



# Real Estate Sector Study



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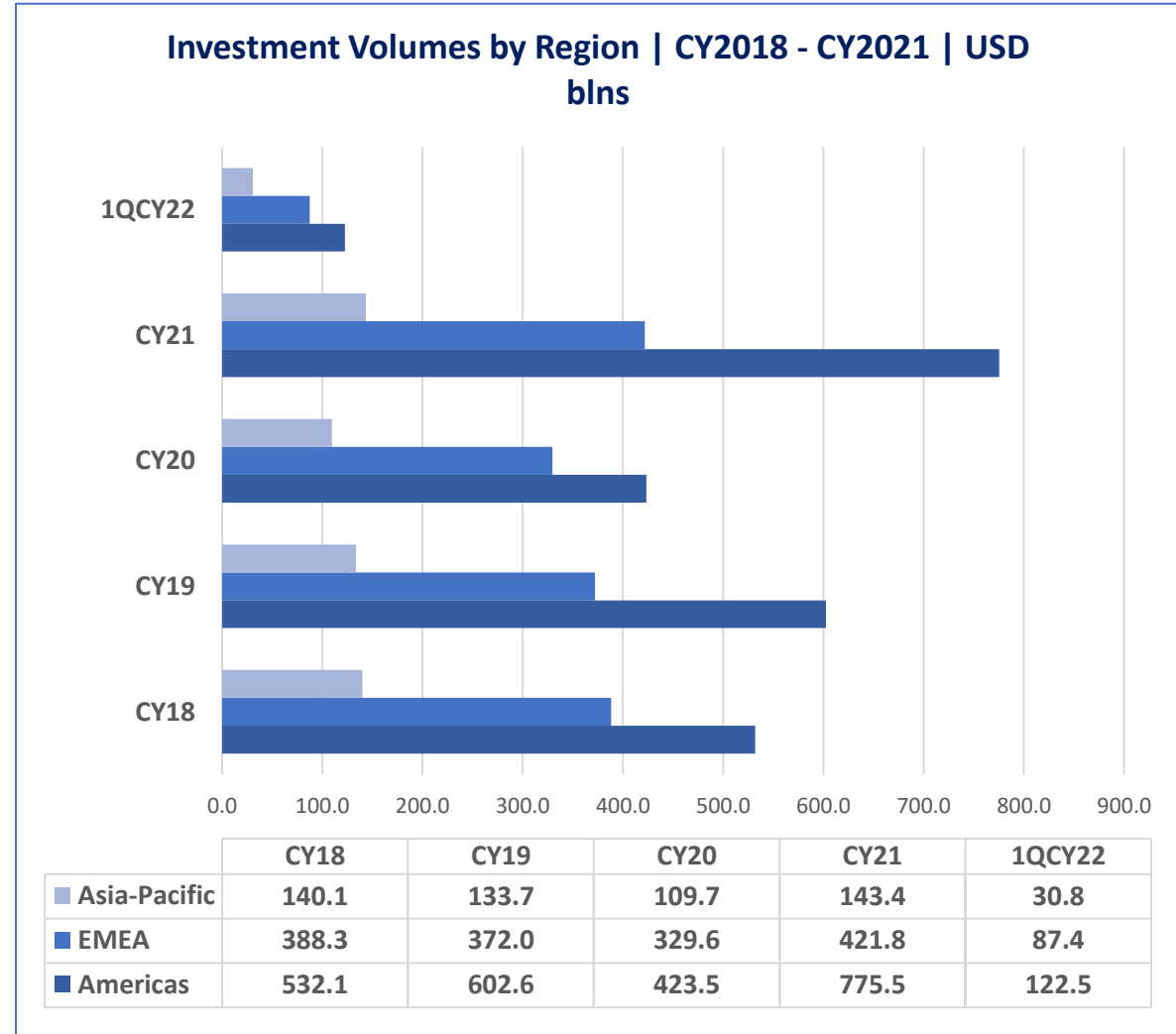


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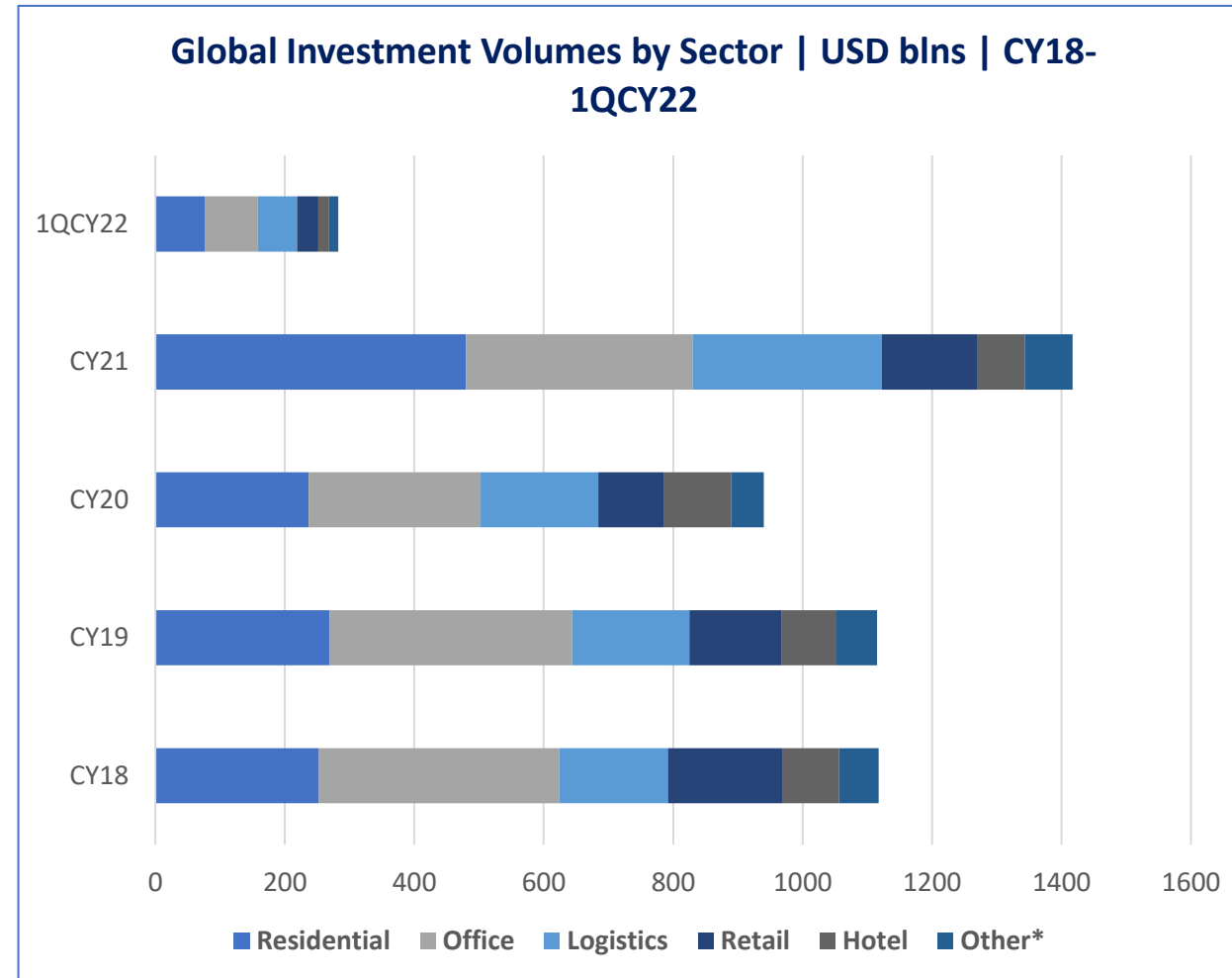
## Global Overview

- The real estate sector comprises four sectors: office, residential (or multifamily), logistics (or industrial), and retail.
- Global commercial real estate volume increased by ~ 34% YoY to ~ USD 282 bln in 1QCY22 making it the most active first quarter on record. This quarter marks the end of low interest rates across the world.
- 1QCY22 volumes in three regions totaled ~USD 240.7 bln (investment in Americas, EMEA and Asia-Pacific was up ~47%, ~ 25%, and ~5%, respectively). 4QCY21 volumes in EMEA, Americas and Asia-Pacific outstripped 4QCY19 levels (~ USD 503.5 bln and ~USD 365.1 bln, respectively) with the former two regions recording their highest volumes.
- The real estate sector experienced a record ~ 55% surge in investment volumes amounting to ~ USD 1.3tln in CY21 (CY20: investment activity was ~USD 0.8tln and growth was ~21%)
- With interest rates rising, inflation picking, and geopolitical uncertainty, the real estate sector is now facing a new set of risks. Real estate lenders are now looking to mitigate their risk. This has led to an increase in cost of borrowing and reintroduced focus on price discovery. 1QCY22 was left largely unscathed by these market events.



