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Drivers of change for the Real Estate Industry

Executive Summary

Just six years from now, the real estate industry is likely to look very different from the way it does today, as nearly 100 delegates gathered in Sandton for PwC's first South African Real Estate Conference held recently.

Rapid urbanisation and demographic changes, especially within emerging markets, will lead to substantial growth in the real estate industry. At the same time as the industry's opportunities grow, so too will assets invested in the sector.

"As confidence returns to real estate, the industry faces a number of fundamental shifts that will shape its future," says PwC Global Real Estate Leader, Kees Hage.

The worldwide growth in the real estate industry over the years to 2020 will largely be driven by developments resulting from far-reaching economic and social changes. By 2020, real estate managers will have a broader range of opportunities, with greater risks and new value drivers. As real estate is a business with long development cycles – from planning to construction takes several years – now is the time to plan for these changes.

"High energy prices, climate change and government regulation are already pushing sustainability up the real estate agenda, but by 2020 their impact is expected to be far greater," says Hage. "Technology is already disrupting real estate economics, but by 2020, it will have reshaped entire sectors. And the real estate community will have taken a greater role in the financial ecosystem, in part moving into the space left by the banks."

A study by PwC, titled Real Estate 2020: Building the Future, focuses on the likely changes in the real estate industry over the coming years and identifies the key trends, which are expected to have profound implications for real estate investment and development.

The study predicts that the global stock of investable real estate will expand by more than 55%, from US$29.0 trillion in 2012 to US$45.3 trillion in 2020. It may then grow further to US$69.0 trillion in 2030. This huge expansion in investable real estate will be the greatest in the emerging economies, where economic development is expected to lead to better tenant quality and, in some countries, clearer property rights. And it will play out across the housing, commercial, real estate and infrastructure sectors.

Hage says: "In order to prepare for these implications, real estate investment organisations will need to make sure they have the right capabilities and qualities."


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Global megatrends will change the real estate world as we know it today

PwC Asset Management and Real Estate Leader for Africa, Ilse French, says: "The study goes on to examine how global megatrends will change the real estate landscape considerably over the next six years and beyond. While these trends may already be evident, there is a natural tendency to underestimate how much the real estate world will have changed by 2020."

These global megatrends are:

- A huge expansion in cities will produce mixed results. By 2020, the 21st century's great migration to the cities will be well underway. Cities will swell across the fast-growing countries in Asia, Africa, the Middle East and Latin America. Even the developed Western nations will be urbanising, albeit at a slower pace. But not all cities will prosper. While some will become great centres of wealth creation in a multipolar world, others are likely to fail.

- Unprecedented shifts in population will drive changes in the demand for real estate. The burgeoning middle-class populations in Asia, Africa and South America will need far more housing. Meanwhile, the advanced economies' ageing populations will demand specialist types of real estate, while their requirements for family homes will moderate.

- The emerging markets' growth will ratchet up competition for assets. The growth of emerging countries is rapidly creating powerful new real estate players and new asset managers. As a result, there is both growing competition for real estate assets and growing competition within real estate asset management.

- 'Sustainability' will transform the design of buildings and developments, presenting opportunities and risks for real estate asset managers.

- Technology will disrupt real estate economics: Growth in online shopping will continue to reduce the need for retail space, but shorter delivery times will increase the need for warehouse space close to customers. For developers, technology advances will make eco-efficient building more practical.

- Real estate capital will take financial centre stage. Private capital will play a critical role in funding the growing and changing need for real estate and its supporting infrastructure. Just as asset managers, real estate funds and sovereign wealth funds will find the assets under their control swell, so there will be a need to finance urbanisation. Private real estate capital will become an important partner of governments. Real estate managers will also need to leverage the full range of financing possibilities to take on new types of risk, often with long-term investment horizons.

French says: "There is a natural tendency to underestimate how much the real estate world will change by 2020."

