



Real Estate Sector Study



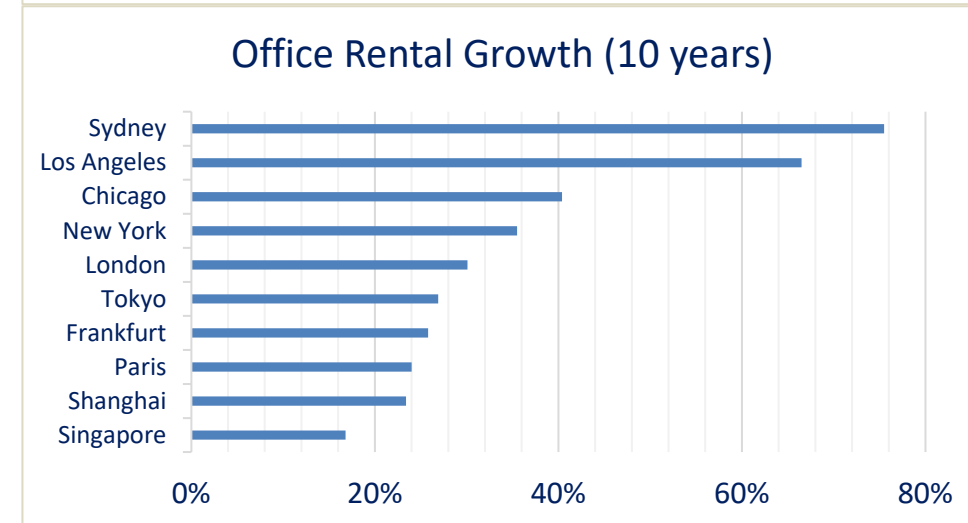
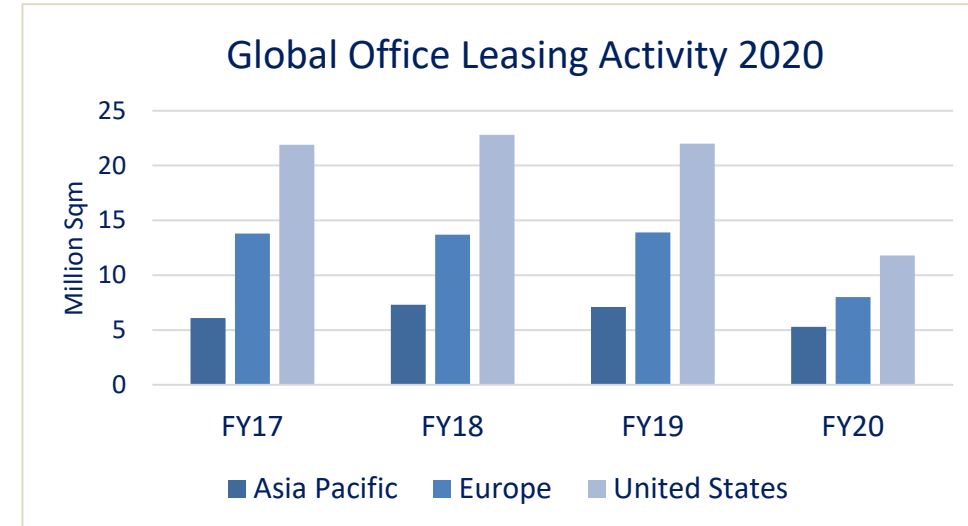
Table of Contents



Contents	Page No.	Contents	Page No.
Global Overview	1	Duties & Taxes	9
Sector Overview	2	Regulatory Environment	10
Demand Dynamics	3	Outlook	11
Supply Dynamics	4	Bibliography	12
Supply Dynamics Office Space Market	5		
Business Risk	6		
Financial Risk	7		
Rating Curve	8		

Global Overview

- The global real estate market is expected to grow from USD~2,687bln in CY20 to USD~2,774bln in CY21 with YoY growth of ~3.2%. Asia Pacific was the largest region in the global real estate market, accounting for ~40% of the market in CY20. Western Europe was the second largest region accounting for ~24% of the global real estate market. Africa was the smallest region in the global real estate market.
- The Real Estate Sector represents nearly ~4% of the equity market capitalization of the S&P 1500. Equity REITs make up about ~98% of the equity market capitalization of the sector. Real estate management and brokerage companies make up the remainder.
- Uncertainty prevailed in the office market at the end of CY20 as tenants and owners alike navigated rapidly changing conditions including rise in work from home and concerns about fresh COVID waves in developing countries. Global leasing volumes were ~43% lower in Q4 2020 from a year earlier as momentum in the market slowed on the back of new outbreaks combined with heavier restrictions.
- CY21 is expected to be a story of two halves. With strong vaccine roll out in North America and parts of Europe, certain countries are expected to witness uptick in demand in the second half of CY21.