## Global Real Estate Investment | Sector Investment Patterns

- Out of the four sectors, the residential sector was the largest by volume for the sixth consecutive quarter in 1QCY22; investments totaled ~ USD 76bln up by ~ 18% a year ago (1QCY21 investments: ~ USD 65bln and YoY growth: ~16%). All sectors are showing signs of growth in 1QCY22.
- In 1QCY22, the multifamily sector accounted for ~ USD58 bln or 40% of investment volumes in Americas up by ~ 40% from last year. In EMFA multifamily investment volumes fell by ~23% due to lack of for sale-assets.
- Residential prices are increasing rapidly in the US due to increased investor interest, compressing the cap rate and raising rentals. Europe's price acceleration has been driven by solely a cap rate compression owing to increased investor interest.
- Office overtook logistics in 1QCY22 with the second highest volume in Q1 at ~ USD 82 bln, a ~ 44% increase from 1QCY21. There was a growth in office investment in Americas and EMFA (the latter reporting a surge of ~ 73% from 1QCY21.) Asia-Pacific reported a drop in investment volumes.
- Quarterly leasing volumes were up ~ 36% on 1QCY21. Leasing volumes were up in all three regions. However, global leasing volumes are still below pre-pandemic (1QCY19) levels. There is a shift in global demand towards quality and flexible work spaces which features hybrid work arrangements.



\*Other includes health care, mixed-use and alternatives

## Global Real Estate Investment | Sector Investment Patterns

- Global office vacancy rates edged up in Q1CY22 to ~14.7% as vacancy moved up in the US but remained relatively stable in Europe and Asia-Pacific; working from home is becoming a commonly observed pattern in the US.
- The industrial & logistics sector grew ~41% YoY in Q1CY22 to ~ USD 61bln with supply-demand imbalances remaining a key global factor. Demand for leasing space remains steady across the three regions.
- In 1QCY22 the region wise industrial and logistical sector investment grew by ~50% in Americas with single asset sales slowing but portfolio and entity-level transactions picking up pace. The growth rate observed in EMFA in the same period was ~41% with investor interest driven by rent growth from low vacancy rates and e-commerce. Investment volume grew by ~-2% in Asia-Pacific.
- Office vacancy rates remain low in all America, EMFA and mature Asian markets putting upward pressure on rents.
- The retail sector has experienced the highest YoY growth rate of ~65% for a total of USD ~33 bln. The Americas reported a ~79% YoY growth rate; EMFA reported a ~56% YoY increase while Asia-Pacific experienced a ~46% YoY increase. This dramatic recovery was due to the increase in mobility following the easing of Covid related restrictions and greater portfolio and entity-level transactions.

## Global Real Estate Investment | Mainland China's Real Estate Crisis

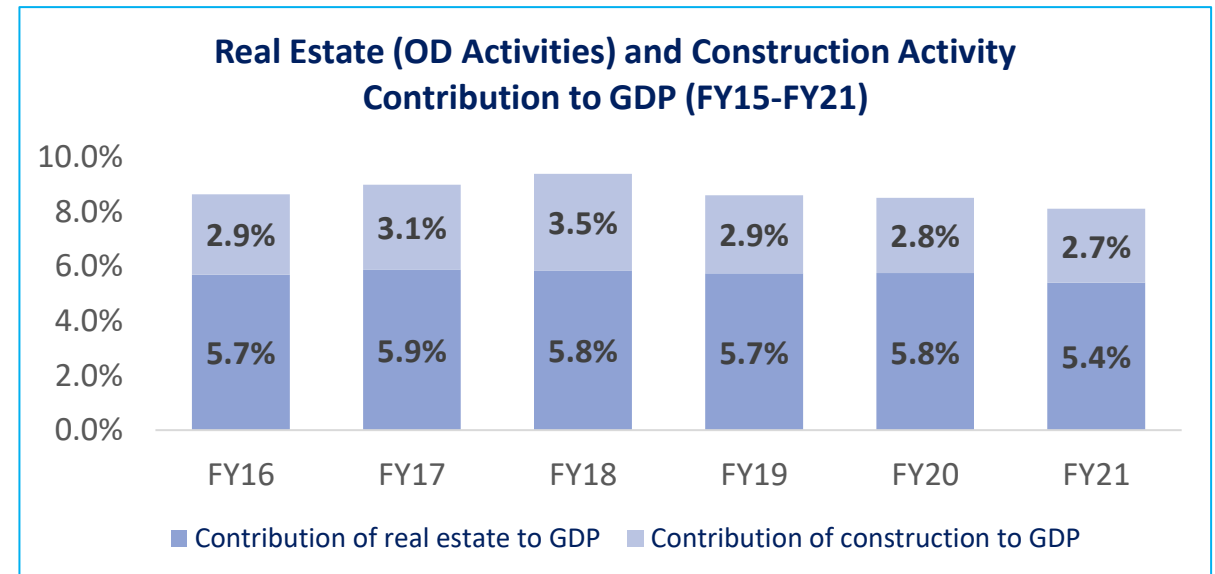
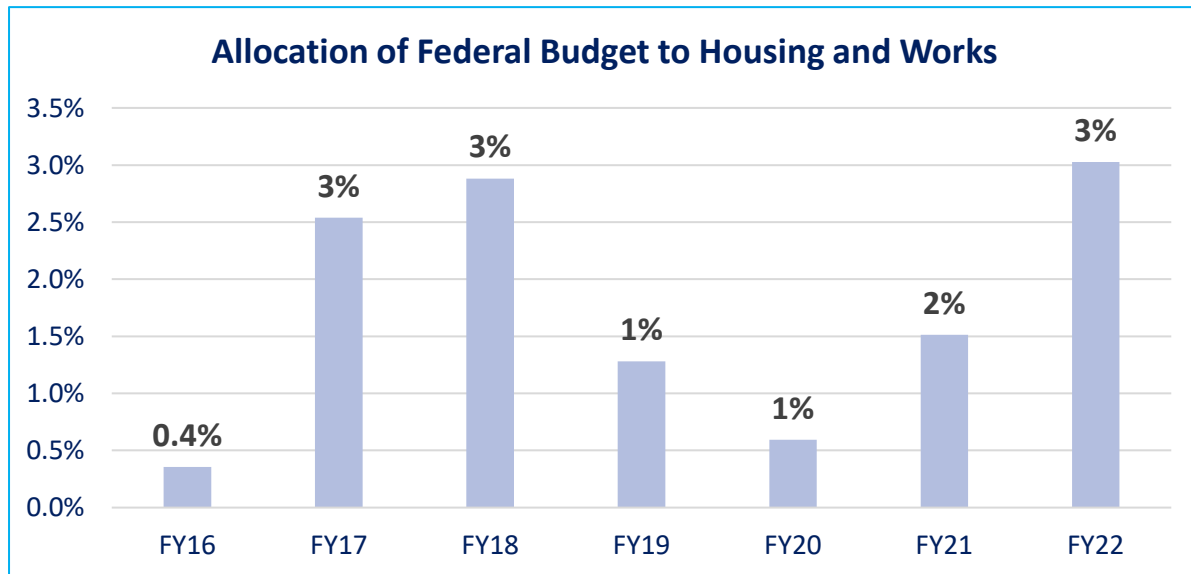
- According to China's National Bureau of Statistics, direct real investment contributes ~7.4% to GDP while the construction industry contributed ~7.2% to CY20's GDP.
- Real estate accounts for a significant proportion of household's net worth as property is regarded as a sense of economic stability and security. China has depended on the sector's expansion to contribute to economic growth and household's net worth in the past.
- 30% of China's bank lending goes to house construction and 60% of bank loans are back by property as collateral.
- In the first two months of CY22 housing sales fell by ~22% and housing prices slumped in the wake of a property market crises which started in December CY21 with the default of Evergrande Group on its ~USD 1.2 trillion overseas bond issues and escalated with the inability of other real estate developers to repay their heavy debt obligations. Evergrande Group is the first to default after the People's Bank of China implemented its 'Three Lines Policy' in an effort to maintain the sector's financial health.
- Mortgage benchmark rates have since been lowered and the People's Bank of China is relaxing the Three Lines Red Policy in an effort to ease pressure on the industry.