Six predictions for 2020 – and beyond

"The changing landscape will have major implications for the real estate investment and development," adds Hage. The PwC study highlights six predictions and their implications for real estate managers and the investment community.

1. Real estate managers will need to think more globally, as global investable real estate will expand substantially, especially in emerging markets.
2. Real estate managers will need to understand the underlying economics of cities.
3. Real estate managers will need to factor technology and sustainability into asset valuations.
4. Real estate managers will need to decide where and how to compete as the competition for prime assets continues to intensify.
5. Real estate managers, the investment community and developers will need to partner with the Government to mitigate risks of schemes that might otherwise be uneconomic.
6. As the nature of real estate investment changes, demanding greater global specialisation, more risks will emerge. Climate change risk, accelerating behavioural change and political risk will be key.

> *"The successful real estate managers of 2020 will have already started to shape their responses to some or all of the changes we have identified."*

PwC Asset Management and Real Estate Leader for Africa, Ilse French

Technology is disrupting the way in which we do business

Technology is disrupting the way we interact with each other and carry out business, and is having a profound impact on the way in which businesses operate in today's new digital economy.

The expectation of companies and communities to go digital is continually increasing. "While new organisations will embrace the concept of the digital era, more established ones will need to think about how to transform their businesses," says Johan Potgieter, PwC Technology Leader for South Africa.

More data is being generated than ever before, and across a broad spectrum of business interactions, hiding within it potentially valuable business insights.

With the proliferation of mobile devices, the attachment of physical sensors to 'things', smart appliances, energy grids, and data around web usage, the networked world is creating vast amounts of data at a significantly increasing rate.

Digital is a collective term which refers to an integrated and collaborative platform that allows consumers, suppliers and organisations to transact using various electronic devices or technologies. It brings together emerging technologies which include social media, analytics and mobile to provide a cost-effective and convenient distribution channel for consumers to use.

The world's leading companies know that participation in social media is no longer an option but a requirement. While social media should not replace the art of traditional communication, it can enhance the overall customer experience in that it offers organisations a new way in which to engage in dialogue with customers, says Potgieter.

In just 60 seconds

Two million searches are conducted on **Google**

70 ***new domains*** are registered

2 460 000

posts are posted on Facebook

278 000

tweets are tweeted

11 000

professional searches are carried out on LinkedIn

Source: Qmee.com

Successful social media stories

US clothing retailer Gap scrapped its new logo in 2010 just one week after its introduction in the wake of an 'outpouring of comments' online.

Google broke 1 billion users in 2013

Instagram and ***Facebook*** hashtags took the world by storm in 2013

Home-shopping consumers are placing their reliance on the Internet

Home-shopping consumers are increasingly placing their reliance on the Internet. According to a study carried out by Google and the National Association of Realtors, 90% of prospective buyers used the Internet to search for properties, with 52% indicating that the Internet was the first step taken during the property-buying decision. The majority (70%) found their agent online.

Source: Socialmediatoday.com

Technology is shaping the buildings of the future

Worldwide, new cities are being built, while those that we have lived in for centuries are being upgraded for the future. Potgieter says that technology is forcing us to relook the way in which we construct our buildings of the future. Buildings of the future should be low-energy, sustainable, and able to respond to future changes in the climate, technology and regulation.

"Buildings of the future will become 'green', where there is a convergence of technology with real estate."

Companies of the future

The digital era has all but obliterated traditional business models. To maintain relevance, organisations – and this applies equally to the real estate industry – will need to rethink their approach to how they do business. Organisations must place innovation high on the agenda. They will require a business strategy for the new digital age. “They will also need to consider new forms of leadership, as well as increased levels of collaboration, greater innovation and faster decision making than ever experienced before. This means an accelerated programme of change,” says Potgieter.

In addition, organisations will need to think about how customers’ expectations and needs have changed in the light of new technology such as social media. “They will be required to have a deeper understanding and knowledge of their customers and how customers use their various products and services. This will also include a focus on new product concepts.”

