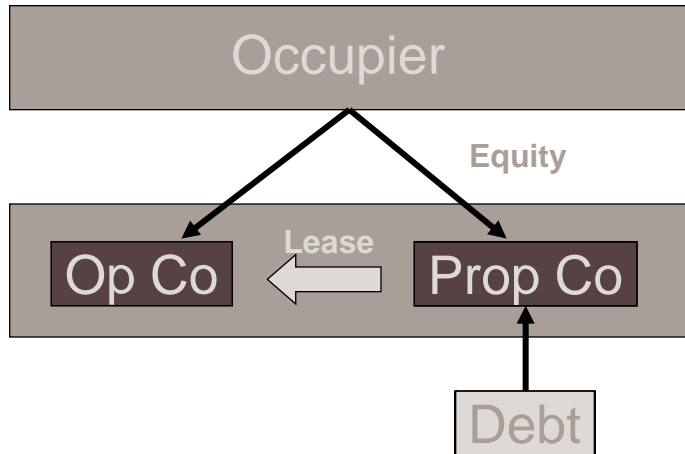
➔ Operation where real estate is transferred and right of use is retained

Rent back (operational lease) vs. Lease back (financial lease)

	Operational Lease	Financial Lease
<i>Belgian GAAP</i>	<i>Not defined</i>	<i>A lease where the lease payments (excluding interest and expenses) allow for the <u>invested capital (building) to be fully reinstated</u>. Any purchase option is not taken into account</i>
<i>IFRS</i>	<i>A lease other than a finance lease</i>	<i>A lease that <u>transfers substantially all the risks</u> and rewards incidental to ownership of an asset. Title may or may not eventually be transferred.</i>
<i>Balance sheet</i>	<i>Off balance</i>	<i>On balance inclusion of building and debt</i>
<i>P/L Account</i>	<i>Rental payments</i>	<i>Amortisations + interest charges</i>
	Corporate income tax treatment	
	<i>Corporate income tax law follows accounting law. The treatment under accounting law will thus determine the treatment for corporate income tax purposes.</i>	

➔ IFRS rules regarding leasing are currently changing! It is now proposed to consider all lease back transaction as a financial lease (whatever the terms and conditions of the lease). An exposure draft is expected later this year. The final Standard itself is not expected before 2011 (with effective application as from 2012 probably)

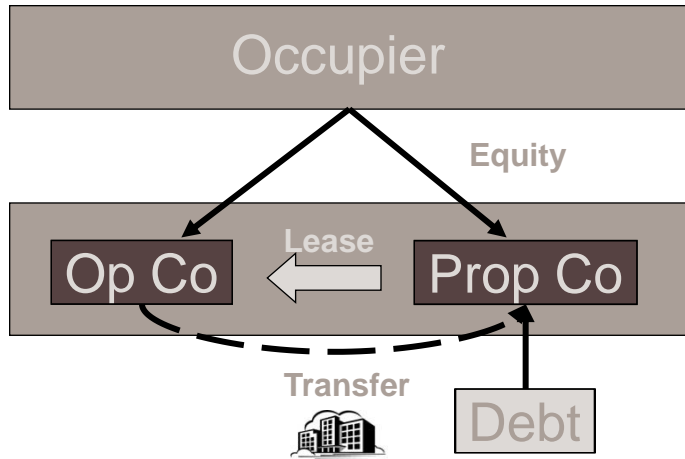
OpCo – PropCo split (intragroup)



Why envisaging an OpCo/PropCo split?

- Segregation of business risk and real estate risk
- Preparing the Group to a future exit of their real estate or their business!
- Tax considerations:
 - increased fiscal flexibility in case of later sale (share deal exit)
 - possible property tax planning in respect of machinery and equipment
 - manage capital gains taxation (however tax loss planning, positive impact NID)
 - minimize VAT leakage
 - minimize registration duty costs (through a so-called split-ownership structure)
- Possibility to securitize the receivable (future lease instalments) in the hands of PropCo
- Possible replacement of existing debt

OpCo – PropCo split (intragroup)