## Global Outlook

- Rising inflation, higher interest rates, and the war in Ukraine will impact investment volumes in the global real estate markets going forward.
- While demand will continue to remain high, global investment volumes should experience a decline with the EMEA experiencing the most drastic fall. This region will be most affected because the ongoing conflict in Ukraine means a shortage of labor (primarily in Eastern Europe). In addition, ongoing supply chain disruptions and rising inflation pressure will elevate the cost of construction projects currently in the pipeline. This will impact the budget of tenants and affect locational decisions as well as lead to the stalling of some projects. This holds true across all the sectors.
- In the long-run, there will be an increased reliance on local (or near shore) supply sources to reduce dependency of global supply chain networks. Countries or developers which focus on redesigning their supply chains will experience a boost in demand in the long-run.
- Increasing demand for residential real estate will continue driving prices upward. New homeowners will now face the challenge of rising mortgage rates as interest rates are increased to control inflationary pressures. An increased cost of financing may put downward pressure on prices, particularly in US and Europe, while equity investors' interest in the asset class will somewhat offset the decline. Rents will face upward pressure due to strong upward demand.
- On the supply side, significant investor demand means that availability of space will continue to remain a challenge. This will continue to push land values up further.
- In the search for portfolio diversification investors will explore niche real estate properties such as student housing and senior homes leading to a wider living investment market.
- How the debt crises is resolved in China depends on whether the government proactively chooses to resolve the crises with monetary and fiscal initiatives or whether reducing the sector's debt is the first priority. Nevertheless growth outlook for this residential real estate sector should shrink.

## Local Market | Broad Sector Overview | Real Estate

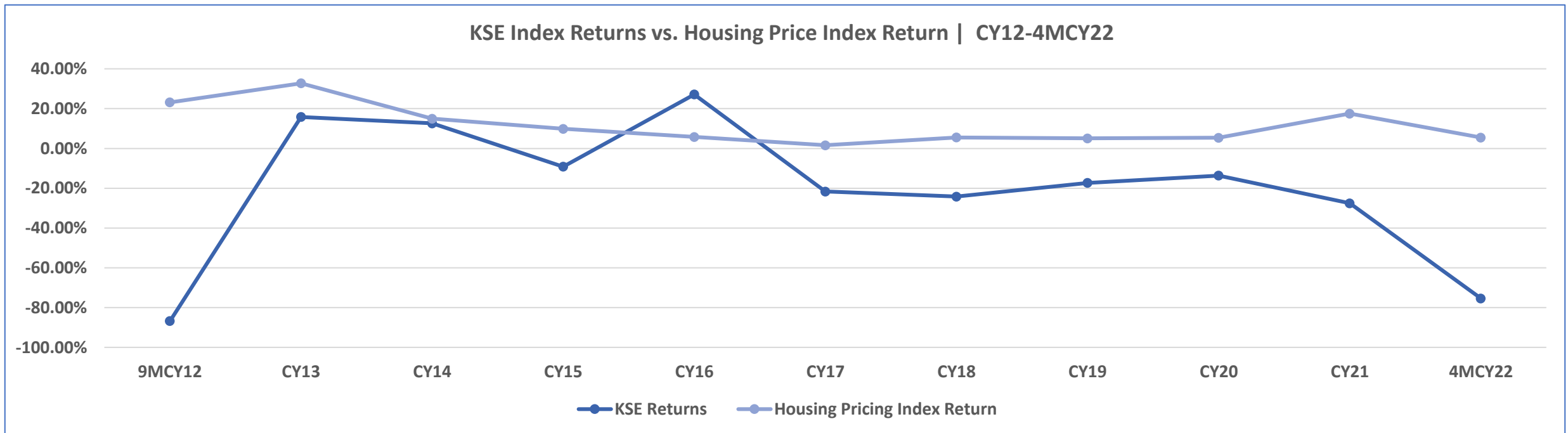
- Real estate includes developed or undeveloped land, housing or commercial projects including commercial markets or multi-story buildings (both commercial or residential), shopping centers, restaurants, hotels, industrial projects, infrastructure development, and mixed-use buildings.
- The real estate sector contains companies engaged in real estate development and operation. It also includes companies offering real estate related services and real estate investment trusts (REITs).
- Relative to construction activity, real estate contributed a greater amount to Pakistan's GDP over the FY16-FY21 period. FY21's real estate contribution was ~5.4% (FY20's real estate contribution: ~5.8%). Housing and works (which includes construction of roads and refurbishment of public property and infrastructure development) has received a slight increase in budget allocation in FY22 of ~3.0% (FY21: ~2%) which echoes the PSDP's objective of 'improving livelihoods', announced by the office in their FY22 initiatives document.





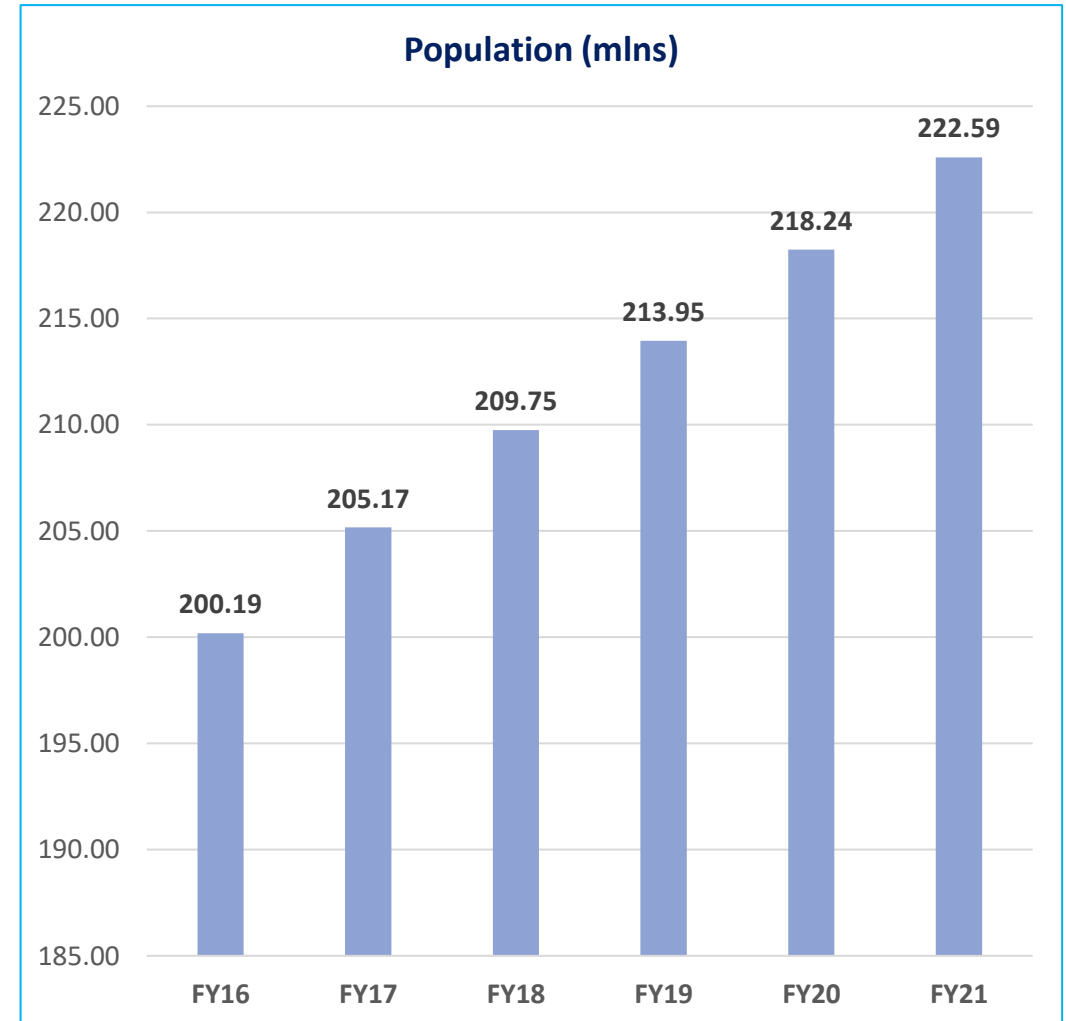
## The Real Estate Asset Class | Potential for Higher Portfolio Returns

- Over the CY12-4MCY22 period, the KSE100 index displayed more volatility in return relative to the housing price index. Volatility in returns offer more opportunity for rewards and losses.
- On the other hand, the lower volatility of the housing price index indicates the ability of the real estate as an asset class to provide portfolio protection for investors during market slumps.
- From CY20 onwards, prices are rising due to higher demand for residential real estate following the introduction of government schemes for builders, developers, and aspiring homeowners.



