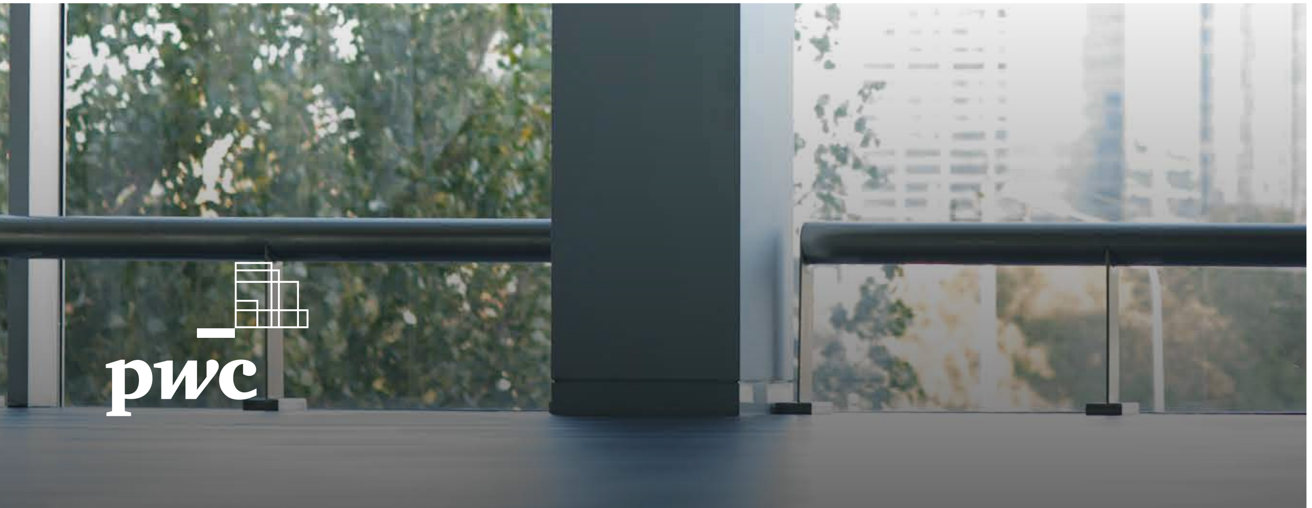
Real estate trends 2019

This year's market value multiplier is customer connection

Part of PwC's 22nd Annual Global CEO Survey trends series



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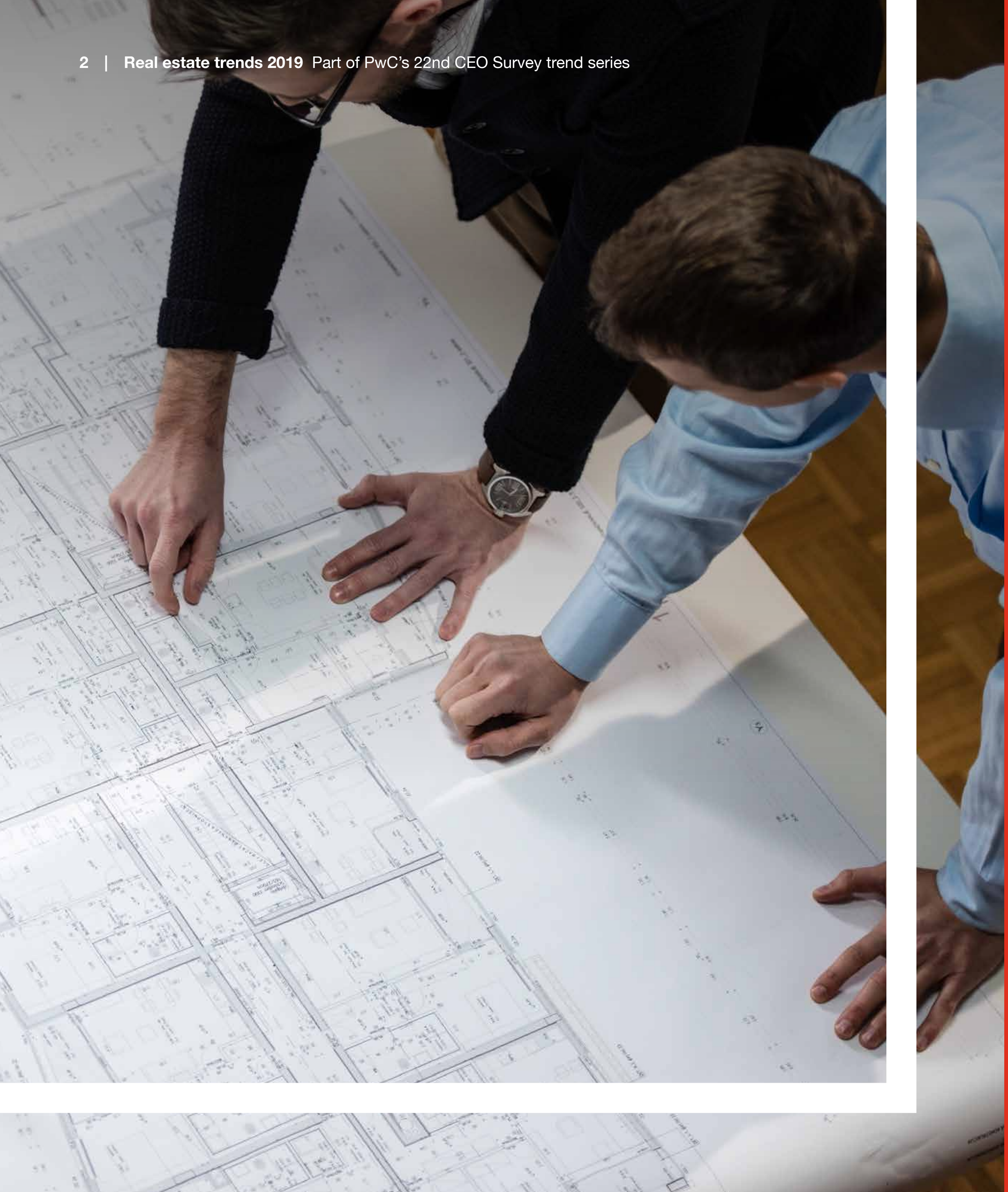

