



# Entering the mainstream

**A review of alternative real estate**



June 2018

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# Introduction

The alternative real estate market has grown exponentially in recent years, with JLL estimating that alternatives accounted for 26 percent of the total UK investment market in 2017. Alternative assets have attracted a whole range of investors, both domestic and overseas, public and private, and from large institutional investors to small niche players.

While there are many similarities between traditional commercial real estate and alternatives, and indeed some alternatives such as student accommodation are becoming increasingly viewed as 'mainstream' real estate, there are some key differences that those operating in this space need to consider in order to ensure the potential returns. Those range from the increased operational risk and importance of specialist sector expertise to the different approaches required for factors such as valuations, accounting and due diligence, due to the value-add nature of alternative real estate offerings. Legal and regulatory requirements also play a greater role, as does customer service and strength of brand.

In this guide, we've set out to highlight some of the key issues that real estate players should take into account when approaching alternative sectors. We hope you find it informative and useful. Please do not hesitate to contact me, the contributors, or your usual KPMG contact if you would like to discuss any of the themes further.

**Andy Pyle**  
UK Head of Real Estate



# Overview

As investor allocations to real estate continue to increase, competition for assets remains high. With ever-rising prices and ongoing yield compression, investors are struggling to find suitable opportunities to deploy their capital in traditional commercial real estate sectors.

Add to this market cycle uncertainty and the structural, demographic and technological changes driving consumer demand for assets such as PRS (private rented sector), co-working offices, and senior living, and it's unsurprising that the last few years have seen the rise of so called alternative real estate assets.

Investors searching for better returns and portfolio diversification are looking to emerging sectors in established markets, rather than established sectors in emerging markets, where local nuances may be little understood and factors such as stable economies, rule of law and transparent political environments can be less reliable. Alternative real estate assets can offer long-term income solutions and an opportunity to deploy capital in sectors that are often less impacted by economic and market cycle uncertainty.

However, these assets are not without their risks and challenges. The operational element of alternative real estate requires specialist expertise that real estate players do not always have. There is a need to understand the niche aspects of assets at a more granular level, in order to be fully aware of the risks and deliver the expected returns. This may require firms to enter joint ventures or partnerships with operating platforms, or to invest in training or acquiring in-house management teams. Achieving the investment case requires closer attention to the operating model and management, as well as factors such as on-site staff and branding.

Furthermore, real estate players in these sectors need to have a deeper understanding of their customers, what they want and how they interact with the buildings they use. In other words, customer service needs to be as high grade as the product itself. This also requires future-planning and a degree of flexibility as customer needs evolve over time.

As real estate developers, investors and operators become more comfortable with the fundamentals underpinning these sectors, and more data becomes available through increased activity, we expect to see more players entering and expanding in these markets. The key to success will be a customer-centric approach and an understanding of the niche factors that influence alternative assets. Investors focused purely on the asset itself will struggle to reach the potential returns on offer, or indeed survive in these sectors.



# Tax

Most of the key tax considerations for traditional real estate assets also apply to alternative real estate. For example, the impending introduction of the corporation interest restriction (CIR) rules for non-resident property investors from 2020 will have implications across the sector. Investors in alternative asset classes may need to reconsider how they finance assets to optimise their position under the CIR rules.

While the use of internal gearing has allowed for historic tax efficient planning, the likely impact of the CIR rules mean deductions for shareholder loans will be limited after 2020. Investors may therefore wish to optimise their external gearing where possible.

It is often common for institutional investors to participate in funds or club deals when entering a new alternative asset class for the first time, until they build up the relevant expertise. With the amendments to the Substantial Shareholding Exemption in 2017 to extend to property investment structures, certain Qualifying Institutional Investors ("QIIs", such as pension funds / sovereigns) may be able to benefit from a tax free exit when they own over 80% of a UK property structure. As a result, QIIs may instead prefer to hold majority stakes and partner with specialist operators so that they can benefit from SSE – which might otherwise not be available when investing into fund structures, due to the minimum ownership requirements.