## Housing Demand Drivers

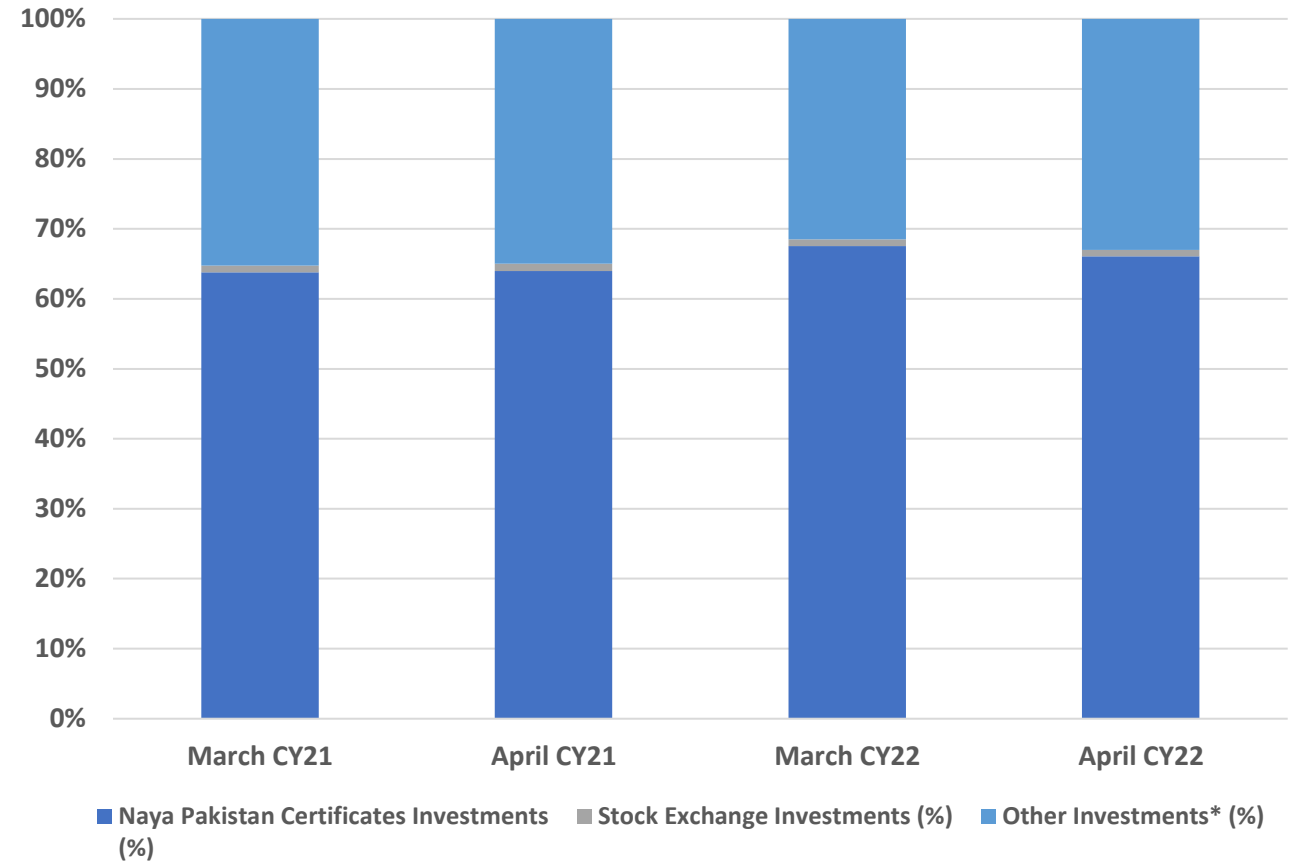
- Pakistan’s population has grown by a CAGR of ~2.1% over the FY16-FY21 period and by ~2% in FY21. If this trend prevails, the national population will grow to ~227.04 mln in FY22 and ~231.58 mln in FY23. A growing population will increase demand for housing, more significantly in urban centres.
- Based on the Pakistan Social and Living Measurement (PSLM) CY19-CY20 survey, conducted by the Pakistan Bureau of Statistics (PBS), the number of occupants per housing unit averages ~6.56. Based on current and projected population, the required number of housing units in FY22 and FY23 will approximate to ~34.86 mln and ~35.30 mln.
- Further findings by PIDE, using the same PSLM survey, finds that occupancy of dwellings is ~82% and rented space is only ~11% in Pakistan (in both rural and urban Pakistan).
- Housing demand in Pakistan has increased by several folds due to the two markup subsidy schemes launched by the SBP, Mera Ghar Mera Pakistan (for country residents) and Roshan Apna Ghar (for overseas Pakistanis).
- In addition, the tax amnesty scheme, lower interest rates and tax incentives were the key drivers behind the surge in commercial and residential real estate activity.



## Overseas Real Estate Investments | Roshan Digital Account

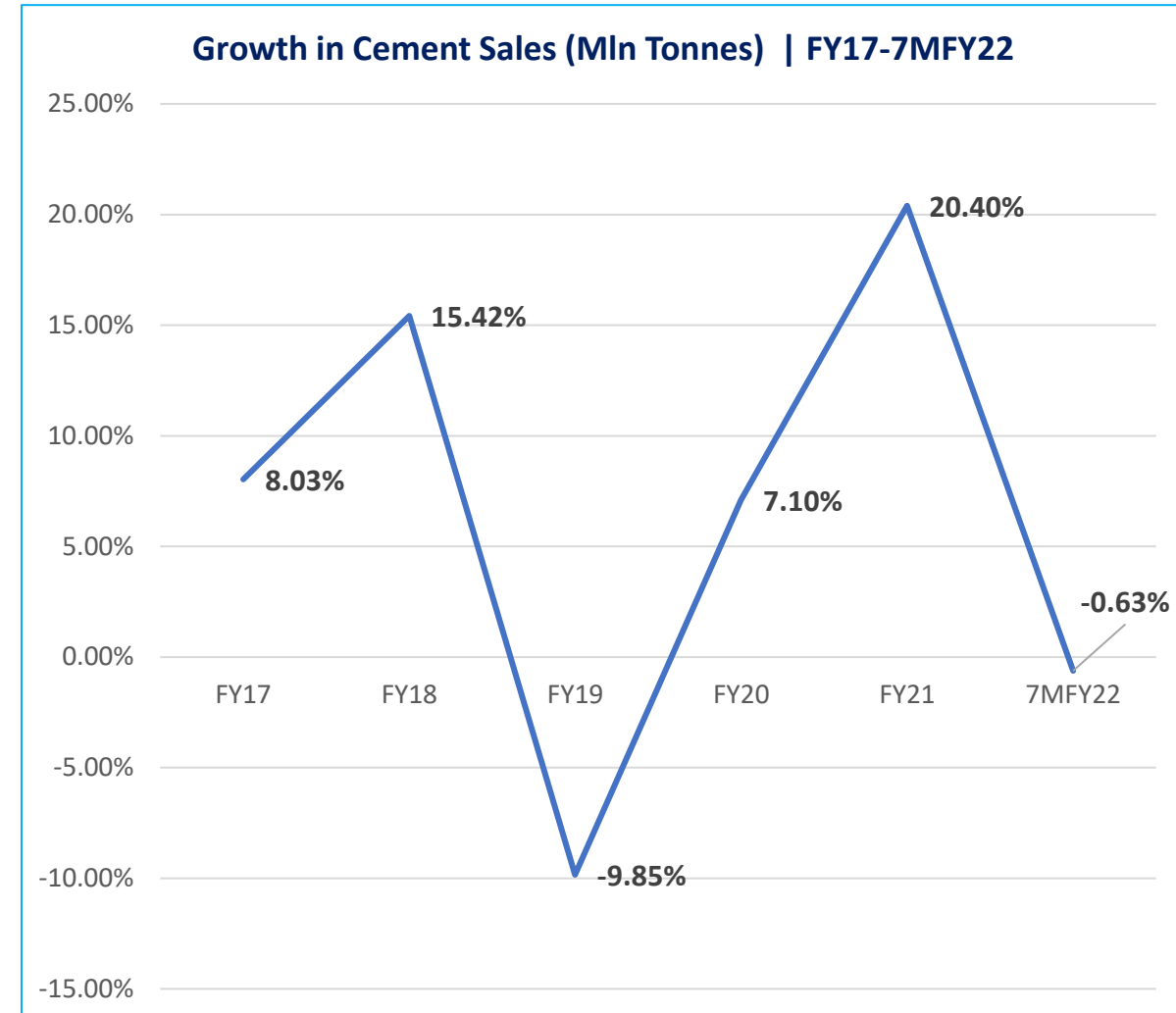
- Launched in September CY20, the Roshan Digital Account (RDA) is an initiative by the State Bank of Pakistan in collaboration with commercial banks operating in Pakistan.
- The RDA provides innovative banking solutions for millions of non-resident Pakistanis who seek to invest, bank and/or execute payments in Pakistan. Account holders are given the opportunity to open a digital account remotely.
- The RDA enables overseas Pakistanis to avail conventional account services, purchase a car under the Meri Gari Scheme; invest in shares and funds listed on the PSX; invest in Naya Pakistan bond certificates; make charitable donations; and to invest in the Pakistani (residential and commercial) property market.
- Other investments comprised ~33% of RDA inflows in April CY22 or ~ USD 1,376 mln (March CY22: ~32% or ~USD 1,236 mln; April CY21: ~35% or ~USD 369 mln). A record of ~USD 4,176 million were deposited into RDAs in April CY22 (March CY22: ~USD 3,922 mln; April CY21: ~USD 1,055 mln).
- The Roshan Apna Ghar scheme, launched by the SBP in CY21, makes it easier for non-residents to digitally purchase property; and build or renovate a home.