Building customer relationships

Real estate is becoming an increasingly consumer-oriented business, one in which people are not just aware of, but engaged with, the companies that own and operate the buildings in which they live and work. This change is putting a spotlight on the industry's long-standing disconnect with customers — and the problems with awareness, reputation and trust that stem from this.

Although industry buzzwords such as *PropTech* and *social impact* may sometimes point the way to better customer relationships, they aren't sufficient in themselves. Indeed, they can be a distraction and even an excuse for ignoring the pressing need to get closer to customers, work out what those customers really want and deliver that value in a way that makes social and commercial sense.

By connecting more effectively with customers, pioneering new ways of living and working, and developing innovative solutions to the challenges facing urban communities, your business could transform its brand image and boost its market value.

Confidence and caution

The real estate sector continues to deliver strong returns around the world. Although there have been some late-cycle jitters and divestments over the past 12 months, money continues to flood into this sector. That's one key finding of PwC's report *Emerging Trends in Real Estate: The Global Outlook for 2019*. Investors are targeting the high yields and asset-backed securities that few if any fixed-income alternatives can currently match. And as interest rate increases in developed economies recede, real estate looks set to maintain this ROI edge over other fixed-income securities.

The findings from PwC's 22nd Annual Global CEO Survey also support the feeling that when the cycle does eventually turn, the impact will be relatively gentle compared to that of 2008–09. More than 80% of real estate CEOs are confident about their company's prospects for revenue growth over the next three years. As our CEO Survey report suggests, this type of chief executive confidence (particularly concerning 2020) is typically a leading indicator of general economic growth. And although more than three-quarters of CEOs have some concerns over policy uncertainty — Brexit being a prominent example — this doesn't appear to have affected investment flows into prime assets.

It would therefore be reasonable to ask 'Why change a winning formula?' The answer: Because the rules of the game are changing.

1) Real estate businesses are competing more consistently as customer-oriented enterprises.

2) Businesses see the real estate they occupy as critical to attracting and retaining talent and increasing productivity.

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3) Awareness of tenant well-being and the social and environmental impact of real estate is increasing.