## VAT is often a key consideration

Many of the alternative real estate asset classes involve residential development projects, often making VAT a key consideration. Where this is the case, for example with PRS and student accommodation developments, it can be necessary to create OpCo-PropCo structures in order to recover VAT incurred on land and construction costs. This leads to a more complex structure with additional tax considerations (see below). Where student accommodation is developed, specific issues can arise, depending on the design of the building and whether or not the student flats constitute "dwellings" for VAT purposes.

VAT is also complicated where the project involves the conversion of a commercial building into residential.

## SDLT legislation needs to catch up with alternatives

UK stamp taxes will, to some extent, impact all transactions in UK land. There are now four taxes to consider, depending on the location of the land and buildings and their intended use.





Stamp tax legislation has not yet caught up with alternative asset classes. This matters, because there is roughly a 10 percent difference in the maximum effective tax rate between a residential property transaction and a non-residential property transaction. There is no bright line test separating, for example, serviced apartments on the one hand and a hotel on the other. Certain questions that might seem simple to answer occasionally aren't, such as 'what are the key characteristics of a dwelling?' and 'when is a building suitable for use as a dwelling?'. And features that one might reasonably consider irrelevant for the purpose of calculating the tax can tip an asset class into one bucket, producing a significantly greater (or lesser) tax charge than expected.

Currently, sales of purpose-built student accommodation enjoy two tax benefits: they are eligible for a partial tax relief and are excluded from the higher residential rates. This means that they are taxed to a much lesser extent than, say, private-rented sector sales.

Occasionally, stamp tax and VAT conflict. Care should be taken to ensure that granting an operating lease to a captive entity to recover input VAT does not jeopardise a claim for stamp tax relief, or lock out the relief for a future purchaser.

Unfortunately, in recent years, property disruptors have found themselves victims of 'collateral damage': stamp tax anti-avoidance legislation targeted at a different activity that inadvertently hits innovative structures or products. It is ironic that those offering sustainable alternatives to property financing or assisting market liquidity should be punished by penal tax rules. We have lobbied on behalf of three such disruptors in as many years.



- KPMG provided buy-side services in the form of financial and tax due diligence, tax structuring and SPA advice to Brookfield on its acquisition of SACO, Oaktree Capital Management's serviced apartment business.
- In 2017 KPMG's capital allowances team identified expenditure qualifying for tax relief of c.£80m across 15,000 beds in the student accommodation sector. We are also currently working with Equites Property Fund, a South African REIT, to optimise tax relief across their logistic portfolio. The platform includes 8 UK assets, four in which have completed and four in which are at various stages of development. Capital invested across the 8 assets is c. £200m.

## OpCo-PropCo structures

The requirement to have an intra-group lease in an OpCo-PropCo structure gives rise to additional tax issues. For example, transfer pricing needs to be considered in respect of the lease and any other transactions between the PropCo and OpCo in these types of structures.

The UK anti-hybrid rules can also have a detrimental effect on OpCo-PropCo structures, where the entities are “checked open” for US tax purposes. This is relevant where there are internal recharges within the group or where there are intra-group loans. In particular, where a group may borrow third party bank debt at the parent level and then lend this to the property subsidiaries, this can be problematic from an anti-hybrid perspective – even if the intra-group loans are on arm’s length terms.

Some businesses such as serviced apartments or serviced offices may be structured using PropCos, which in turn enter into a management agreement with a third party operator. In this case, the PropCo will probably be treated as a trading company rather than a property investment company for UK tax purposes, which may lead to significantly different tax results. One potential benefit of this structure may be that it would allow shareholders to benefit from the UK Substantial Shareholding exemption on capital gains on exit. In light of the proposed introduction of non-resident capital gains tax from April 2019, a key debate for serviced real estate offerings now is whether investors should rationalise OpCo-PropCo structures into a single entity, so that investors may be able to benefit from the Substantial Shareholding Exemption.

## Calculating capital allowances can be more challenging

With regards to capital allowances, the analysis which is required to identify tax deductible expenditure is often more involved and challenging in the alternatives asset class than in traditional asset classes. For example, there are boundary issues around what claims can be made on assets within the residential sector, including build to rent, student and assisted living/retirement homes. This includes how the restriction that no capital allowances can be claimed on a ‘dwelling houses’ is applied and also what constitutes ‘trade specific’ plant and machinery, and is therefore tax deductible.