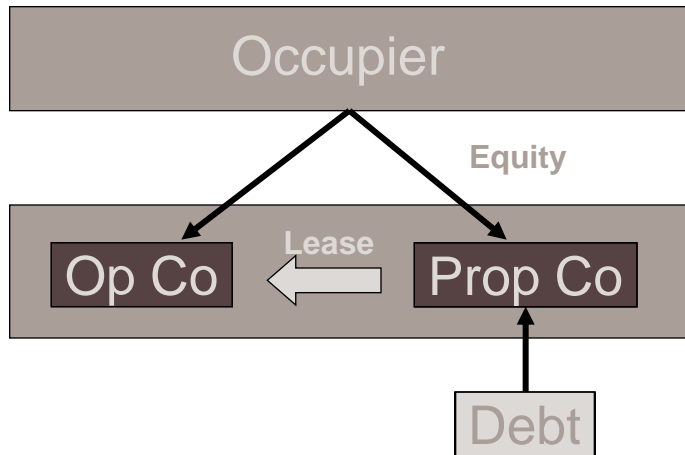


Tax consequences (cont'd)

Transfer of the building to PropCo

- Transfer of the property can take place through sale (12,5% or 10%), through long lease structures (0,2%) or split sales (effective rate of less than 1%)
- Partial demerger/Contribution can also be envisaged
- Special attention to mixed contribution transactions
- Lease back agreement subject to registration duties of 0,2% (on total amount of lease instalments)

OpCo – PropCo split (intragroup)

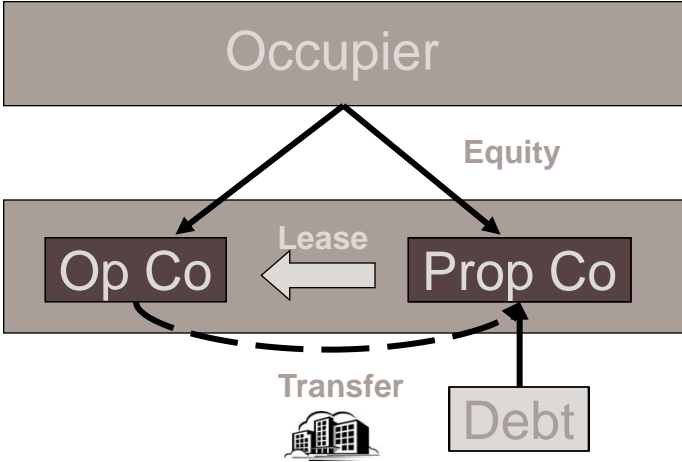


Tax consequences (cont'd)

Corporate income tax

- Capital gains tax issue (taxation at 33,99%):
 - Financial lease vs. operational lease
 - Deferred taxation (article 47 BITC):
 - in case of financial lease, "sold and leased back" building qualifies
 - in case of operational lease, sales proceeds to be reinvested
 - If no application of article 47 BITC, possibility to use available tax losses and notional interest deduction
 - In case of operational lease, possible increase of NID basis
 - Transaction must be at arm's length
 - In case of financial lease, 15% withholding tax on interest part, but exemption if paid between two Belgian entities or application of Interest-Royalty Directive
 - The rental fee paid by OpCo to PropCo is, in principle, tax-deductible
 - Tax free partial demerger? In principle, positive rulings on tax-free split of real estate are quite difficult to obtain but conditions imposed by the tax authorities are relaxing provided that it can be proved that the transaction is not pure tax driven.

OpCo – PropCo split (intragroup)



Tax consequences (cont'd)

VAT

Main VAT issue = potential VAT revision due to the transfer of the building with application of registration duties

- Part of the VAT previously deducted to be paid back due to the sale of the building not subject to VAT (We assume that the building cannot be sold with application of VAT, i.e. old building)
- VAT revision applies to renovation works carried out during the last 5 years and on acquisition/construction cost borne during the last 15 years

This could lead to significant VAT cost



The VAT cost can be reduced if monitored properly and solution such as VAT grouping can be envisaged to avoid/mitigate the VAT cost.

