

Real Estate Strategy and Real Assets

*Insights from PwC's global
asset management practice*

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Active management of real estate assets is becoming a strategic imperative for users, and real assets include investment alternatives that present new and unique risk factors that need to be carefully evaluated in making investment decisions.

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It used to be that only those dedicated to the real estate industry actively sought to create value and generate risk appropriate returns from buildings and similar assets. But that's changing. As asset values increase, companies are re-evaluating capital committed to real estate, focusing on maximising returns on investment and planning for the strategic role of infrastructure and the related capital requirements. As a result, most organisations need a thorough real estate strategy that is in alignment with the overall corporate strategy. At a minimum, the importance of real estate and related priorities for serving operations, administration and other corporate demands, should be clearly reflected within the corporate strategy.

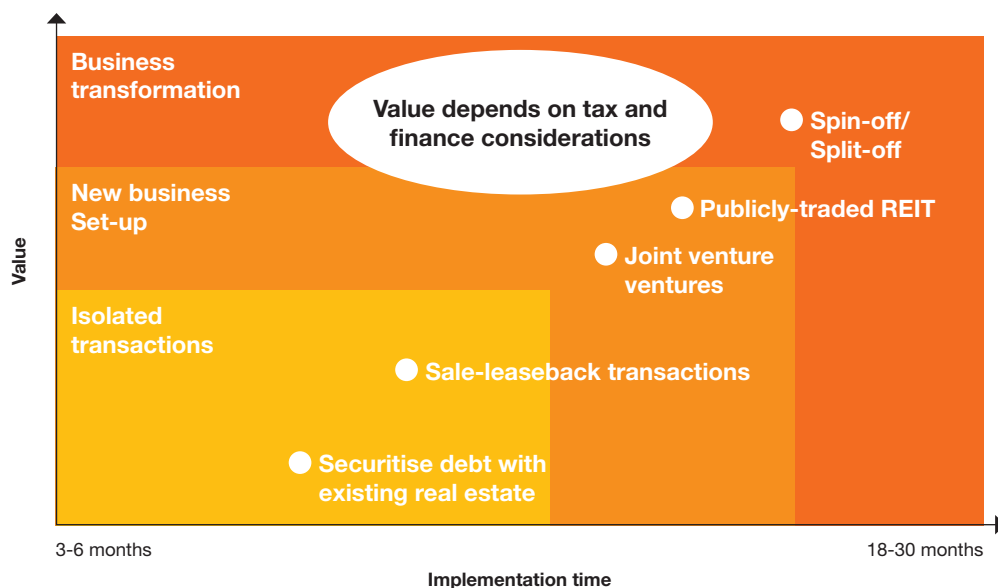
Many companies have significant capital tied up in real estate, which can lead to questions about the alignment of real estate investments with the overall corporate strategy. In addition, it has become fairly common for investors to challenge management on whether the deployment of capital to real estate is justified relative to more strategic priorities that might provide a superior return. How a management team chooses to deal with these issues can be critical to overall performance and significantly impact operating metrics, enterprise value and stock price. As a result, real estate issues are now being debated, and decisions are being made, in the C-suite at most companies with real estate dependencies (e.g., retail, hospitality, healthcare, technology).

Monetising real assets

In the US, shareholder activists are driving real asset dependent companies with significant real assets on the balance sheet to evaluate the potential benefits of a monetisation strategy whereas in other territories capital optimisation may drive these decisions. Real assets categorically include traditional real estate, such as office buildings, manufacturing facilities or retail outlets, and non-traditional assets, such as infrastructure, cell towers and utility transmission lines. The common attribute among these real assets is the potential to lease the asset and create a lease stream that can be monetised. One would expect that many well-managed companies can earn a better return investing capital in its core business, rather than allocating capital to real assets that are often not reflected at market value in a company's stock price and sometimes provide inferior returns relative to those generated by the core business. There's an argument to implement monetisation strategies elsewhere in the world, although investors in markets other than the US have to this point been less assertive in their demands of management.