Tenant incentives and landlord capital contributions should also be structured in the most tax efficient manner. This is specifically applicable in the logistics market, where single tenants take on long term occupational leases and require trade specific fit out.



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# Accounting

The trend of property owners presenting themselves as providing a service to customers rather than renting space to tenants could change more than just how they manage their business.

A property landlord receiving purely rental income from property would be in little doubt they owned an 'investment property' and the accounting standards would tend to agree. However, a growing feature in alternative assets classes is that property is seen as a service provided to customers, rather than simply a landlord-tenant relationship. As the level of non-rental services to tenants/customers increases, so does the judgement involved in the accounting for the acquisition and subsequent classification of the property.

## At acquisition

Acquiring traditional real estate is typically considered an asset acquisition. You are paying for an investment property: bricks and mortar and tenants. However, where the skills, knowledge and experience of the property management team are intrinsic to the success of the acquisition, it is likely the acquisition is a business combination under IFRS 3.

This is more likely to be the case where the level of non-rental services provided is high.

Business combination accounting requires all assets, including off-balance sheet intangibles, to be recognised at their fair value on acquisition. The value of 'data' could be brought on-balance sheet, with customer databases and relationships each potentially recognised as assets. The management team itself could give rise to goodwill.

Structuring a transaction as a corporate or asset purchase does not change the need to make this assessment. What matters is whether the processes in managing the property have been taken over. This could happen via novating a property management contract or a transfer of employees to the acquirer.



KPMG advised EcoWorld International on their acquisition of a 70% stake in Be Living, Willmott Dixon's residential development business. The acquisition adds 8,200 units to EcoWorld's current prime central London residential stock of approximately 2,500 units which it holds in a joint venture with Ballymorepages.



## Subsequent classification

The definition of an investment property is a property held to earn rental income or for capital appreciation, or both. Property for use in the supply of services is excluded and would be recognised as PPE. Judgement is required when a property's operations have features of both renting and providing ancillary services.

The accounting standards provide no quantified thresholds in assessing the level of ancillary services provided, but they should be 'insignificant to the arrangement as a whole'. Take the example of flexible office space: a property with defined minimum rental periods of dedicated space, providing only basic furnishings and services, would be considered investment property. Provision of communal spaces or car parks for tenant use would not affect this classification. At the other end of the spectrum, a business centre providing mostly non-specific hot-desking space and a high level of services (such as secretarial support or other technology support) would not be investment property. That calls for a careful assessment of the facts and circumstances, above all focusing on the owner's business model for the property.

A property classified as PPE can still be held at fair value, although any gains above acquisition price would not be presented in the income statement, but as 'other comprehensive income'. Revaluation losses that take the asset below depreciated cost, on the other hand, would be an income statement expense. Furthermore, the property would also be subject to annual depreciation which could involve judgemental allocations of cost to the land, building, and fixtures and fittings components of the acquired asset. While net assets need not therefore be impacted, profit metrics could be notably different under a PPE classification.





# Due diligence

While many alternative real estate classes are heading towards becoming mainstream elements of a real estate investment portfolio, there are often key factors that shift the focus during the bid pricing and due diligence phases from those normally involved in a more traditional real estate acquisition.

It's vital to understand the sources and structure of the income streams, and the cost base and the level of exposure to operational risk, as well as the legal and regulatory implications. This requires a broader management structure and blend of skills to identify and manage suitable investments than has been required in the past in the world of real estate investing. Many of our clients have therefore been investing in their teams or establishing strategic partnerships to adapt to this trend.

More often than not, there is a shift from 'tenant' to 'customer' and medium/long-term leases to short term income streams. Asset fundamentals such as location and quality remain, but added to the mix is a greater pressure to ensure good management teams are in place – and that the asset delivers an experience that satisfies customers and avoids negative reviews on social media or damning press coverage.

Together with the space itself, support infrastructure and complementary services are often offered to users and occupiers.