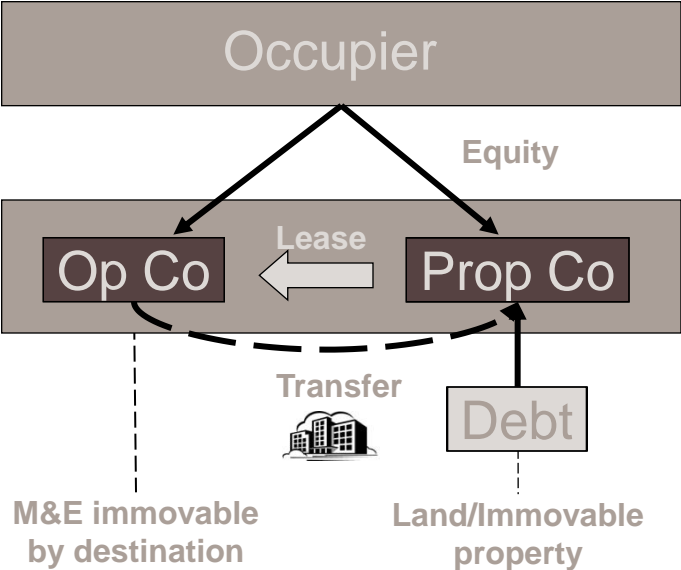
The so-called "VAT lease" will in principle not apply



VAT grouping can also be a solution to mitigate the VAT leakage (e.g. Joint-venture sale and lease back)

- The leaseback will normally take the form of a VAT exempt lease (exception warehouse/parking under conditions)
- This could also lead to a VAT leakage when refurbishment/renovation works have to be carried out by the PropCo

OpCo – PropCo split (intragroup)

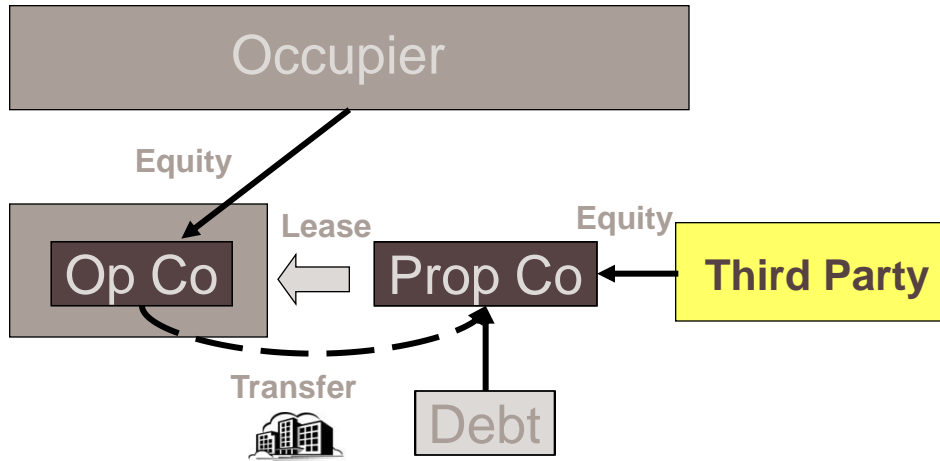


Tax consequences (cont'd)

Property tax planning for machinery and equipment

- No property tax for Machinery and Equipment (M&E) qualifying as immovable by destination
- Concept of immovable good by nature interpreted by jurisprudence more and more extensively (e.g. printing press, crane, weaving loom, containers)
- However, many M&E today no longer is subject to property tax (e.g. Flemish and Walloon Region)

Sale-and-lease / rent back (third party)