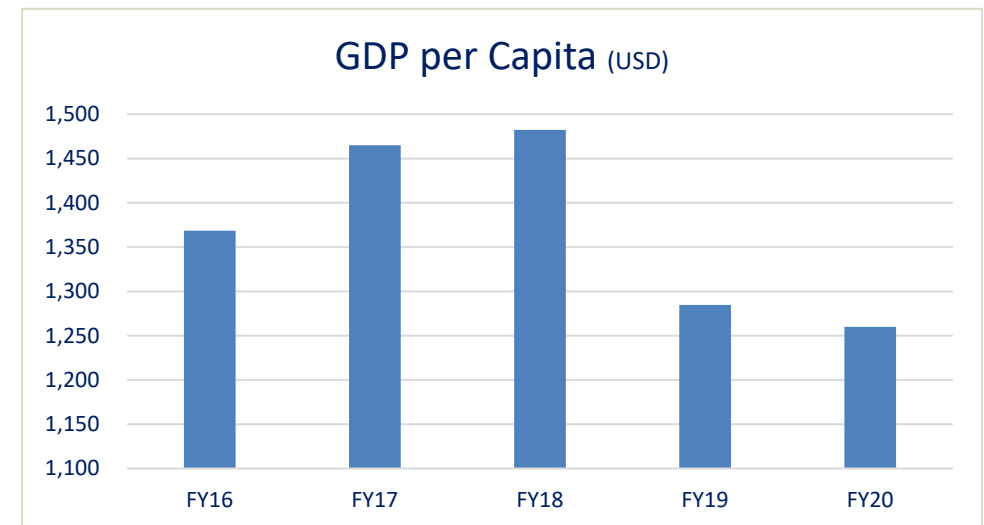
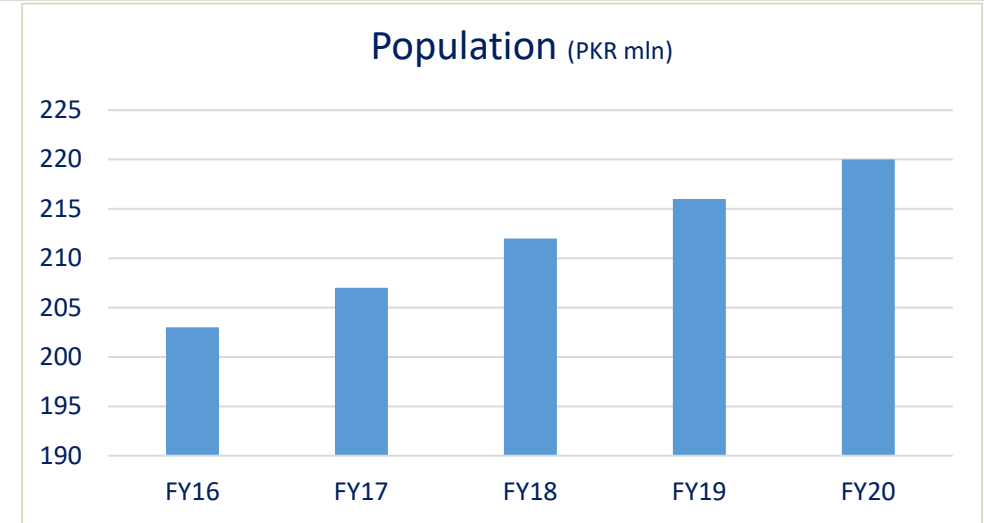
Sector Overview

- 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 etc.
- 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).
- REITs: Modeled after mutual funds, the companies registered as REITs with Securities and Exchange Commission of Pakistan (SECP) can pool the capital from numerous investors. This makes it possible for individual investors to earn dividends from real estate investments without having to buy, manage, or finance any properties themselves. According to SECP following are three types of REITs;
 - Developmental REIT Scheme: A REIT Scheme established for investment in real estate with the object of development, construction and refurbishment of such real estate for industrial, commercial, residential purpose or a combination thereof.
 - Rental REIT Scheme: A REIT Scheme established with the object of making investment in industrial, commercial or residential real estate with the purpose of generating rental income from it.
 - Hybrid REIT Scheme: A REIT Scheme, which has a developmental component as well as a rental component.