“Organisations will need to consider new forms of leadership, as well as increased levels of collaboration, greater innovation and faster decision making than ever experienced before.”

Johan Potgieter, PwC Technology Leader for South Africa

Total retail – an outlook for South Africa

The global financial crisis of 2008 and the recession that followed brought with it pervasive uncertainty, which has been exacerbated more recently by the Eurozone crisis.

These global events have been sorely felt in South Africa with its moderate GDP growth rate, high unemployment and structural shortcomings in the economy.

John Wilkinson, PwC Retail and Consumer Leader for South Africa, observes: “Retail and consumer product companies must contend with limited volume growth, increasing costs and falling prices.”

PwC’s publication titled South African retail and consumer products outlook: 2012-2016, written in cooperation with the Economist Intelligence Unit’s industry and management research division, considers South Africa’s outlook for both retailers and consumer goods firms, providing growth estimates for the 2012-16 forecast period. It reviews the major opportunities that are present, the key pressures faced and some of the growth strategies being deployed.

Total retail sales will continue to expand steadily from 2012 to 2016, driven in particular by the continued emergence of a black middle class. Both food and non-food sales will rack up steady, if unspectacular, growth. Measured by volume, sales are expected to climb an average of 2.9%, after recovering from a low in 2012. By value, sales are anticipated to expand at an average of 7.85% in nominal terms. In 2011, the country’s retail sales surpassed a trillion rand for the first time in history, and they are likely to hit R1.46 trillion by 2016, according to the study.

Every major retailer and consumer goods company has started to expand into the rest of Africa, along with ongoing efforts at home to expand retail space. For retailers in particular, many are operating in tandem with property developers, opening up in parallel with new mall developments and shopping complexes.

> *“As pressures on consumers’ wallets increase, retail sales by value are expected to slow this year. The economic outlook going forward is expected to be modest,” says Wilkinson.*

Nevertheless, most brands are treating the Africa aspect of their growth cautiously, given the significant risks and challenges that remain. As a result, most are embracing a strategy of steady organic expansion.

Online retailing remains a niche proposition for the medium term, although growth is starting to accelerate.

Growth in Internet access, which has long been a major constraint in South Africa, is now speeding up as the market gets more competitive. South African consumers are looking for a full slate of shopping options, according to a new publication recently released by PwC, titled *Total Retail: Customer Expectations Driving the Next Retail Business Model.*

“The survey results are indicating clearly that online shopping is catching on rapidly with South African consumers,” says Wilkinson. “Twenty-five per cent of South African online shoppers have made their first ever online purchase less than one year ago and 45% within the last two years.”

Based on a survey of more than 15 000 online shoppers across 15 countries, including South Africa, the study discloses eight consumer expectations that call upon retailers to create a ‘total retail’ business model transformation.

South Africans want convenient physical store locations, websites that enable them to find and purchase products, and easy-to-use mobile sites or apps – and retailers need to adapt in order to compete.

Consumers now view multichannel shopping as a given, and the costs and complexities of managing a multichannel model are too great and offer too few rewards to benefit the customer experience. “Today’s non-stop shoppers have taken things into their own hands, becoming more tech-savvy than retailers. Consumers have the tools at their fingertips to immerse themselves in the retail brand.”

REIT regime to boost South Africa's listed property sector

"The South African REIT (Real Estate Investment Trusts) tax regime provides a clear and certain tax structure, bringing it in line with international norms," says Craig Miller, PwC Tax Mergers and Acquisitions Director. After a six-year journey, the international REIT regime was finally implemented in South Africa with effect from 1 April 2013.

Any qualifying company with a tax year commencing on 1 April 2013 or thereafter can adopt the South African REIT structure at the start of its tax year.