These areas of focus all affect the diligence process itself. Quarterly rental streams with minimal irrecoverable costs may be replaced with agreements for lease, daily rates, nomination agreements or local authority funding, for example. A focus on how the revenue streams and pricing has been managed is therefore needed, to ensure that forecast growth

expectations are reasonable. Seasonality may also become a significant factor: the timing of any acquisition/disposal should be considered in light of embedded seasonal fluctuations, alongside the fixed versus variable nature of the cost base.

In short, the way in which alternative asset transactions need to be approached is more similar to Private Equity, than traditional commercial real estate. The effectiveness of the operational platforms, the ability to secure and retain staff who will deliver the brand promises and satisfy legal and regulatory requirements, and the ability to blend skills and capital while maintaining a common aim all need to be considered.



- KPMG provided financial due diligence and SPA advice to Safestore Holdings plc on their acquisition of Alligator Self Storage.
- KPMG provided financial and tax due diligence and SPA advice to iQ Student Accommodation on their acquisition of Pure Student Living and its portfolio of 11 sites in Bath, Bristol, Edinburgh, London and York.

While not exhaustive, below are some points to consider if you are thinking of making the move to 'alternatives':

- Operational platforms come with people and processes; has the need for and impact of carve-outs, separation and integration been considered and priced in?
- Has thought been given to potential regulatory and legal changes?
- Do you have access to the right skills set to understand the risk of obsolescence?
- Does the pricing mechanic make sense in the context of the assets you are acquiring? Or do you need to consider constituent parts, where the deal involves a blend of operating, property holding and development companies.
- Are you buying an investment property or a business combination for accounting purposes?
- Do you understand the impact of seasonality and the extent of working capital that you may be required to inject? Does the pricing mechanism take account of the impact of seasonality?
- Blending entrepreneurial and institutional backgrounds can be challenging. Understanding the 'conditions' that comes with any strategic partnership is vital.



# Valuations

The increasing level of deal activity in alternative real estate asset classes has presented investors and the valuations community with a new set of challenges. These properties don't always fit neatly into traditional real estate appraisal models and are challenging conventional thinking around what drives value.

A common thread among all alternative real estate asset classes is an increased element of business or trading activity. Higher returns come hand-in-hand with higher levels of operational risk.

One thread is clearly evident. Whether in the case of serviced offices, serviced apartments, PRS or student accommodation, operators are finding ways to increase utilisation levels and profits from the use of floor space. In other words, 'value' in a broad sense is being created.

Investors are recognising this, potentially leaving more formal property valuations behind. It is commonly accepted that the valuation of a hotel or pub, for example, is approached as a business valuation: they trade on this basis on the market. But what about an office property operating as a serviced office? Should it be valued in the same way as the traditional office next door? Typically, higher values are ascribed to traditional offices with a single tenant on a long lease (through the application of a lower yield or capitalisation rate), as this income stream is thought to represent a lower risk. Does it really make sense that a single tenant office on a long lease, with a cliff edge rental profile, should result in a higher valuation than a serviced office generating higher income at stable occupancy levels? Take the following comparison:

Serviced office	Traditional office
Ability to re-price licences throughout the year and to manage occupancy levels	Concentration of credit risk in single tenant
Ability to generate additional income streams from ancillary services	Cliff edge income profile, with re-let risk
Diversified credit risk and ability to monitor and manage this risk in real time	Property obsolescence risk at the end of the lease and inflexibility/lack of incentive for both landlord and tenant to manage this

There are, of course, counter arguments, notably the attraction of annuity style income, particularly through turbulent periods of the property cycle. Nonetheless, if the premium returns generated by an alternative property justify a higher overall valuation, is this higher value attributable to the property or the operating business?

These may seem like simple questions – yet they result in fundamentally different allocations of value and are a source of much debate within the valuations community. And there isn't a right answer. Each situation must be approached based on its own circumstances.