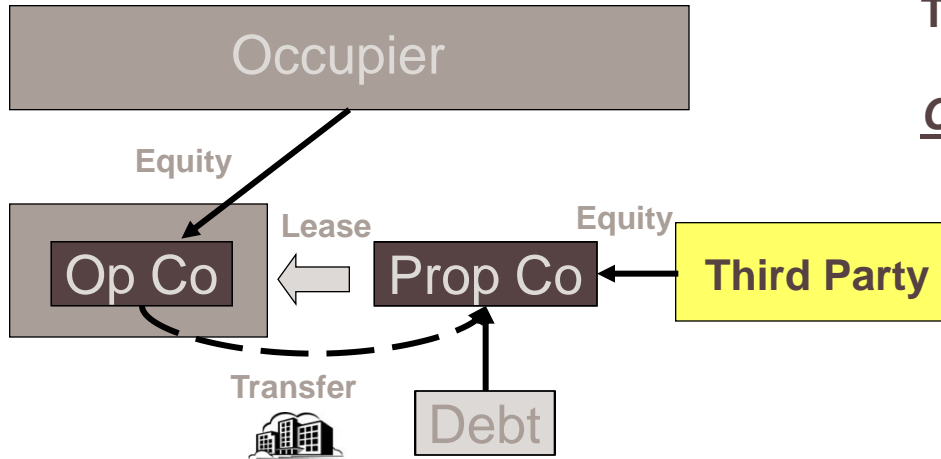
Why envisaging a sale and lease (rent) back?

- Concentration on the core business
- Increase of the financial ratios (reduction of debt level)
- Renting is more flexible than owning (but no capital gain potential)

Lease will typically be an off-balance lease (operational lease)

- The lease back is not a financial operation
- Except in case of a very long rental agreement, the invested capital/market value of the building and financial costs will not be reconstituted

Sale-and-lease / rent back (third party)

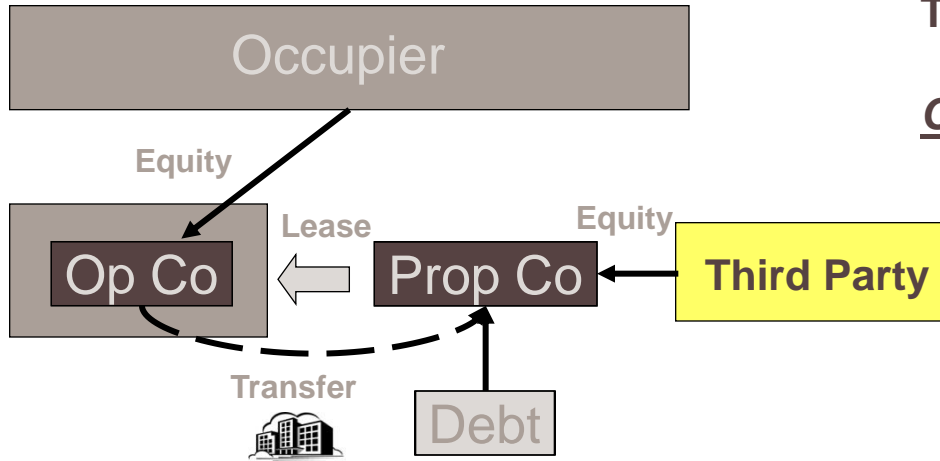


Tax consequences

Corporate income tax

- Operational lease (i.e. no full reconstitution of invested capital):
 - Lease agreement is seen as rental agreement
 - Real estate disappears from B/S of OpCo
 - OpCo receives cash
 - PropCo will depreciate the real estate (step-up)
 - Capital gains tax issue but increase of the NID basis of OpCo
- Taxation of capital gain at 33,99% (to be offset against carried forward tax losses and NID, if any), but possibility of deferred taxation (article 47 BITC)

Sale-and-lease / rent back (third party)

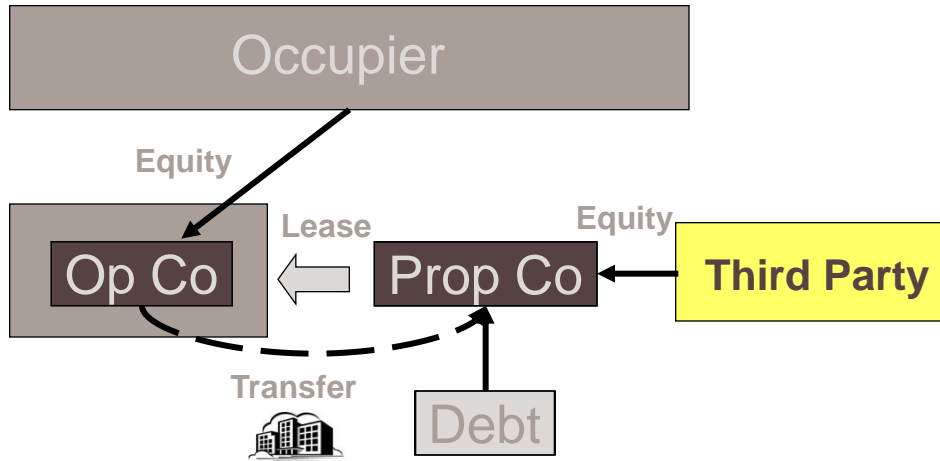


Tax consequences (cont'd)