Roshan Digital Account Investment Allocation | March CY21-Apr. CY22



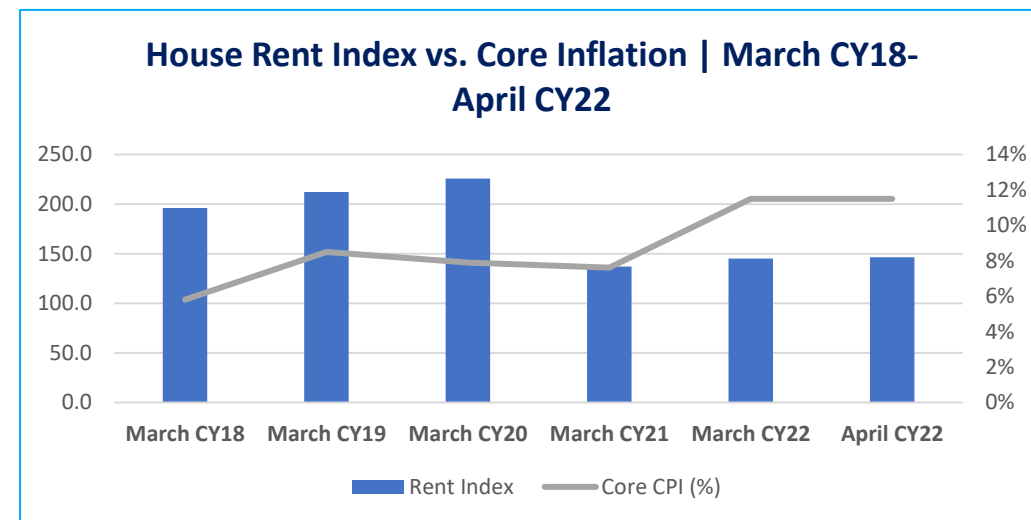
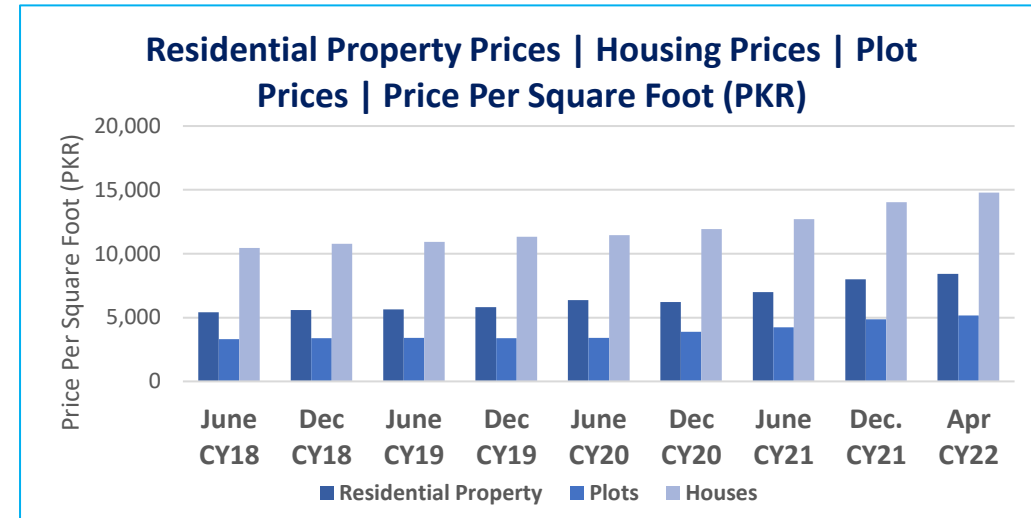
## Cement Sales Trend | Real Estate Development

- Cement is a key construction input for commercial and residential real estate. Growth in cement sales is a leading indicator for real estate development activity and supply.
- In the 7MFY22 period, demand for cement (in mln tonnes) plummeted by 0.63% from SPLY. This appears to indicate a slowdown in construction and development activity owing to rising input costs (including coal).
- The surge in sales observed in FY21 (~20.40%) was due to the construction relief package provided in FY20 (~7.10%) in an effort to boost real estate construction. Relief measures included fixed tax rates (to be levied only at the time of sale) of PKR 50 per square foot for builders and PKR 100 per square yard for developers; the package expired at the end of CY21.
- Real estate development activity surged during FY20 and FY21 due to monetary and fiscal incentives provided by the government. In an effort to boost low-cost housing development activities, the FBR completely exempted provincial sales taxes on the sale of low cost housing for the sector in all provinces of the country in addition to tax exemptions on the purchase of building materials (except for cement and steel).



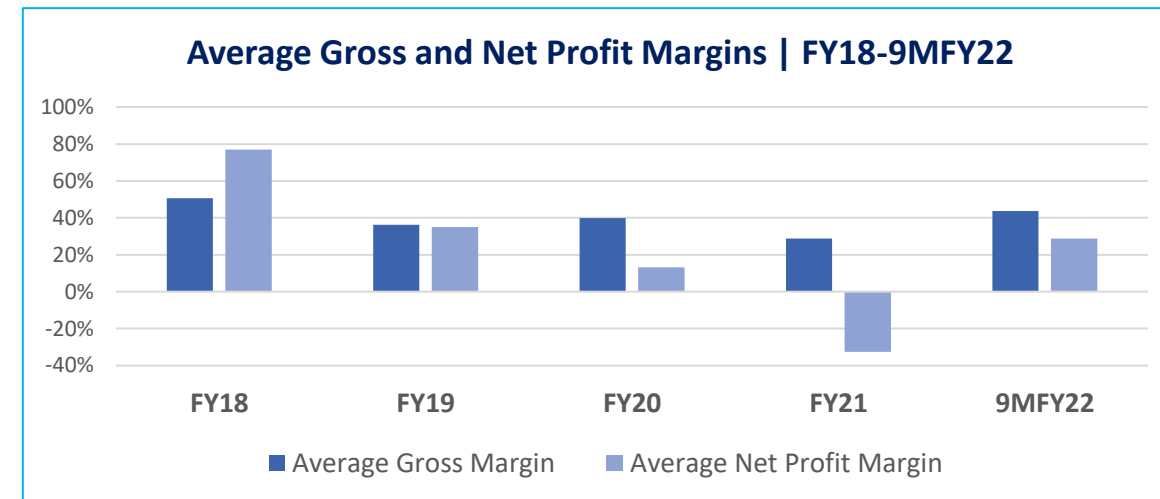
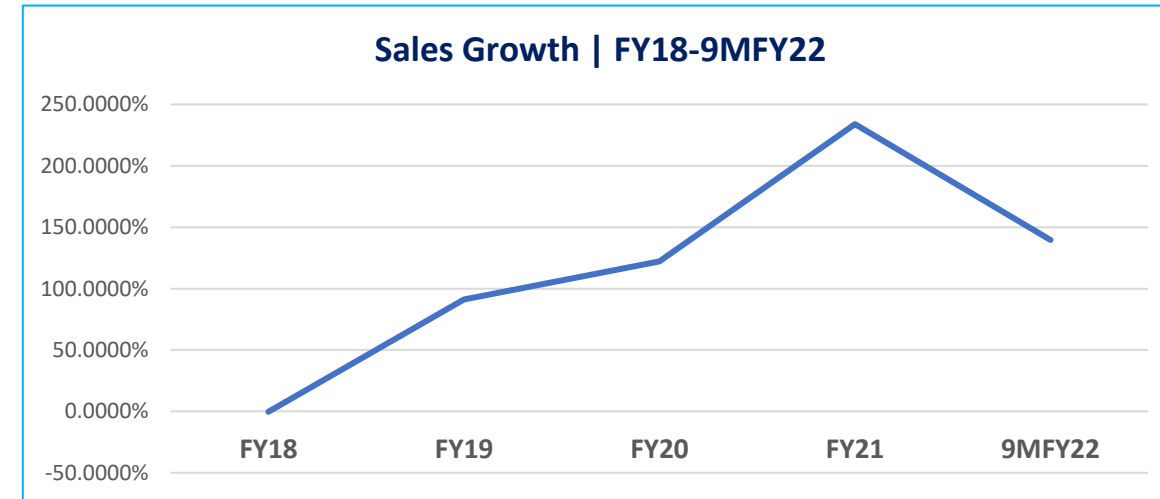
## Supply