As discussed above, many companies now incorporate domestic and global real estate priorities into strategic planning. If there are motives or needs to free up capital or unlock shareholder value, and it can be achieved without compromising the alignment of real estate strategy with overall corporate strategy, real estate monetisation presents some interesting options (see the accompanying table) and should be considered. Historically, monetisation transactions were typically used for traditional real estate, but the market has expanded to real assets. Real assets include traditional real estate and a diversity of other assets that generate discreet revenue streams from long-term leases, including billboards, cell towers and utility/telecom infrastructure.

Real Asset Monetisation Strategies



For real asset monetisation to make sense, a company needs to have a sizeable portfolio of real assets and/or long-term leasehold interests in real assets. There are sometimes implications derived from monetisation transactions that conflict with priority imperatives of the core business. These situations might arise from the need for absolute control over facilities, tight security and limited outside access or to locate in specified markets that align, convey an image or contribute to brand. It is important that these and other similar factors are thoroughly evaluated and resolved as part of the feasibility assessment of monetisation alternatives. In addition, management should assess whether the existing real asset footprint and usage models are optimum – from financial, operational, capital, tax and investor perspectives.

Infrastructure as an asset class

Turning to infrastructure, needs are growing fast. The World Bank estimates that, by 2030, the world will require 40% more energy and face a 40% shortfall of water – pressures that may be further intensified by climate change, amplifying the requirement for infrastructure investment globally.

The challenge is to solve the need for basic services like power, transport, water and sanitation with investable projects that provide risk-appropriate returns and can attract private capital. In 2015, the World Bank launched its 'Global Infrastructure Facility' (GIF), specifically to expand the universe of infrastructure projects that are suitable for private investment. To give some idea of the capital that could be put to work, the GIF's private sector advisory partners include investment institutions with approximately US\$12 trillion of capital.

For investors, infrastructure is a potentially huge opportunity. The World Bank estimates an infrastructure funding gap of more than US\$1 trillion a year in emerging markets and developing economies. At PwC, our 2014 Asset Management 2020 paper suggests that asset managers will play a more central role in economies, including through the financing of infrastructure projects. Investment managers are raising significant sums to invest in everything from airports, to power plants, transportation hubs and water treatment facilities. We've recently identified more than 200 dedicated infrastructure funds with a total value of US\$86 billion, of which only US\$19.6 billion has been deployed, leaving an abundance of dry powder competing for investment opportunities.



Collaboration between private investors and governments, whether through public-private partnerships or other creative structures, will be important to the pace of infrastructure development around the globe. As highlighted in PwC's 2014 Real Estate 2020 paper, unless governments can finance infrastructure through private investment, insulating them from the risks that have in the past imposed liquidity problems, impaired their borrowing capacity and put essential government services in jeopardy, many of these projects will not be economically feasible.

Real estate moves centre stage

Determining how capital should be deployed to maximize a company's overall return, in a low interest rate environment, is a unique challenge of the times and increasingly important for finance teams in the C-suite. In some cases, decisions regarding composition of the balance sheet or the capital stack can impact company performance to the extent that it becomes a differentiator among competitors. Integration or alignment of real estate strategy with financial, capital, operating, risk management and overall corporate strategies has emerged as an important priority for the C-suite. Meanwhile, the investment landscape continues to evolve, as demand for properties is affected by outside influences, development is underway or being planned in certain supply constrained markets and investment returns are at or near historical lows in many global markets. These and other factors will impact real estate strategy and should be monitored so that companies can move quickly to capitalize on market opportunities or eliminate downside risk.

Collaboration between real asset users and private investors has enabled monetisation and resulted in less real estate risk for many users, as well as new and unique investment opportunities for a broad range of investors. Comprised of relatively diverse income producing assets and including traditional real estate, real assets has emerged as a legitimate investment alternative for institutions, asset managers and private investors. In addition, infrastructure continues to attract large sums of capital which has contributed to intense competition for new deals. The attractive return potential and substantial capital requirements associated with infrastructure development projects is causing many asset managers to recast their allocation strategies.

Real assets have introduced new demands, presented new opportunities and become an important element of corporate strategy that requires significant consideration in the C-suite. The evaluation of investments and asset allocation strategies by investors have been complicated by the emergence of real assets, in particular the projected capital needed for infrastructure development and the new and somewhat unfamiliar risks that these diverse investments present. For both users and investors, the importance of real assets will require new competencies, the implications of real asset performance can be significant and decisions around capital allocation to real assets will be important to long-term success.