Real Estate

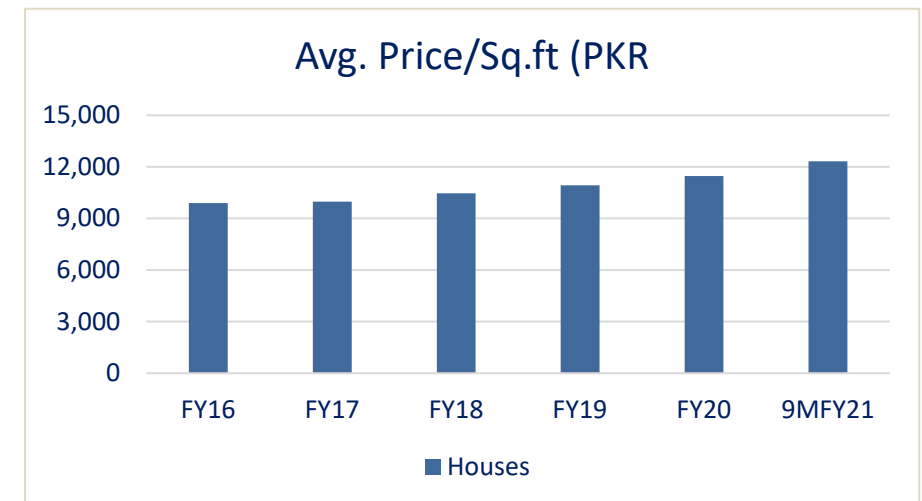
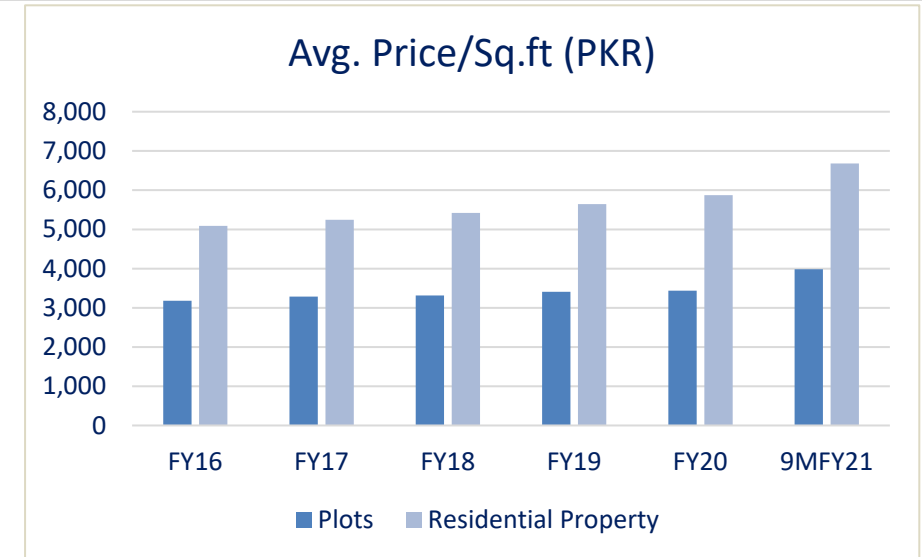
Demand

- The most crucial factor for demand in real estate is the income level or GDP Per Capita. The growth rate of population is also one major factors leading to increase in demand for real estate.
- There is a rising interest in the real estate sector in Pakistan. For many investors, it provides a relative safer investment option with steady cashflow streams.
- Pakistan property prices have been increasing in the last two decades. The income level of the masses is unable to keep up with inflating property prices resulting in an even higher demand for rental property and houses.
- In Pakistan, housing services are widely fragmented and is operated by individuals and scores of small private builders. Activity at both individual level and roll out of new major housing projects is expected to increase amid increased government focus on housing construction.