Corporate income tax

- Possibility of spread taxation (article 47 BITC) under certain conditions:
 - assets have been held for more than 5 years
 - capital gain is and remains accounted as a tax-free reserve
 - the entire proceeds of the sale are reinvested in depreciable tangible or intangible fixed assets (used for the business in Belgium)
 - reinvestment within:
 - three years (as from the first day of the taxable period during which the sale took place)
 - If reinvestment in real estate: five years (as from the first day of the taxable period or the first day of the penultimate taxable period preceding the year during which the capital gain was realized)
- Operational lease : the leased assets do not qualify as reinvestment

Sale-and-lease / rent back (third party)



Tax consequences (cont'd)

VAT

- Same as for OpCo / PropCo split
- However, VAT grouping is in principle impossible to implement as OpCo and PropCo do not have the same shareholder

Registration duties

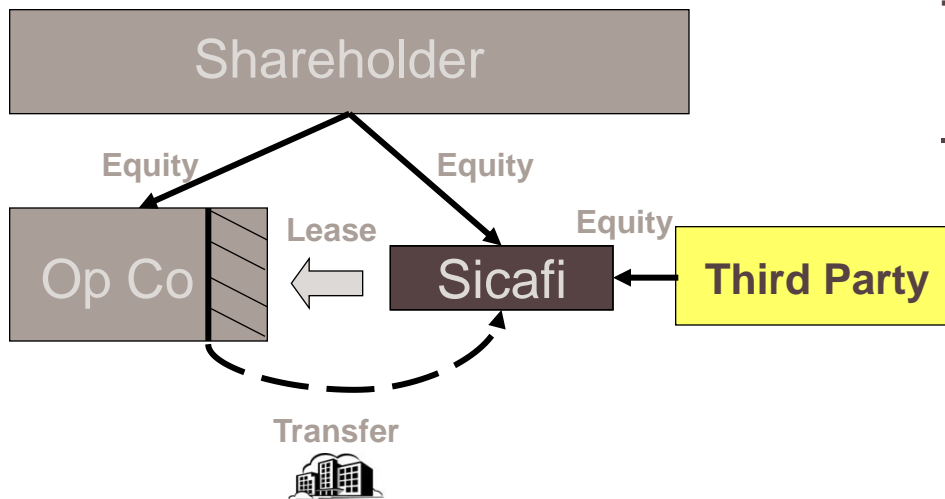
- Same rules apply as for OpCo/PropCo split

Transfer of real estate into a SICAFI

Why transfer of real estate into a Sicafi/ Vastgoed BEVAK?

- In case of transfer in exchange for Sicafi/Vastgoed BEVAK shares, bank financing or capital markets are not required
- Favorable tax regime of the Sicafi/Vastgoed BEVAK (increase of the net income)
- Increase of the equity of the Sicafi/Vastgoed BEVAK (not to exceed maximum loan to value of 65%)
- Can be realized either via a transfer into capital of third party' Sicafi or intra-group' Sicafi
- Main disadvantage: contribution/partial demerger will be fully remunerated by shares (no immediate cash return) + no participation exemption in case of capital gain on sale of Sicafi shares + mind lock up clauses and anti-abuse measures