- The supply side of real estate mainly consist of offices, plots, residential property, infrastructure projects, and houses. The concept of vertical cities and mixed-used buildings is also increasingly becoming popular.
- In addition, currently popular real estate investment trends include hotel/service apartments, townhouses, and real estate investment trusts (REITs).
- Due to increasing demand for real estate, property prices have surged. From December CY18 to December CY21 residential property prices have surged by ~42.7%; housing prices by ~43.8%; and plot prices by ~30.2%. In April CY22, the YoY price increase for residential property was ~24.3%; houses was ~18.8%; and plots was ~ 26.9%. Prices are at their highest for each type of residential property.
- In April CY22, MoM change in non-food non-energy core inflation was ~0% (YoY change from March CY21 to CY22 was ~50.0%). Rents increased by 1% MoM and 5.9% YoY, respectively. One possible reason for difference in rental growth and CPI could be the built-in inflation hedge in rentals.
- Real estate construction activity was at its peak in FY21 due to incentives provided to developers and builders. This resulted in an increase in the supply of residential and commercial properties and the commencement of many development projects.



## Industry Performance | The Past and Present

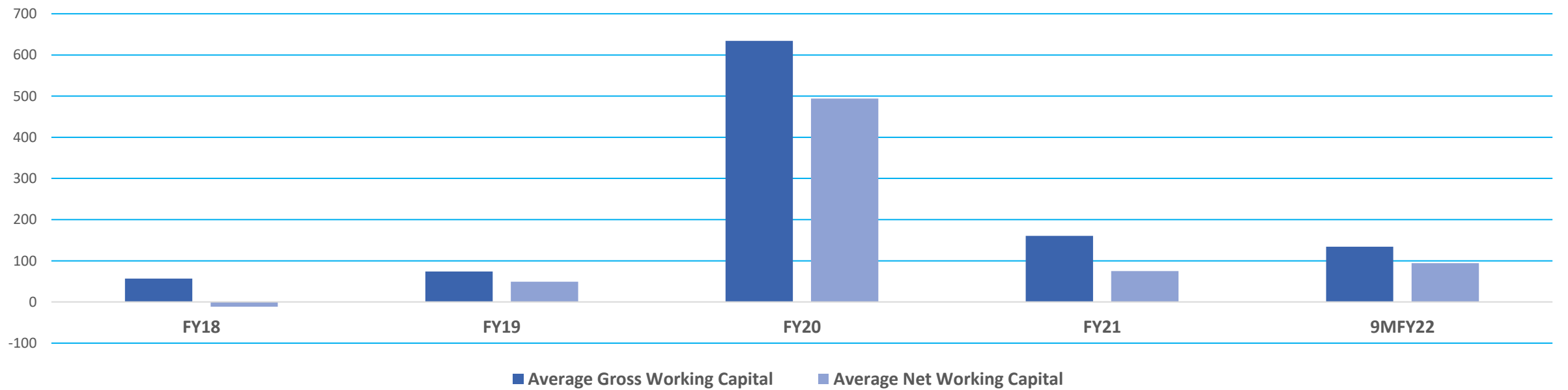
- Sales revenue declined by ~ 94% in 9MFY22 from FY21 after industry sales growth peaked in FY21 for the first time since FY18. However, this does not indicate a decline in demand but was attributable to restructuring of company products including the sale of a flagship project, a key contributor to the revenue stream.
- In addition, the government monetary and fiscal incentives were a major reason behind the surge in sales growth in FY21 and until mid-FY22.
- The 9MFY22 period has resulted in a healthy gross profit margin of ~ 44% compared to FY21 (~ 29%). Strong sales growth has been a major factor behind this; cost of sales have been slightly elevated due to higher development costs of properties sold owing to increase in construction costs.
- Average net profit margins have dramatically improved (9MFY22: ~ 29% and FY21: ~ -33%) and this is due to income realized from the sale of a key revenue source for one player and more efficient working capital management as a result of reduced financing costs on short-term financing for others.



## Financial Risk | Working Capital Management

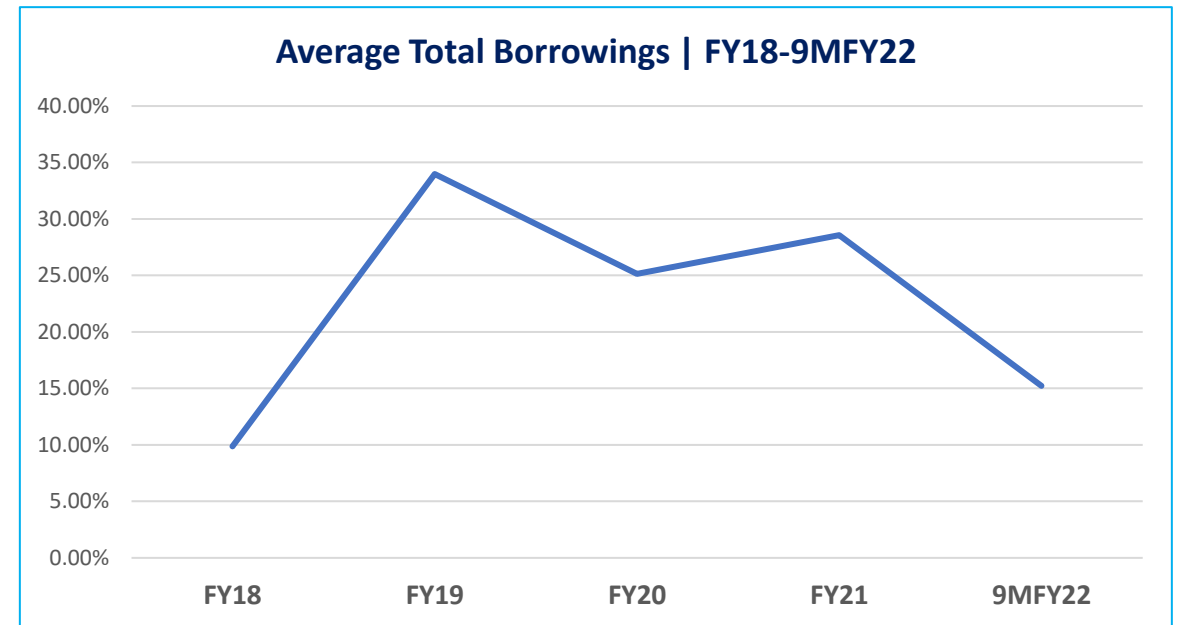
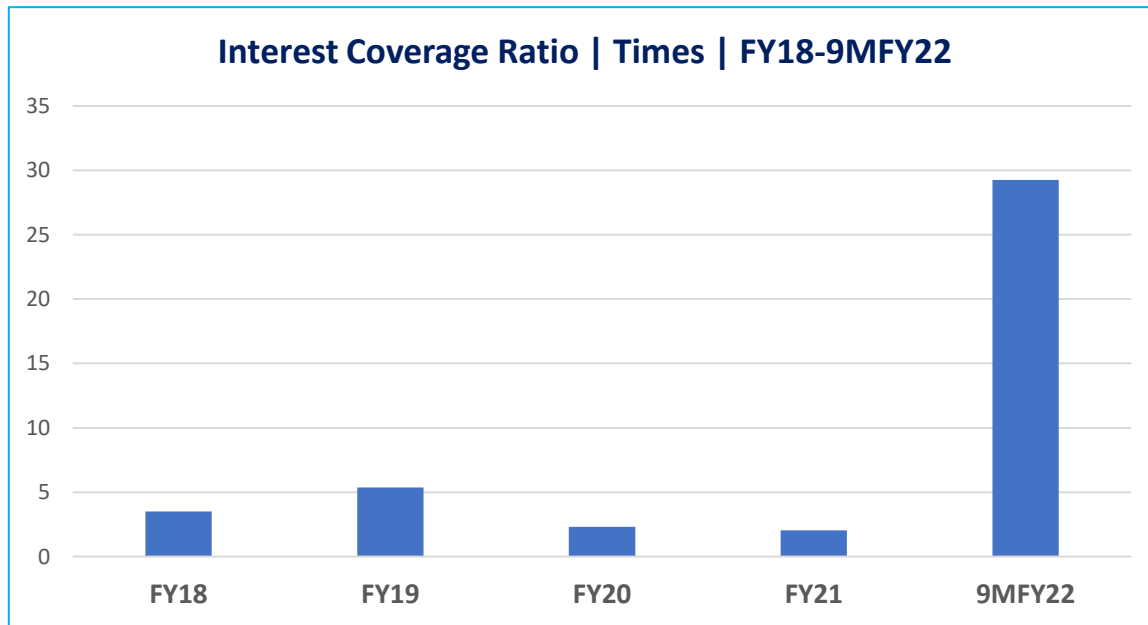
- The real estate industry’s main components of working capital are advances from customers and suppliers as well as trade debts. Inventory is not a working capital component. Average gross working capital declined by ~26 days in 9MFY22 (FY21 gross working capital: ~ 160 days). While trade debts and loans and advances increased in the current period for some players, so did net revenues which was a major reason for the decline.
- Net working capital increased in 9MFY22 to ~94 days (FY21 net working capital: ~75 days). The major reason for the increase has been an increase in trade debts and sale of investments to a subsidiary.