Supply

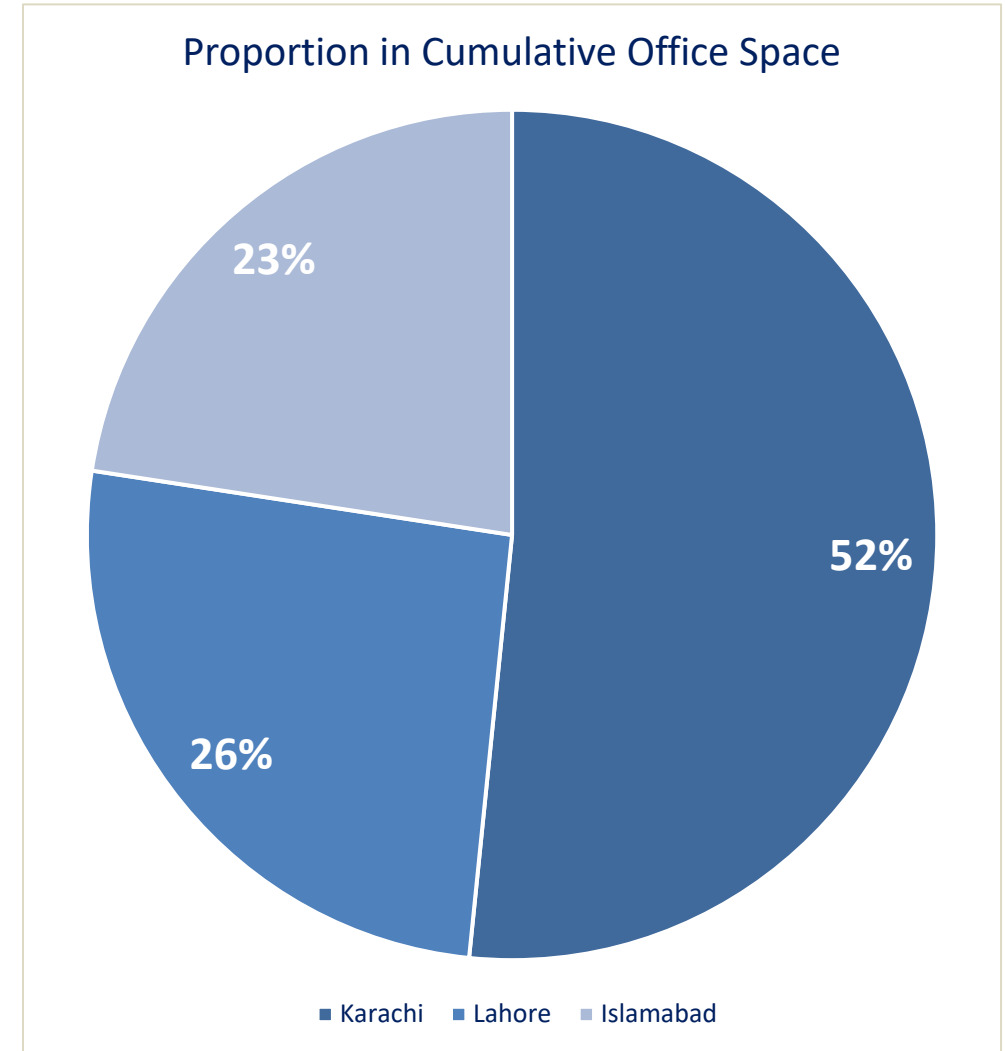
- The supply side of real estate mainly consist of offices, plots, residential property and houses. Pakistan housing infrastructure is mostly based on suburbs design. Although recent hike in apartment buildings can be seen but it is only limited to major cities such as Karachi, Lahore and Islamabad.
- Due to increasing demand for houses, there prices escalated from PKR~9,894 Sq.ft in FY16 to PKR~12,324 Sq.ft in 9MFY21. Residential property prices also inflated from PKR~5,092 Sq.ft to PKR~6,683 Sq.ft from FY16 to 9MFY21 where as prices of plots rose from PKR~3,180 Sq.ft to PKR~3,984 Sq.ft in the same period.
- The affect of corona pandemic has led to sluggish activity in the construction of real estate and activity came to near halt during COVID-19 lock down in last quarter of FY20. In a midst of third corona wave and lock down, real estate activity is diminishing while prices are rising as observed in 9MFY21.
- During FY20, two new REIT management companies (RMCs) were granted license to undertake REIT management services, raising the number of RMCs to seven. Only one REIT is listed on Pakistan Stock Exchange.