The REIT is one of the most flexible regimes internationally, and this is a significant development for South Africa's publicly traded real estate sector. Currently, more than 25 countries worldwide use a similar REIT model, such as the US, Belgium, the UK, France, Japan and Singapore.

To address the anomalies between the taxation of Property Loan Stock Companies (PLS) and Property Unit Trusts (PUT), National Treasury announced in late 2012 that a unified position to the taxation of property investment vehicles would be implemented. Both will be able to qualify as a REIT in terms of the JSE listing requirements. Section 25BB, which governs the taxation of REITs, was inserted with effect from 1 April 2013. The legislation aims to provide certainty to investors in REITs with regard to the tax position of the REIT and that of the investor.

The JSE's rules to list as a REIT provide: A South African REIT must own at least R300 million worth of property. It must keep its debt below 60% of its gross asset value. It must also earn 75% of its income from rental, from property owned, or from investment income from indirect property ownership. It must have special measures in place to monitor risk and must not enter into derivative instruments that are not part of the ordinary course of business. Finally, a REIT must pay at least 75% of its taxable earnings available for distribution to its investors each year.

Once the PLS or PUT is listed as a REIT on the JSE, it will be known as a 'company REIT' or a 'trust REIT', respectively. It will then qualify for the tax dispensation provided under section 25BB.

Miller points out that a REIT is exempt from capital gains tax (CGT) on the disposal of its immovable property, shares in another REIT or shares in a controlled property company. The holder of the REIT share will only pay CGT when the REIT share is sold.

Furthermore, the shareholders of a South African REIT will not have to pay securities transfer tax on buying or selling South African REIT shares.

"An extraordinary journey with a remarkable goal"

Guest speaker Estienne de Klerk, President of the South African Property Owners Association (SAPOA) and executive director of Growth Point Properties Limited, says that the introduction of the REIT regime comes after more than six years of consultation with National Treasury. De Klerk gives a graphic account of this "extraordinary journey", detailing how the listed property sector, spearheaded by the South African REIT Association, actively campaigned for the REIT structure to align it with international norms. It worked closely with National Treasury, the South African Revenue Service, the Financial Services Board (FSB), the JSE, and the Association of Property Unit Trusts in achieving this remarkable goal. The aim was to bring about transparency, simplicity, efficiency and tax certainty.

Overview of the South African REIT industry

The South African listed property industry has experienced substantial growth over the past decade. The sector is dominated by a few large entities, with the biggest 10 accounting for about 80 per cent of the sector's market capitalisation. There are currently 27 entities listed as REITs on the JSE, with more attempts to bring new entities onto the exchange. According to the South African REIT Association, REITs represent about R233 billion worth of real estate assets. South Africa is estimated to be the eighth-largest REIT market globally, with the US dominating the global REIT sector. Most South African REITs invest in commercial properties, such as shopping malls, warehouses, hotels, hospitals, and office buildings, with some investment in properties offshore.

De Klerk says that the property sector will need to contend with the continuing pressures of above-inflation increases in administered costs, such as electricity, and rates and taxes. He also highlights the skills shortage and poor education as other areas of high priority, as well as attracting tourism and foreign investment to the country.

Future trends in the listed property sector

The sector saw a number of listings during 2013. Historically, listings tend to be followed by consolidation. Larger companies trading at low yields are buying entities trading at higher yields. The REIT industry is also expected to encourage consolidation in the sector.

Expansion into Africa will also remain a theme, he says. Each country has its own set of laws, regulations and tax regime. "In the future we will see a larger, more transparent listed property sector."

A growing global population, demographic shifts, and climate change have all brought sustainability to the top of the political and business agendas. Reporting on social and environmental issues has become more important than ever, as consumers, investors and other stakeholders

"Consolidation is on the cards for the listed property sector for 2014. Expansion into Africa will also remain a theme."

Estienne de Klerk, Chairperson of the South African REIT Association Committee and executive director of Growth Point Properties Limited

Sustainability trends driving business in the real estate industry

demand greater transparency about all aspects of doing business today.