We recommend thinking through the following key questions, which can help guide the approach and best basis of value:

- What is the purpose of the valuation?
- For example, a valuation for secured lending purposes, where security is over the property only, may lead to more emphasis on alternative use value.
- Economically, what underpins or drives the fundamental value?
- Are returns simply linked to the location or use of space, or is it the operational excellence or business model driving returns?
- Linked to this, what are the risks and who bears them?
- On the income side – what are the risk factors that drive pricing? What risks are inherent within the operating costs? Who is operating the asset and how are these risks managed?
- What does the investment market for this type of asset look like and how will it evolve?
- As new investors enter alternative real estate markets, approaches to pricing and the perceptions of risk will change.



# Equity financing

Alternatives have become mainstream over recent years, with investors increasing their exposure. Alternatives, or more appropriately phrased, “operating real estate” is centred on the ability to trade successfully within the bricks and mortar.

Equity investors coming into the sector are seeking exceptional management teams that can be trusted to run the business given the operational importance which is driving value. Premiums have been seen for platforms, given the rarity of these management teams and the opportunities in growth sectors. Substantial recent transactions included SACO serviced apartments and The Office Group.

Other key considerations when investing in this space include the quality of the asset, its location and an understanding of the customer. Consumer preferences are changing fast: getting the product right is vital, as is the flexibility to adapt to change. Developers have to ensure that they are well connected to end users, especially in this dynamic market, given the lag between land acquisition and delivery.

As well as those sectors which have matured, such as healthcare, hotels and student, investors are seeking opportunities in the less mature sectors, such as build to rent, self-storage, and privately run cemeteries.

Institutions that were historically less “hands on” in operating real estate are now considering becoming more involved, aware that ensuring the product and operations are addressing customer needs means they will ultimately incur less risk.

Investors looking to expand into this area should consider the following:

- Backing the right management team
- Providing equity for those resilient or high growth sectors, understanding the macroeconomic and demographic drivers
- Platform growth potential
- Assets that are fit for the future and located in the right locations for customers



- KPMG acted as financial advisor to Betterstore Self Storage Holdings Ltd on the sale of their self-storage business Storage King to South African REIT Stor-Age REIT.
- KPMG advised UK-based real estate investment company Aprirose on their acquisition of the Qhotels portfolio from Bain Capital Credit and Canyon Partners. The portfolio of 26 UK hotels totalling 3,680 beds was acquired for a sum £525m, and marks the largest UK hotel transaction in 2017.

# Debt financing

## The challenge

In a number of alternative asset classes (hotels and more recently student accommodation being the notable exceptions), lenders' thinking is at a fairly early stage. Commercial real estate lenders have a mind-set that focuses on the asset first and tends generally to be driven by valuation, followed by cash flow. However, most alternative sectors need to be viewed differently to get to the right debt financing outcome, both from a leverage quantum and operating flexibility perspective. That means they need to be considered as operating businesses first and foremost, supported by assets.

These asset classes don't always fit neatly into either the commercial real estate, leveraged finance or corporate teams within banks. The best solution needs to combine each of these different lending mind-sets. Pure cash flow lending provides flexibility but insufficient leverage for many sponsors, while pure commercial real estate lending tends to focus on alternative use or vacant possession value and doesn't provide enough flexibility for an operating business. Valuers also often struggle to allow for the 'intangible' value of a top drawer service wrapper or well-choreographed common areas and communal space. As a result, red book valuations are often significantly below an equity case on these assets.

## How can investors, developers and operators address this?

There are a few key actions which real estate organisations can take to help overcome these challenges:

- Preparation of the business plan and articulation of track record, proposition and management skill is essential – at least as important as the situation of assets
- Cash is king: being really clear on the sustainability of cash flow and required ongoing maintenance capex and R&D spend is critical
- Continued business development and demonstration of the 'cutting edge' and efficacy of the customer proposition needs to be fully articulated
- Relationships will need to develop over time and initial financing deals might be at a premium to what borrowers would like. They will need to educate the market on their proposition, by demonstrating their track record
- Nailing the approach to market for financing is critical: lining up the right set of bankers (who understand assets and cash flow) is a skill and requires nuance
- Knowing which non-bank institutions to approach is also important and can be the key to unlocking financing. In some alternative sectors, debt funds and institutions have focused their efforts and are more in tune with the equity mind-set / further "up the curve"



KPMG was lead advisor to Select Property Group (SPG) in delivering two multi-tiered capital structure financings for their Affinity Living and Vita Student brands. Our corporate finance experts advised on SPG's landmark £247m funding deal with the Greater Manchester Property Venture Fund and a consortium of lenders. KPMG also advised on the raising of debt facilities for a new Vita Student asset.