Transfer of real estate into a SICAFI – partial demerger

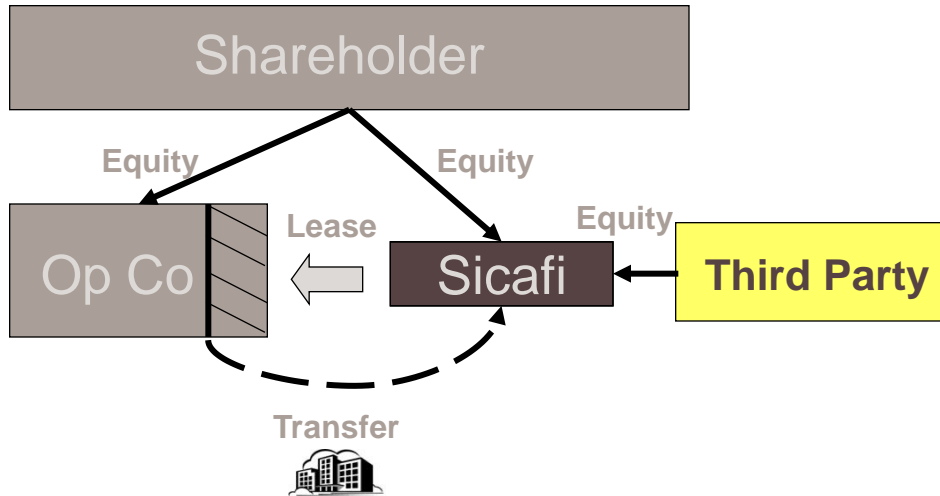


Tax consequences

Corporate income tax

- Partial demerger:
 - the company which is partially split is not dissolved
 - the shares issued in remuneration of the contribution are granted to the shareholder of the company which has been partially split (therefore the shareholders of OpCo will receive shares of the Sicafi)
 - the equity of the company which is partially split is reduced

Transfer of real estate into a SICAFI – partial demerger

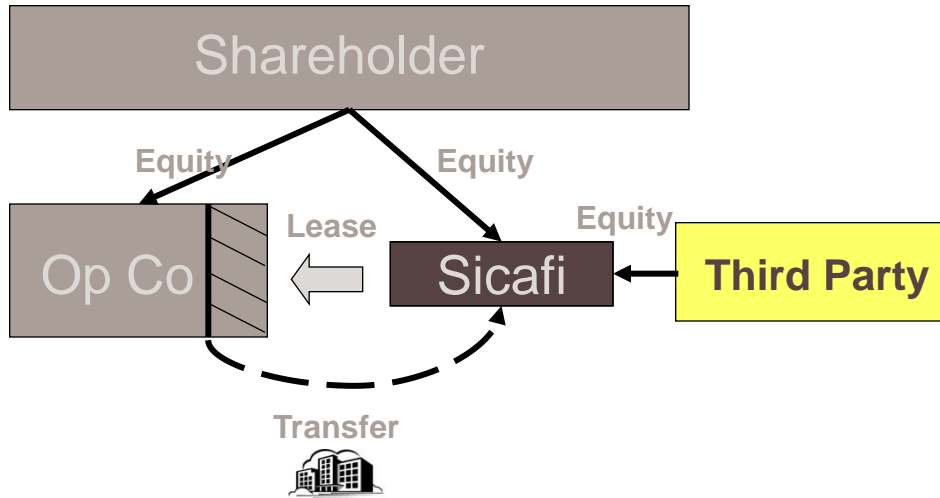


Tax consequences (cont'd)

Corporate income tax

- A partial demerger involving a Sicafi can be performed at half of the normal tax rate:
 - taxation of the realized capital gain (and transferred tax-free reserves) at a reduced rate of 16,995%;
 - property value : agreed price or expert value? - deduction of VAT and/or registration duties (Circular letter)
 - accounting continuity foreseen by advice of Commission Bookkeeping Standards
- 10% withholding tax on liquidation proceed (difference between transferred assets/liabilities and fiscal capital contributed to Sicafi), except if conditions of the Parent Subsidiary Directive are met (not the case if shareholder of OpCo is a private person)

Transfer of real estate into a SICAFI – partial demerger



Tax consequences (cont'd)