Many businesses have taken the view that sustainability is a matter of corporate philanthropy – it's all about green buildings and efforts to avert climate change – with no relevance to their organisations' core strategies.

However, PwC Sustainability and Integrated Reporting Director Alison Ramsden says this perspective has changed, with corporations understanding that their abilities to prosper hinge upon their responses to an array of issues on the sustainability agenda. Sustainability can encompass a wide range of issues that can affect a business, from climate change to education, health and human rights. And it involves a broad spectrum of stakeholders, from employees and communities, to governments and NGOs.

Corporate reporting is an ever-evolving field as companies continually strive to improve their communication with their stakeholders.

"South Africa has become known as the 'cradle of integrated reporting', largely due to the work of Professor Mervyn King."

Professor King was elected as the first chairperson of the International Integrated Reporting Council(IIRC). The annual integrated report seeks to align relevant information about an organisation's strategy, governance systems, and performance and future prospects in a way that reflects its economic, environmental and social impact on the environment in which it operates.

The mission of the IIRC is to create a globally accepted integrated reporting framework that assists organisations to recognise and present material information about their strategy, governance, performance and prospects in a clear, concise and comparable format.

Each sector has its own individual approach towards corporate sustainability and, says Ramsden, the real estate sector too needs to consider its approach to sustainability and integrated reporting. There are a number of key issues that the real estate sector should consider in this regard. These include the organisation's long-term strategy; its major stakeholders; its material risks and opportunities; and how it manages its risks and issues.

There are a number of guidelines, norms and standards to assist organisations with their approach to sustainability. For example, the Global Reporting Initiative (GRI) guidelines cover the economic, social, and environmental aspects of organisations' operations.

A number of common environmental issues relating to carbon emissions, recycling, the use of water, environmental supply chain management, and noise pollution are reported by the construction and real estate sectors in their GRI reports. Ramsden points out that GRI reports may be of assistance to some organisations and not to others.

An organisation must identify the groups to which it will report information and the framework which suits it, as well as analysing the information that must be included.

Pressure is mounting on organisations to report on sustainability. More transparency is required. Together with national regulations, a number of stock exchanges require, or will soon require, reporting on sustainability for listed companies.

The Government Employees Pension Fund in South Africa recently signed on as member of the Global Real Estate Sustainability Benchmark, an industry-driven organisation committed to assessing the sustainability performance of real estate portfolios worldwide. This is an example of stakeholder pressure.

‘Green’ regulation is also expected to intensify in the near future. Examples include Europe’s Energy Directive, which is driving near-to-zero-energy buildings by 2020. Amendments in the UK require all homes to be six per cent more energy efficient and commercial buildings nine per cent more, starting in April 2014.

In South Africa, there are also a number of social, labour, health and safety directives that have been issued.

The financial services sector is also making its contribution to corporate sustainability, with German banks incorporating the sustainability of commercial properties into their mortgage terms. In addition, Swiss interviewees report securing better mortgage terms for green refurbishments. Insurers and other institutions entering the real estate debt markets may also bring a keener sustainability focus.

We can expect to see a significant push in the drive for sustainability in the real estate sector in the near future, in particular as regards improving real estate development by way of revising standards and policies. Sustainability is expected to be mandated as a business imperative.

Conclusion

It's an exciting time for the real estate sector worldwide. Private capital is in huge demand for investment, with the competition for prime assets increasing. Looking into the future, there will be a need for more specialist roles in the industry. The quest for local knowledge, expertise and good government relations has become increasingly important.

Looking forward to 2020, it is the real estate managers and invests who have the vision and momentum to anticipate emerging trends in the medium term and prepare adequately for them, who will be most successful.

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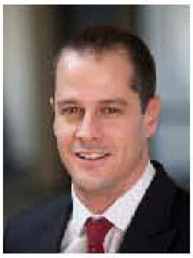

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