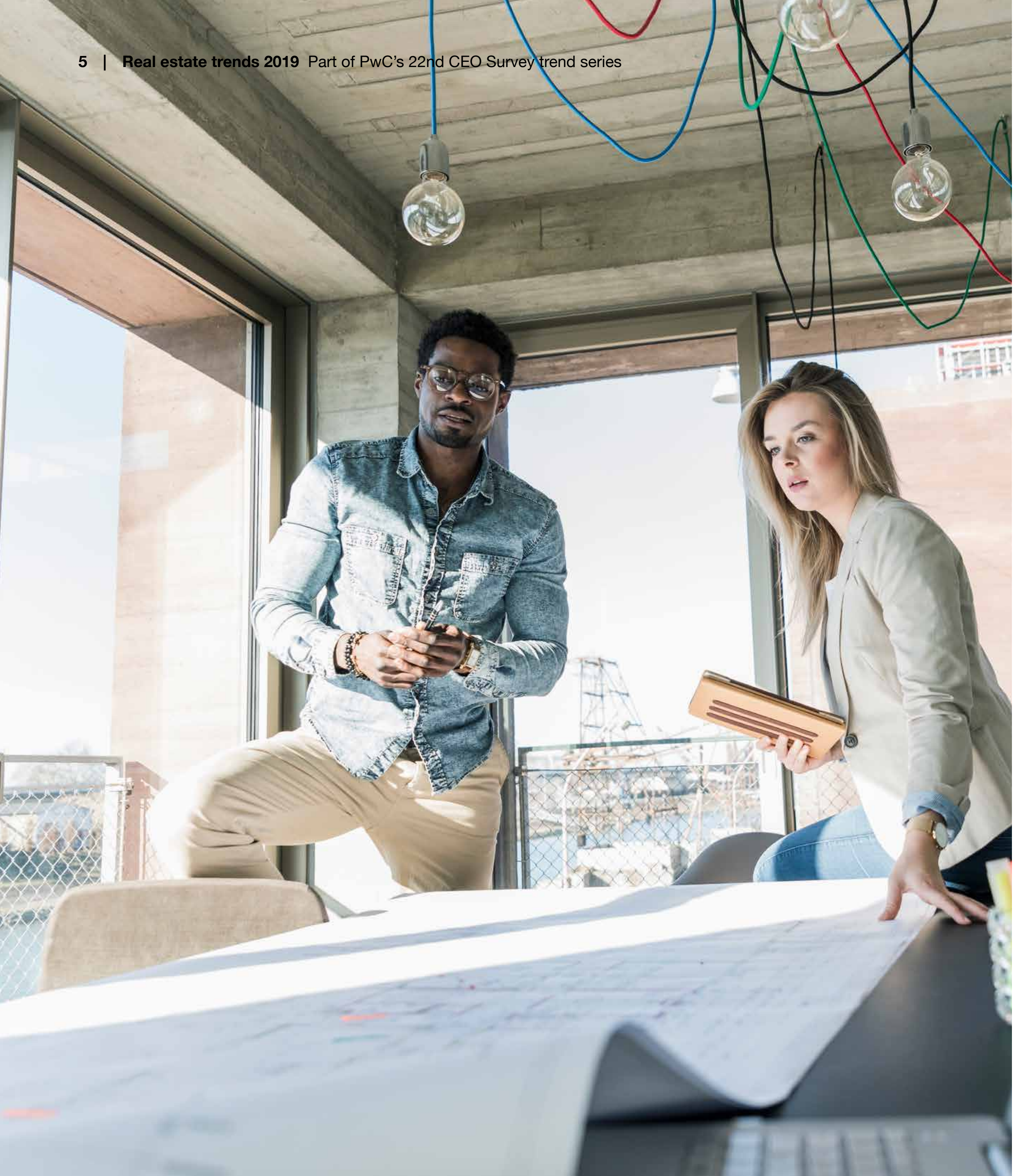
4) Quality of service (amenities) and of place (infrastructure as well as setting) are becoming more important than the size and design of the space.

5) The risk of rapid obsolescence, prevalent in retail, is now creeping into other areas of real estate. Examples include offices becoming more difficult to rent or lease because they fail to adapt to the evolving priorities of the modern-day workforce.

In this new world of 'real estate-as-a-service', the brand of a real estate owner and operator — which includes trust, social/environmental impact, health/well-being and how a building makes a person feel — will have more immediate implications for the owner's ability to attract occupiers, secure finance and be regulated and taxed appropriately.