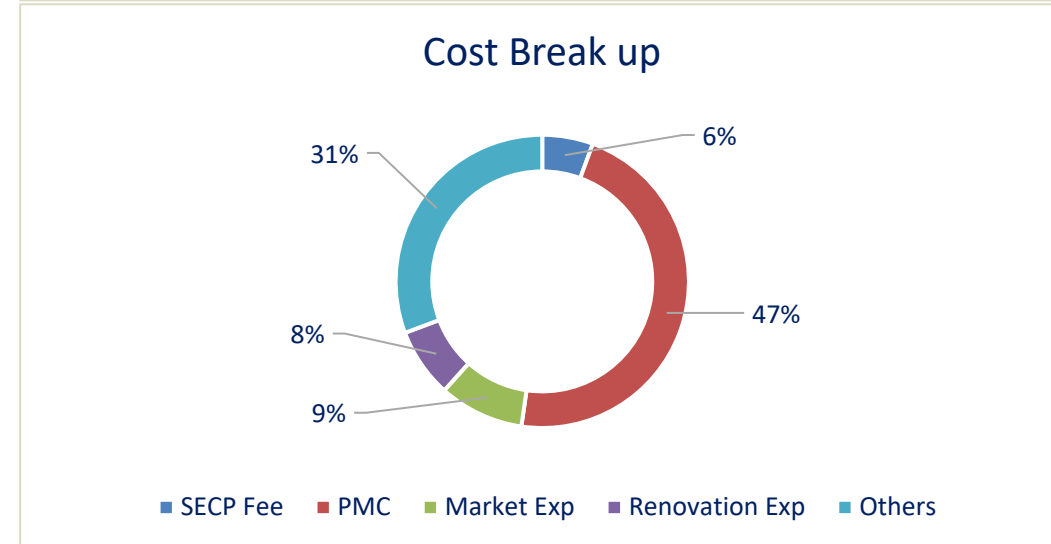
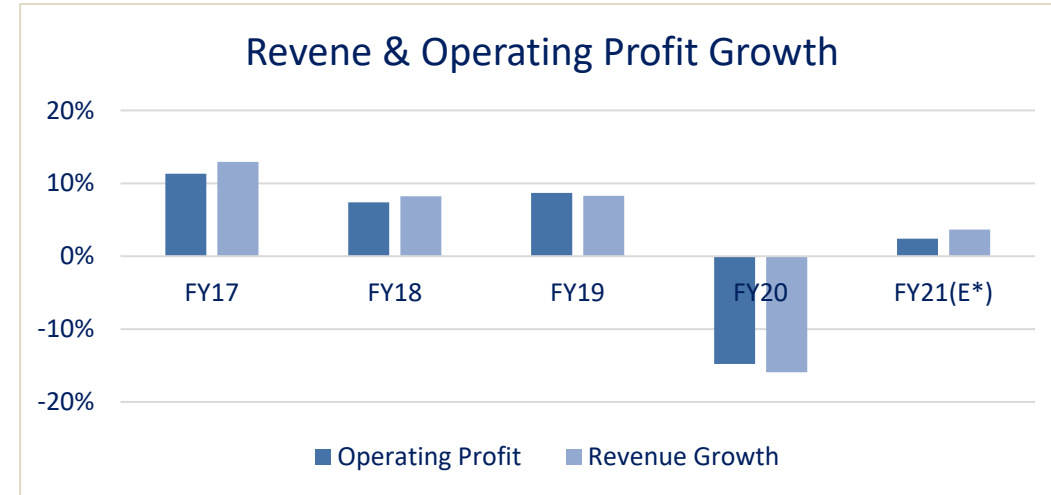
Office Space Market