# Customer

Customer and service sit at the heart of the operational property organisations typical of alternative assets. Demand is therefore high for platforms which can demonstrate an ability to reduce vacancy rates, increase rents and improve operational efficiency, while still meeting customer expectations and brand affinity. In this digital age, a happy customer can soon become a powerful social advocate for the organisation, and vice versa.

For property organisations this often requires a different mind-set and skills from the traditional product-centric approach. Being customer-centric goes to the heart of an organisation's strategy and focuses the mind on a number of key questions:

- What will we be famous for?
- What role do we want to play in customers' lives?
- Where will we play?
- How will we win?

Answering these questions helps to develop a clear view on a number of tough choices and trade-offs – and which business model the company should adopt.

There are three elements:



**Markets & sectors:** Identify which markets/sectors represent the greatest opportunity for profitable growth. Prioritise these markets/sectors based on their attractiveness and the organisation's relative business strengths. Continual market monitoring is key to building contingency plans.



**Customers:** Develop effective customer segmentation to evaluate your customer and really understand their priorities – and how you can shape your offering to fit.



**Propositions and brands:** Understanding your customers will help develop and position your brand to build on the financial and strategic objectives set by your organisation.

## Creating value from customer insights

The fixed nature of property means as an organisation you need to understand your locations and micro-markets (including transport access, amenities, shopping and leisure). That allows you to build in the associated network effects and deeper knowledge of your customer requirements. Micro locational knowledge is now critical.

A deeper understanding of your customers is an essential requirement to developing a customer value proposition. This level of insight is beyond the data traditionally collected by organisations and might include:

- Churn by type of customer – which ones are sticky and which churn more
- Characteristics (age, socio demographics, income)
- Needs and requirements: how is the asset used and what are the frustrations they face?
- The role the asset plays in their day-to-day life
- The trade-offs they are willing to make (such as price versus distance from transport, amenities on site versus local alternatives and so on). This will help inform value based pricing.

Effective use of technology to collect and analyse data about the building and its occupiers will improve the way an organisation can segment and communicate with its customers, while allowing you to enhance the customer experience.

## What needs to be done?

Developing a winning value proposition follows a few key steps:



**Understanding the customer.** There are a number of needs based analytical techniques and approaches to customer segmentation that can be used to inform the process.



**Design the value proposition.** Insights on customer segments can be consolidated to help support the development of new propositions and develop the brand.



**Business implications.** It is important to assess the internal implications of different value propositions and how to prioritise these, as well as monitoring external factors like competition, societal and technology change.



**Financials.** Spend time testing and selecting a proposition based on key performance indicators such as reduced vacancy rates and rental rates as well as ease of implementation.

## Why should I bother?

Well-designed value propositions based on current and emerging customer requirements will be more likely to sustain the organisation's financial objectives through improved brand loyalty. Meeting the needs of customers should support a longer average occupancy, can yield higher average rents, and should lead to better overall operational efficiency. We believe that value-added services will gradually cease to be a differentiator but will become the norm, ultimately leading to value-based pricing which will help support overall returns.

# Future of alternatives

We expect interest in alternative real estate to continue to grow, with some asset classes such as student accommodation already starting to be classed as established sectors. Not only are the returns often favourable, compared with traditional commercial real estate – the long-term income opportunity, portfolio diversification, and strong consumer demand resulting from structural changes make these sectors particularly appealing. As the industry evolves into offering ‘property as a service’ and the need for landlords to be closer to their customers becomes fundamental, the alternative sectors are leading the way as the future of real estate.