Average Gross and Net Working Capital | Days | FY18-9MFY22



## Financial Risk | Coverage and Solvency

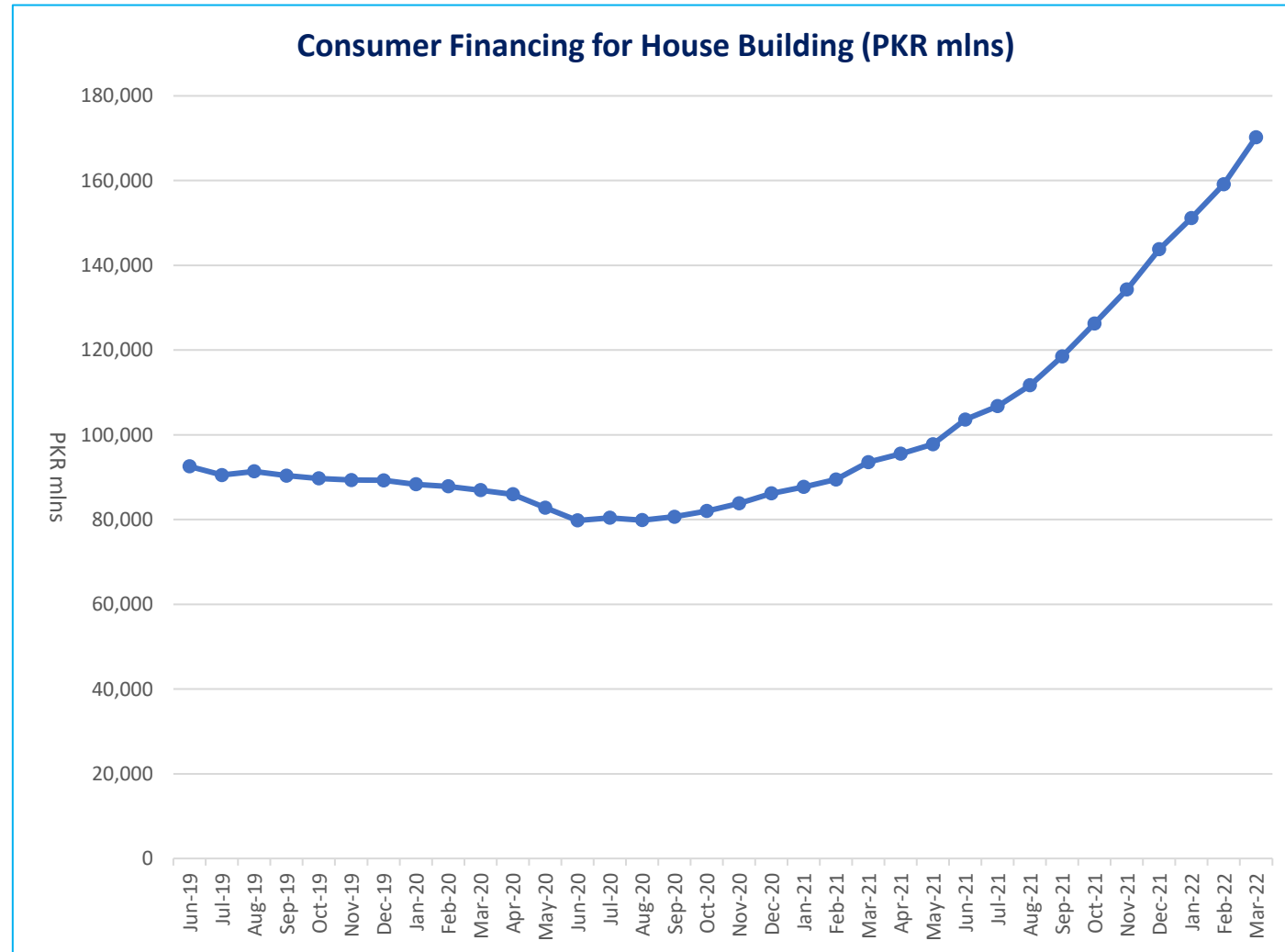
- There was a dramatic improvement in interest coverage owing to reduction in finance costs on long- and short-term borrowings; far value gain on investment property; and transfer fees received from plots and bungalows sold.
- There has been an improvement in the solvency position of companies in 9MFY22; the average financing structure in the period comprised ~15% debt and ~85% equity (FY21 financing mix: ~29% debt and ~71% equity). This improvement is largely due to a growth in equity capital base arising from upward revaluation in property fair values which are being parked in revaluation reserves. The industry’s reliance on borrowings has also increased between these two periods as developers seek to take advantage of attractive interest rates offered by the SBP.





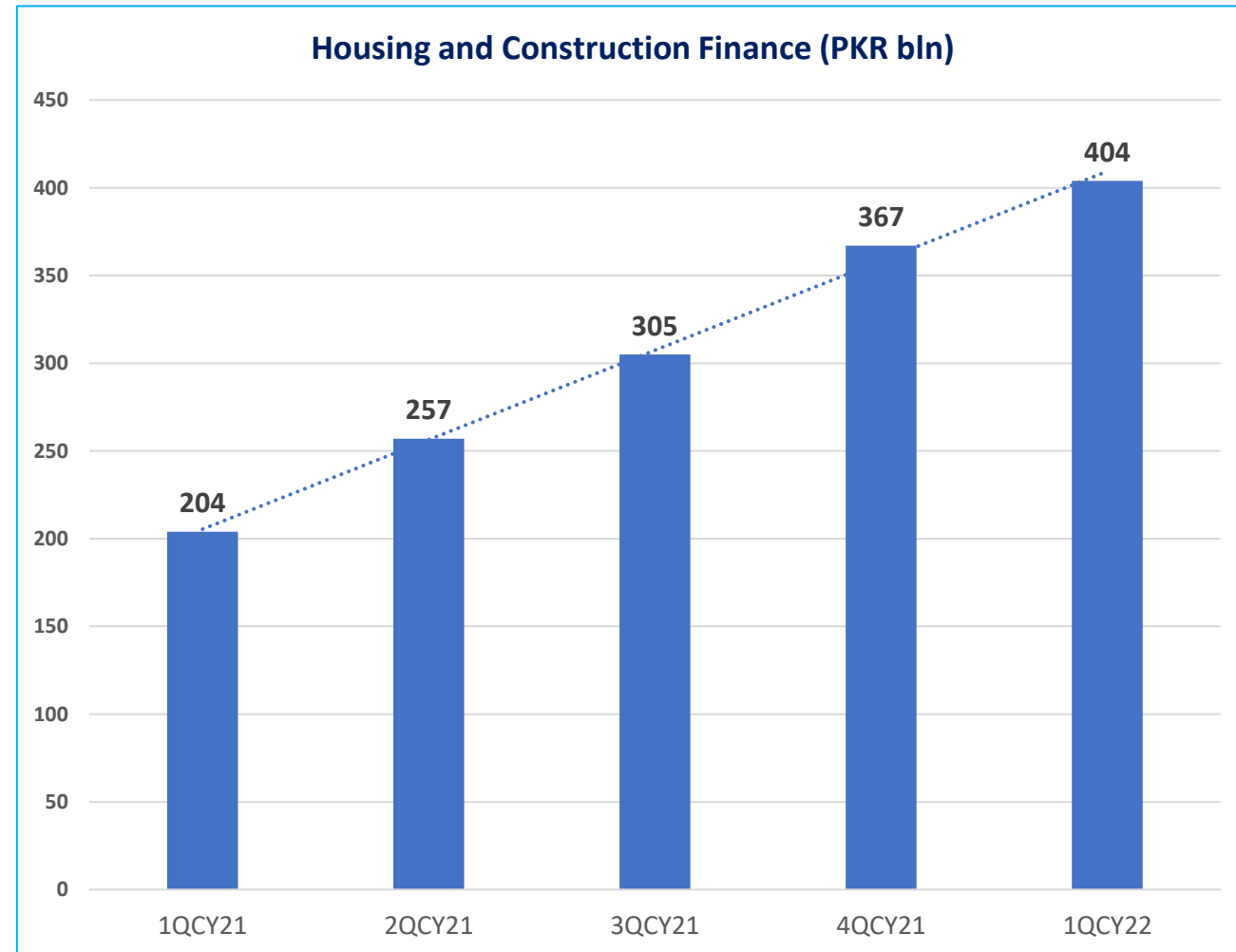
## SBP | Financing Initiatives for Homeowners and Developers