- Karachi:** The city has an approximate office supply of more than ~16mln Sq.ft. COVID-19 lock down has significantly dampened the positive impact of improved security position in the city on office space demand.
- Lahore:** Lahore office market is fragmented as there is no core central business district in the city. Being the second largest city in the country, the demand for office space is expected to increase further owing to couple of reasons. Increased offices relocation due to better infrastructure and security situation of the city will have positive impact on the office space demand. Overall estimate office space of the city is more than ~8mln Sq.ft.
- Islamabad:** Islamabad, being the capital, is an administrative hub dominated by Government offices, Embassies and Foreign Mission offices. Other major corporate occupants of offices are from telecom industry, oil & gas sector and banking sector. Overall office space supply in the capital is more than ~7mln Sq.ft.
- Rental Growth:** COVID-19 lock down has significantly impacted the rental growth rate across the country. Rental growth rate is expected to remain under pressure in coming period as well.



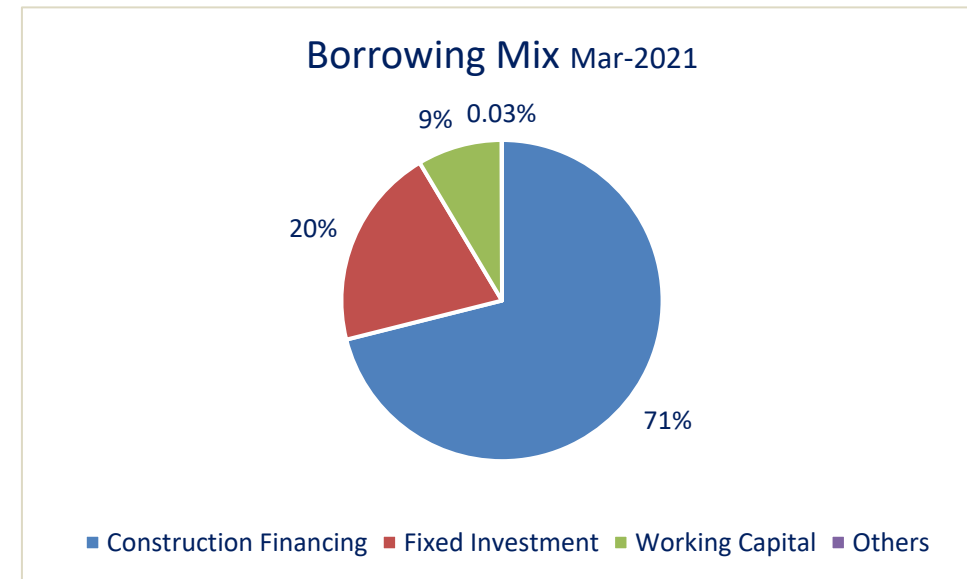
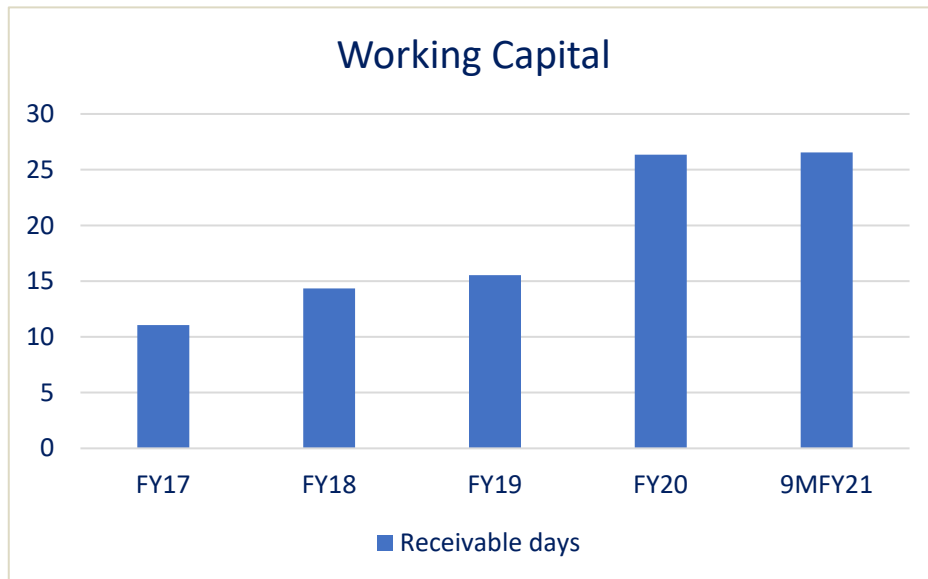
Business Risk