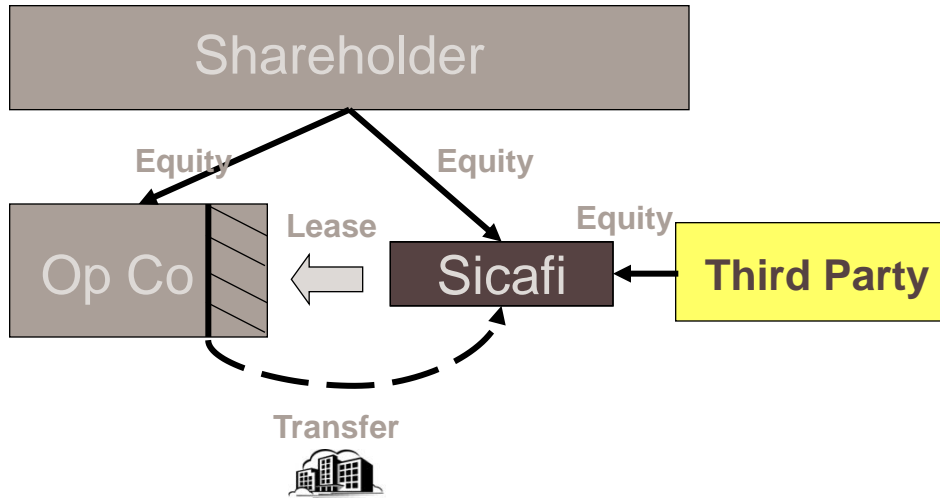
VAT

- Same as for sale and lease (rent) back
- However:
 - VAT grouping is difficult to implement as OpCo and Sicafi do not have the same shareholders
 - Can the contribution of the building be regarded as a transfer of a branch of activity to transfer the building under article 11 VAT Code (VAT free transfer)?



In principle not, as a building as such does not qualify as branch of activity for VAT purposes.

Transfer of real estate into a SICAFI – partial demerger

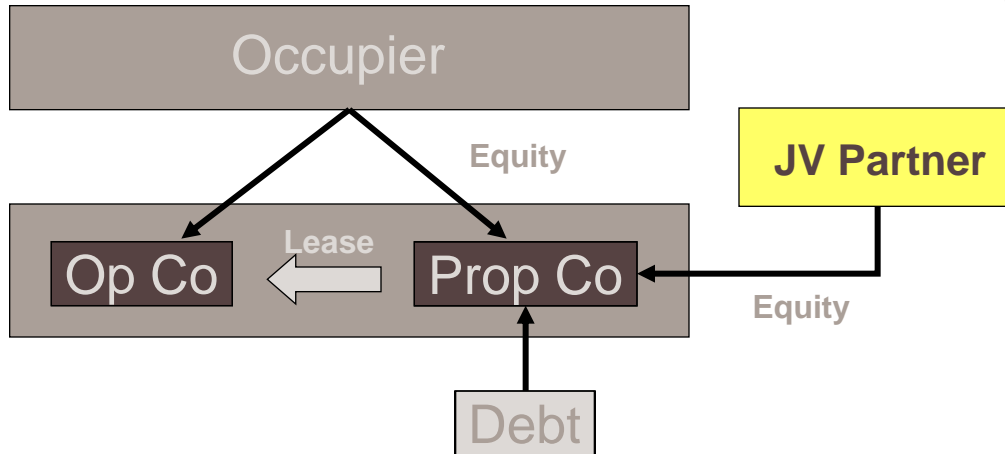


Tax consequences (cont'd)

Registration duties

- Only **fixed registration duty** of 25 EUR upon the contribution of real estate if the beneficiary of contribution is a Sicafi and the contribution is fully remunerated by shares
- **BUT** in case of a **mixed contribution** (e.g. in case of transfer of debt) :
 - registration duties of 12,5% or 10%
 - the shares and other elements which constitute the remuneration of the contribution will be split proportionally between the value attributed to the building(s) and the value attributed to the other contributed assets (no exception possible)
- Mixed contribution rule does not apply if the contributed real estate qualifies as a **branch of activity**

Joint-venture sale and lease (rent) back



Why envisaging a Joint-venture sale and lease (rent) back?

- Segregation of the risks between the group and the JV Partner
- VAT grouping can be used to mitigate/avoid the VAT cost as OpCo and PropCo have a common shareholder (10% rule)

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