- The Mera Pakistan Mera Ghar and Roshan Apna Ghar Schemes launched by SBP for local and overseas Pakistanis, respectively, in CY20 provides house financing on markup subsidy rates; financing is available in Shariah and conventional modes.
- In March CY22, consumers secured ~ PKR 170 bln loans representing a MoM increase of ~ 7.0% and YoY increase of ~ 81.9%.
- In its April CY22 press release, the SBP announced that banks received loan applications of PKR 409 bln to date, which was merely PKR 57 bln a year ago. Out of these, banks have approved applications amounting to PKR 180 billion and disbursed PKR 66 bln; this represents a ~11 times increase in loan approvals from one year ago.



## SBP | Regulations for Banks

- In an effort to boost mortgage financing and boost housing and construction financing for builders and developers, SBP required banks to allocate 5% of their advances for lending over a period of eighteen months; i.e. by December 31, 2021.
- SBP had also specified targets in the form of number of housing units to be financed and amount to be financed. Monthly targets were assigned to banks based on their asset size with targets effective from July 31, 2021. A penalty was charged in case a target was not met.
- As a result, bank financing to the housing and construction sector increased to ~PKR 404 bln as of 1QCY22 from ~PKR 367 bln as of 4QCY21 (from ~PKR 204 bln as of 1QCY21).
- For CY22, banks have been advised to increase their housing and construction portfolio to 7% of their domestic sector private advances (up to PKR 560 bln).



## Taxes | Capital Gains Tax on Immovable Property

The amnesty tax scheme, which allowed investment in real estate without questioning the source of income, ended on June 30, CY21 while the construction relief package ended on December 31, CY21. The Income Tax Ordinance 2001 was also revised on 30 June CY21 to include new tax rates for immovable property.

- If the gain does not exceed PKR 5 mln, applicable tax rate is 3.5%.
- Where the gain exceeds PKR 5 million but does not exceed PKR 10 mln, applicable tax rate is 7.5%.
- Where the gain exceeds PKR 10 mln but does not exceed PKR 15 mln, applicable tax rate is 10%.
- Where the gain exceeds PKR 15 mln: applicable tax rate is 15%.

The tax rates applicable to builders and developers for buildings and plots, respectively, has been revised on 30 June CY21 with the flat tax rate scheme being replaced by a new series of rates for commercial and residential buildings and plots.

The revised tax rates for builders on buildings is as follows:

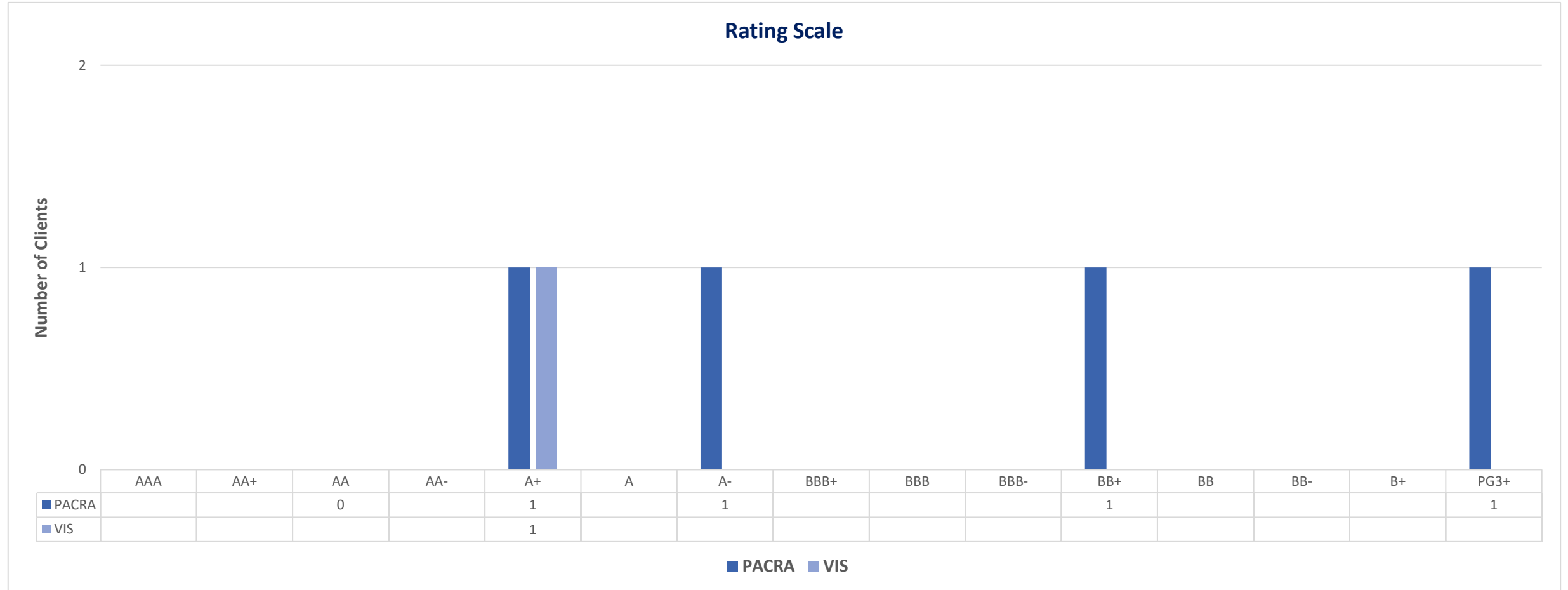
- All commercial buildings in urban areas will be taxed at a rate of PKR 210 per square foot
- Tax rates for residential buildings have been devised based on their area per square foot.

The revised tax rates for developers on plots is as follows:

- All commercial plots in urban areas will be taxed at a rate of PKR 210 per square yard.
- Tax rates for residential plots have been revised based on their area per square yard.

## Rating Curve

- PACRA rates four companies in the real estate sector.



## Outlook - Stable

- The demand for real estate projects increases with rising population and economic growth. Pakistan is the fifth populous country in the world and also has one of the fastest growing population. This indicates potential higher demand. Urbanization in the country has also increased in recent years; according to the CY17 census ~36.4% of population lives in urban areas, the highest in South Asia. Offsetting this higher demand projection is the end of the tax amnesty scheme which will likely put a dent on real estate demand.
- The conclusion of the construction relief package means that developers and builders will see a decline in near-term profitability due to the payment of higher taxes. On the flip side, an increase in budget allocation to housing and infrastructure projects in FY22 is a likely indicator of an increase in housing supply and growth in the real estate development sector.
- On the real estate development side, rising input costs, global supply chain shortages, a free falling PKR (recently devalued to ~201 against the USD) will increase the cost of construction. Building a home may become next to impossible when considering inflation and a rising cost of living. On the other hand, rupee devaluations have been associated with increased inflow in real estate from overseas Pakistan in the past. This trend may continue given the continued positive inflow in the RDA.
- The SBP aims to ensure the vision of providing low-cost housing to the middle and poor segments of the society is executed through policy measures. These measures have started to yield positive results as evident from the rising approval of housing loans by commercial banks, increase in loans for construction activities, and inflows into the RDA. These initiatives will continue to make home financing affordable in light of rising interest rates; the most recent policy rate is ~ 12.25%.
- Even though the upward trajectory in housing loan approvals appears optimistic, the numbers are considerably low taking into account two factors – firstly, a population of ~222.59 million in FY21 and secondly, these loans are not accessible to the poorest of the poor because the mark-up rates (although subsidized) make paying interest a difficult feat in an inflationary environment where the cost of basic living is rising.
- In addition, mortgage lending is an inherently risky venture and adequate foreclosure laws should be implement such that bank are given necessary protection.
- Favorable results and investment returns in the REIT sector will make this asset class a valuable and alternative investment option; REITs should help serve as a diversifier in times of economic volatility given that they have built-in inflation protection.

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