- Operating cost of Rental REITs consist of property management fee, marketing and other expenses. Due to the requirement of continuous wear and tear of the property, ~35% of cost allocated is for property management and maintenance. Whereas, incase of development REITs development cost constitutes major portion of total operational cost.
- Both revenue and operating profit has showed sluggish growth due to reduced demand amid challenging economic environment in previous years. COVID-19 lock down caused significant cash flow problems for the sector as the significant rental waivers were provided to many tenants in 4QFY20. Relief in form of rental waivers prevented the massive decreased in office occupancy level.
- The sector is expected to post some recovery in ongoing fiscal year as almost all business activities has been resumed amid strict adherence to SOPs after the COVID-19 lock down. The ongoing third wave of COVID-19 and expected lockdown pose serious threat to sector's profitability.
- Major cost components including Property Management Cost (PMC), marketing expense are variable in nature and thus provide support to bottom line in case of reduced revenue.



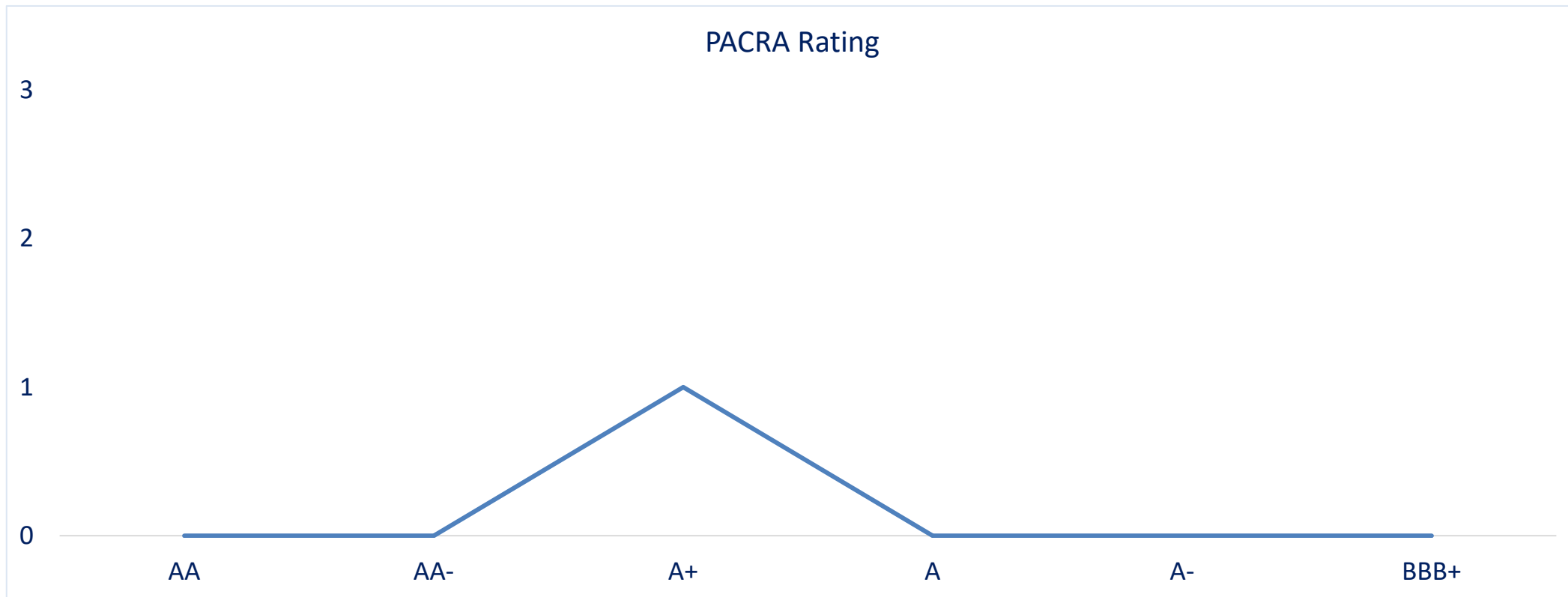
Financial Risk

- Considering nature of the business the working capital financing only required to finance receivable of the company amid absence of inventory and trade payables. Receivable days increased significantly during FY20 due to delayed payment by many tenants, receivable days remained heightened in 9MFY21 as well.
- According to SBP, total borrowings of sector stood at PKR~26.8bln at March-21 (PKR~30.9bln at March-20). Major of the debt financing goes in development of real estate. Due to pandemic, downtrend was observed in total sectors borrowing in FY20 and continued in 9MFY21.