Coming out of the shadows

The challenge for many real estate businesses is that brand recognition, engagement and loyalty with the occupier of a building have never been priority areas in the sector. This may eventually change, but few people currently know who owns the building in which they work, learn or shop. Although this relative anonymity is the norm within real estate, it would be hard to imagine Google failing to put its



name on its search engine, or Apple hiding its iPhone brand as an anonymous platform behind the brand of individual apps. But that is exactly analogous to branding in most of the real estate sector. With limited exceptions — e.g., the Westfield shopping centres — the majority of owners of real estate developments are anonymous to the individual user of the building.

This detachment means that customers seldom make the connection between their daily lives and the real estate industry, despite interacting with it almost every moment of the day. This has implications that ultimately affect your business's ability to meet key priorities, such as nurturing strong loyalty amongst occupiers and 'sticky' tenants, winning support for further development from policymakers and planning authorities, and avoiding the overregulation that comes with being misclassified as a financial enterprise.

In many cities, for example, infrastructure development and changes in planning and zoning practices could pave the way for hundreds of thousands of new homes and help overcome a chronic shortage of affordable housing. But rarely do advocates of lower-cost housing think of developers as their allies, and rarely do real estate companies get involved with advocating new transportation links to underdeveloped areas.

The lack of name recognition and goodwill creates vulnerabilities as well as lost opportunities. For example, governments can hike taxes on commercial real estate businesses without losing any votes because few citizens are aware of what the sector delivers or even of its existence. Related concerns centre on reputation and trust. In PwC's CEO Survey, three out of five real estate chief executives were worried that lack of trust would affect their growth prospects. This was much higher than the general percentage across all industries (50%).

Technological advances are also raising the profile of real estate companies in ways that can seem challenging at first glance — but could lead to opportunities. For example, increasingly advanced data analytics are giving people more information about a building's health and environmental impact, and social media has allowed negative stories to quickly spread. This greater level of transparency is often seen as a threat to the industry, but it actually represents a fundamental shift in the value proposition of a real estate business.

For example, what if the people who worked in an office building became increasingly aware of the air quality in the property? This could affect the amount that a tenant would pay to occupy space there. Employees, corporate tenants and competitors could tell, perhaps by using an app, which buildings were healthier than others and how the value of occupancy was changing.

Transparency of this sort is an opportunity for engagement. To be sure, it puts more pressure on the industry, but many businesses have felt that pressure already. From a sustainability perspective, real estate businesses have started over the last decade or so to embrace the challenge of reducing their impact on the environment, with a focus largely on energy use and carbon emissions. The catalyst behind many of these efforts has been pressure to report and demonstrate good governance to investors. Although reporting and transparency have improved, the level of sophistication hasn't yet reached a point where operational excellence in reducing energy usage or carbon emissions, for example, translates to higher performance recognised by investors. Now, with access to data, investors will be able to target their decisions more precisely, and real estate enterprises will be able to address concerns and raise the quality and appeal of their property much more effectively.

This will affect the standing that real estate companies have in their local regions. "Because of the way these things have worked," Craig McWilliam, chief executive of the property business Grosvenor Britain & Ireland, has said, "communities think development is something that happens to them." But that contentious way of managing relationships in the industry, he says, is poised to change.

Viewed together, these developments underline the extent to which tenant welfare and social and environmental awareness are no longer 'tick box' corporate exercises, but bottom-line imperatives that can't be ignored. Tackling these issues thus becomes a huge opportunity for reinvention and differentiation. If your business is associated with creating greener, safer and more vibrant cityscapes and solving the problems facing urban communities, such as shortages of affordable housing, customers are much more likely to become advocates for your brand — and your standing with policymakers and development opportunities will reflect that.

There are also opportunities to create a new seam of value. Just as the costs of material and manufacturing represent a fraction of the full value of a smartphone to a consumer (especially when you add in the facility of its design, its range of possible apps, and the value of its community of users), the move to a more customer-focussed, service-oriented and brand-conscious real estate business model could boost market multiples to many times the value of the physical asset.

Finger on the pulse

So how can your business gain the customer recognition, insight and trust to prosper and exploit the long-term value opportunity within this evolving marketplace?

Real connection: Think about which parts of the value chain you want to own and serve directly (e.g., tenant/occupier) and where you would prefer to assign someone else to do this on your behalf. Although a service company might be well equipped to engage with customers, it's important to think about how many layers you want to put between you and the ultimate consumer.

Real innovation: Data is clearly important and the technology to harness it is advancing rapidly in areas regarding environmental quality and the efficient use of space. But PropTech can't get to the nub of customer issues and how to resolve them on its own.

