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October 27, 2017

Local property companies should use tough economic times to strengthen themselves for the future

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The property sector has seen exceptional growth and expansion over the past ten years, but in keeping with the more recent deterioration of general economic circumstances, it is operating at rather more depressed levels at the moment.

But, instead of merely "riding the storm" property companies would be best served by using this period to lay solid foundations so that they are well positioned for the future.

Property companies cannot afford to just wait for the cycle to turn – now is the time they should be focusing on ways they can be successful in the future. There are various new types of disruptions in the sector – and these are not limited to companies operating beyond South Africa's borders. The question is whether local companies are ready for these.

According to Grant Thornton's recently published report entitled *"The future of growth and the real estate industry: Great opportunities require strong foundations"* (please insert link to this report), one of the biggest factors weighing on the long-term viability of property companies is the changing profile of investors.

The report cites that: 'Real estate investors today are increasingly global, sophisticated and interested in a quicker return on investment (ROI).'

These international investors are currently looking to selected developed market property investments as a safe harbour, while there is volatility in emerging markets. However, this will not always be the case and companies need to ensure they are ready to take advantage of changes in global sentiment.

According to the report: 'Opportunity and opportunism go hand in hand with risk, calling for real estate organisations to evaluate where they are on the risk (and opportunity) curve. What happens, if due to acceleration in urbanisation, the global market switches its focus to emerging markets?'

Technology is named as another major factor in the making of strong property companies: 'The tradition-bound culture of real estate is becoming more flexible, adaptive and technology-savvy. Organisations must drive innovation and partner with technology experts to create smart building infrastructures and connected systems to manage their properties better.'

This is an area where South African companies have been particularly poor to date. The local sector has been very slow in embracing technology, and it needs to drastically improve on this if our companies want to ensure they can compete effectively with their global peers.

The impact of technology is also reflected in the changing nature of investors, the report states.

‘There is a growing interest from private equity funds and real estate investment trusts (REITs), which comprise investors with an expectation that technology is – or will be – leveraged for maximum ROI. As the profile of the real estate owner shifts, new owners are more technologically savvy and creative on deal structure.’

Only the companies who are most bold in addressing their challenges will perform optimally.

These technological changes often require significant investment and a break from traditional structures, but the long-term benefits to the business far outweighs the short- to medium-term cost.

‘The future of real estate companies is intertwined with technological advances. In particular, data will determine how to manage key priorities – from how real estate companies handle their portfolios to predicting tenant demand,’ states the report.

It’s important to remember that technology can also help to unlock value by addressing the structure of the current property market.

The report cites: ‘The real estate market is opaque and fragmented. Transactions are costly, with multiple intermediaries.’

Here is a clear opportunity for a market disruptor to remove some of the many intermediaries and improve efficiency and transparency.

Finally, the report mentions stronger balance sheets as a key priority for all sustainable property companies: ‘The best offense to weather a cyclical real estate market is a solid defence, which includes a strong balance sheet. Our research highlights that strong balance sheets are supported by establishing high benchmarks for asset performance. Scenario planning and financial forecast models to assess the potential impact of so-called black swan events help to test the sustainability of balance sheets.’

South African property companies must crucially strengthen this element of their businesses to ensure their businesses are built for the long term. They also need to reduce management costs – which are rising beyond inflation currently – if they are to compete for international investors.

The property sector will certainly face major cyclical challenges in the foreseeable future, but it is most important to look through these conditions and ensure that every business is fundamentally strong so that they can effectively attract a new wave of international investors and stay competitive even during downturns.

For more information on Grant Thornton’s Real Estate and Construction Services, please contact Lee-Anne Bac.