Rating Curve

- PACRA rates one player of Real Estate sector.
- No change in rating was observed



Duties & Taxes

- Income tax rate of real estate companies has not changed in past two years. Fixed income tax rate has been introduced for projects registered under Amnesty scheme.

Income Tax			
		FY20	FY21
Small Companies		21%	29%
Large Companies		21%	29%
Projects Registered under Amnesty Scheme			
Area	Tax on Developers (Entire Project)		
Any Size	PKR 150/Sq. yd	PKR 130/Sq. yd	PKR 100/Sq. yd
Area	For Development of Industrial Area		
Any Size	PKR 20/Sq. yd	PKR 200/Sq. yd	PKR 10/Sq. yd

Regulatory Environment

- The State Bank of Pakistan (SBP) has amended prudential regulations to encourage enhanced participation and investment of banks and development financial institutions in REITs. The changes in SBP regulations would enable banks/DFIs to make higher investments in REITs to the tune of ~15% of their equity as against the existing limit of ~10% of equity. This move will bring more capital towards REITs and would also enable banks/DFIs to diversify their investments.
- To address on going property and real estate conflicts, the federal authorities have finalized Real Estate Regulation and Development Bill 2019, under which the Real Estate Regulatory Authority (RERA) will be formed.
- The federal government will appoint the chairman of the regulatory body. Registration with the RERA will be mandatory for real estate agents for selling any type of property in Pakistan. This includes selling plots, houses and buildings as well.
- It will be mandatory for developers to seek approval from the RERA before starting any sort of work on a development project. To get approval from the regulatory body, developers will be required to submit all details pertaining to their current and past real estate projects along with any future plans.
- In case of a violation, the regulatory body will have the power to cancel the license of any promoter/marketer. The Real Estate Regulatory Authority will also protect the rights of both real estate agents and the individuals whom the property is allotted to. Civil courts will not take on the cases related to real estate disputes that fall within the purview of the RERA or appellate tribunal.

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. With growing population the urbanization in the country has also increased in recent years, according to 2017 census ~36.4% of population lives in urban areas, highest in South Asia.
- Moreover, as per UN Population Division half of the country's population will be living in cities by 2025. In line with the rising urban population the demand for real estate projects is expected to increase further wherein, housing projects and living apartments would lead the total demand.
- Keeping in view the rising demand, GOP had introduced a series of regulatory and taxation measures to promote real estate activities in the country. These measures has started to yield positive results which is depicted from the significant growth in sale of building materials. Moreover, more than 1,080 projects worth PKR~340bln have already been registered with the FBR along with another ~292 tentative projects with an indicative investment of PKR~43bln under the prime minister's package for the construction industry.
- Although the disbursement under Naya Pakistan Housing Scheme financing are low as of now, but the financing is expected to pick up in coming period as government is committed to address major concerns of the lender including foreclosure laws.
- COVID-19 lock down has negatively impacted the sector's revenue although, the gradual recovery has been witnessed in FY21 so far. Ongoing third wave of COVID-19 can force GOP to enforce another lockdown which will have serious implication for the sector. Moreover, the support is likely to come from historically low interest rates.



Bibliography

- PACRA Internal Database
- Jones Lang LaSalle
- Zameen.com
- Pakistan Bureau of Statistics
- State Bank of Pakistan
- The Economic Survey of Pakistan
- Colliers
- Federal Board of Revenue
- SECP

Research Analyst 	Saniya Tauseef Asst. Manager R&P	Muhammad Nadeem Sheikh ACCA, CFA Supervising Senior	Zohaib Khalid Research Analyst 
Contact Number: nadeem.sheikh@pacra.com E-mail: +92 42 35869504			

DISCLAIMER

PACRA has used due care in preparation of this document. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. The information in this document may be copied or otherwise reproduced, in whole or in part, provided the source is duly acknowledged. The presentation should not be relied upon as professional advice.