Rather than placing all your bets on investment in technology and PropTech startups, a more viable approach is developing a brand that people relate to. Focus on the consumer touch points that enable you to pick up on the social, cultural and technological trends that are shaping demand.

And you don't have to respond only to emerging trends — you can also shape tastes and lead the market. Companies such as Apple have shown that with a powerful, carefully nurtured brand and a clear vision, you can earn trust and loyalty and ultimately be in a position to shape and influence consumer needs. This ability to understand and influence consumer needs could be a game-changer for the real estate industry, in which huge investments are committed up front to develop buildings that will be meeting the occupation needs of customers many years into the future.

Why shouldn't people get excited about an amazing new real estate development conceived and delivered by a charismatic and innovative chief executive? Why wouldn't they declare their wish to live or work there, with the same anticipation as they might feel about the launch of a new smartphone?

Real inclusion: To develop a relatable brand and confident vision, it's important to ensure your workforce has the diversity and inclusivity to reflect and understand the customers and communities you serve. As real estate evolves into a truly customer-driven business, it will require a more sophisticated approach to understanding the complex needs of different customers. And as the range of services and opportunities increases, business with diverse talent — staff from different backgrounds with a wider range of skills — are more likely to thrive.

This represents a cultural shift — although the people coming into the industry are increasingly diverse, senior management is less so. As PwC explores in *Fast tracking gender balance across real estate*, a 2019 report launched in partnership with Real Estate Balance (an association that promotes women's leadership in the UK real estate industry), accelerating progress on diversity and inclusivity takes more than just policies and initiatives. If diversity and inclusivity are recognised as vital in-meeting customer expectations, they should be treated like any other strategic imperative — and be embedded into business objectives, performance measurement and incentives.

Seizing the prize

Real estate is at a crossroads. The more conscious people are about the owners and managers of the buildings they spend their lives in, the greater their expectations will be. And the more real estate comes to be seen as a consumer product with a profound influence on the quality of people's lives, the higher the rewards will be for businesses that get the connections and outcomes right.

If you as a real estate company executive can create a trusted brand that is synonymous with quality, tenant well-being, environmental awareness and support for the community, whilst maintaining the traditional strengths of an asset-backed business, this would be a huge source of differentiation and value.

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Strategy made real

How can real estate businesses balance social and financial return?

Across cities worldwide, people are struggling to find affordable housing, commuting on worn-out road and rail systems, and attempting to raise families in neighbourhoods where young people see few opportunities and are increasingly alienated from mainstream society.

In many cities, the have-nots now include not just lower-income households, but young professionals and middle-class families priced out of the market by spiralling inner-city housing costs. Social media has enabled people to share their frustrations and put pressure on business and government to respond. Real estate businesses are told, 'If you're not part of the solution, you're part of the problem,' but solutions that fit any viable business model are not obvious.

The leaders of the real estate industry will be called on to think about innovations more closely. These might include collaborating with leading local businesses that subsidise housing for employees, or experimentation with modular buildings in which apartments can be adjusted as family sizes shift, or with mini-apartment designs in which people share more types of common spaces. There might be more opportunities to help develop zoning changes, or open up different types of commuting options, or participate more wholeheartedly in plans that take advantage of data and analytics. Many well-respected real estate companies are those that innovated, in years past, by developing new types of home designs for the middle class.

Many efforts will involve collaboration and trust, and data can make a difference here as well. This means a willingness — not just within the industry, but within local government and community groups as well — to look for common solutions. Can you help foster the necessary conversations? Are you able to lead them? Those skills may make the difference between an enterprise that survives and one that is recognised as a civic contributor.

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About PwC's 22nd Annual Global CEO Survey

PwC conducted 3,200 interviews with CEOs in more than 90 territories. There were 70 respondents from the real estate sector, and 22% of real estate CEOs reported an annual revenue greater than US$1bn.

Notes:

- Not all figures add up to 100%, as a result of rounding percentages and exclusion of 'neither/nor' and 'don't know' responses.
- We also conducted face-to-face, in-depth interviews with CEOs and thought leaders from five continents over the second half of 2018. The interviews can be found at ceosurvey.pwc.
- Our global report (which includes responses from 1,378 CEOs) is weighted by national GDP to ensure that CEOs' views are fairly represented across all major regions.
- The research was undertaken by PwC Research, our global centre of excellence for primary research and evidence-based consulting services: www.pwc.co.uk/pwcresearch.

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