Overseas strategic entries into the alternatives sector will continue, particularly where the sector is less mature in the UK than in domestic countries. There will also be outbound investment where sectors are more mature and pricing is keen in the UK; this is taking place in the student sector across Europe. Brands are also looking to expand and establish national and multi-national platforms. We will see further consolidation in sectors, as players acquire existing portfolios in order to achieve this, often due to a lack of suitable product for organic growth. Players are also expected to move into adjacent sectors, where many of the underlying fundamentals are similar, such as student housing, PRS and retirement living.

With the blurring of sector and work/life boundaries, there is rising consumer demand for hybrid and mixed-used spaces: placemaking has become key. And finally, as more established alternatives become institutionalised, investors are increasingly looking to “alternative alternatives” for better returns. For example, we are seeing more interest in sectors such as cemeteries and airports.

As with elsewhere in the industry, and the wider global economy, technology will continue to transform this space. Harnessed correctly, it will allow for better and faster data-driven decision-making in terms of

investment, property management and customer service, faster and cheaper building costs through modular construction, and smarter and more innovative buildings with Internet of Things connectivity.

To be successful, real estate players will need to keep abreast of emerging technologies and solutions as they develop, be aware of new entrants and fast-growing businesses, and be open to collaboration and change. As we have seen Uber and Airbnb, technology enables new entrants to disrupt and revolutionise industries through providing convenience, value and experience to customers. The real estate sector is no exception.



KPMG advised Swedish hotel group Pandox on their acquisition of 37 hotels including the Jurys Inn chain from Lone Star for £800m. The transaction was made with Fattal Hotels Group (“Leonardo”) as operating partner, whereby Pandox, following a reorganisation of the portfolio, will retain 20 investment properties and one operating property in the UK and Ireland, and Leonardo will acquire the operational platform with 36 hotel operations under the Jurys Inn brand.



# Key takeaways



## **01 The residential nature of many alternative sectors has key tax implications.**

VAT is an important consideration where residential development is involved. It may be necessary to create OpCo-PropCo structures in order to recover VAT incurred on land and construction costs, and attention should be given to the complexities and implications of this. For example with regards to transfer pricing, UK anti-hybrid rules, and SDLT.



## **02 Value-add services may result in a different classification for accounting purposes.**

The high level of non-rental services provided to tenants/customers typical of alternatives may result in a property being classified as a business combination under IFRS 3. This would require all assets, including off-balance sheet intangibles, to be recognised at fair value on acquisition.



## **03 Due diligence is more akin to private equity than traditional commercial real estate.**

Understanding the sources and structure of the income streams, the cost base and the level of exposure to operational risk, as well as legal and regulatory requirements is fundamental to assessing potential investments.



## **04 Valuation assumptions need to be adapted.**

Alternative assets don't always fit neatly into traditional real estate appraisal models and are challenging conventional thinking around what drives value. The value of the operating business itself and less tangible assets such as brand and service wrappers become as key as the actual property value.



## **05 The right debt financing outcome requires a different approach.**

Alternatives need to be considered as operating businesses first and foremost, supported by assets. This requires debt providers to blend the lending mind-sets of both traditional commercial real estate, leveraged finance and a corporate approach.



## **06 It is critical to be able to articulate a clear business plan in order to secure both equity and debt financing.**

The ability to demonstrate track record and appropriate management skills is as important as the quality of the asset itself.



## **07 Innovation and flexibility is key for ongoing success.**

Preferences change rapidly and the typically shorter-term lease terms of alternative assets enable customers to easily vote with their feet.

# Contributors



**08 The customer value proposition is paramount.** Well-designed customer value propositions based on current and emerging customer requirements are more likely to sustain the organisation's financial objectives through improved brand loyalty. Value-added services will gradually cease to be a differentiator and will simply be expected.



**09 Technology should be harnessed to improve the product, customer service, and ultimately returns.** Effective use of technology will enable better and faster data-driven decision making in terms of investment, property management and customer service, faster and cheaper building costs through the likes of modular construction, and smarter and more innovative buildings with Internet of Things connectivity.

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Our real estate professionals draw on experience from a variety of backgrounds, including accounting, tax, advisory, banking, regulation and corporate finance, to provide informed perspectives and clear solutions throughout the asset and investment lifecycle.

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CREATE. | CRT096443 | June 2018