



Grant Thornton

An instinct for growthTM

Microclimates of opportunity

Real estate & construction report 2014



Introduction

This report draws on more than 700 interviews with business leaders in 45 economies to understand how the real estate & construction sector is recovering from the financial crisis, where the opportunities lie and what businesses are doing to keep their operations running smoothly and free from fraud.

Net percentage of real estate & construction businesses optimistic for their sector (next 12 months)

42%
Global

Focused investment is crucial to businesses looking beyond short term survival, to long term sustained growth

56%
North America

33%
European Union

42%
Nordic

83%
South Africa

48%
Eastern Europe

78%
Southeast Asia

Problematic economies of the last few years may become opportunities of the future

Fraud is still rife in construction globally and now is the time to make sure your business has adequate controls to manage risk

Use tried and tested 'supply and demand' theories from economics to determine the viability of projects and investment

Foreword

The real estate & construction sector outlook is brightening. Developers, property companies, investors and homeowners suffered disproportionately during the financial crisis, but now expectations for profitability, jobs and orders are all on the rise.

House prices are climbing in key markets such as the UK and the US, contributing to the 'wealth effect' which boosts the consumption patterns of homeowners, although the market is in no way uniform. Instead we find pockets of opportunity; where money seems to be channelled into cities and regions, rather than countries.

In economies that suffered badly in the recession, such as Spain and Ireland, certain areas are becoming attractive again. In Spain, house prices are still some 30% below their 2007 peak and some half a million homes remain unoccupied, but developers have moved back in to some key areas around Madrid. The fall in Ireland was even more pronounced with houses losing some 50% of their value. House prices rose by 6.4% in 2013, but strip out Dublin and the improvement was negligible.

In China, house prices rose by as much as 25% in 2013 in first-tier cities such as Beijing, Shanghai, Shenzhen and Guangzhou. A number of measures,

such as raising second home deposit levels, boosting the supply of affordable housing, introducing property-taxation and making it harder for non-residents to buy, have been introduced to cool the market.

Major sporting events also offer opportunity. As Brazil prepares for the FIFA World Cup this summer and the Olympic Games in 2016, the government is attempting to modernise local infrastructure and has successfully auctioned off several airports which badly need modernisation and capacity upgrades. Business leaders in emerging economies continue to grapple with substandard transport infrastructure and the hope is that investments in Brazil, as well as in Russia and Qatar, will benefit these economies more widely.

Signs of increasing activity in the sector are a strong indicator that the global recovery is gaining momentum, although, it would not take much to destabilise the improvements. As cities rather than countries seem to be the focus

for investors and businesses alike, this can also mean distorted values in a small area, with the risk of some potential future realignment.

The signs are pointing in the right direction and even countries that have been through a torrid time are beginning to attract investment again.

Real estate & construction businesses have been in 'wait and see' mode for a long time. But now the market is moving in the right direction, they need to identify the microclimates of opportunity, incentivise their key people and make sure that the right controls are in place so that governance issues do not stifle their next phase of growth.

Clare Hartnell
Global leader – Real estate & construction
Grant Thornton



Business growth prospects

There is clear optimism in the outlook for the real estate & construction sector in 2014; net 42% of business leaders express confidence, compared to just 27% when asked about the broader economic outlook. Business leaders in southeast Asia (78%), Latin America (60%) and North America (56%) are the most optimistic and those in the eurozone (19%), and especially in southern Europe (-9%), the least. The BRIC economies (45%) are slightly more optimistic than peers in the G7 (39%).

Business leaders in the sector are markedly more optimistic about expanding their operations in 2014 compared with this time last year. Net 46% of businesses expect to increase revenues over the next 12 months, and while this is below the all-sector average (52%), it represents an eight percentage point year-on-year increase. Similarly, profitability expectations for the sector globally have risen to 38%, up from 33% last year.

Businesses in southeast Asia are most confident about increasing revenues (64%) and profits (54%) over the next 12 months, followed closely by North America where at least half of businesses expect to raise revenues (53%) and profits (50%). Businesses in Latin America, buoyed by the construction work in Brazil ahead of the World Cup and the Olympics also expect to see revenues climb (57%). Profitability (31%) remains slightly more elusive however, which perhaps ties into local currency volatility and government

intervention, especially in Argentina and Brazil.

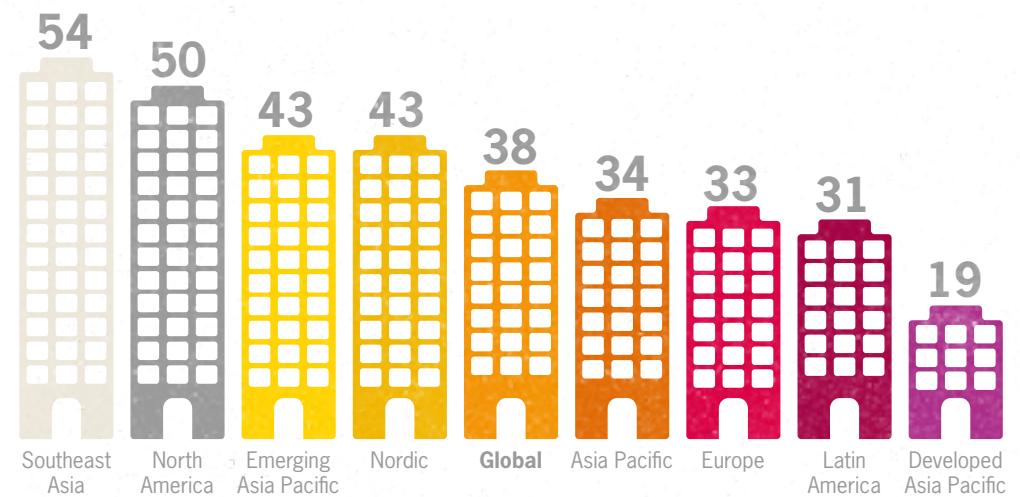
Across Asia Pacific, growth is being driven by businesses in emerging economies which are more than twice as confident about raising profits (43%) as their peers in more advanced economies (19%). Understandably Europe remains more subdued, but across the EU, 39% and 33% expect revenues and profits to rise respectively; the UK & Ireland is the most buoyant sub-region in Europe, followed by the Nordics, with southern Europe at the opposite end of the spectrum.

Investment is crucial to businesses looking beyond short term survival, to long term sustained growth. Businesses in Latin America (38%) and North America (36%) are most likely to increase investment in plant & machinery over the next 12 months. Europe is not far behind (31%) with businesses in the Baltics, UK & Ireland

and southern Europe all expecting to make significant investments. Businesses in emerging Asia Pacific economies (29%) are slightly more likely

to increase spend on plant and machinery compared with peers in the developed regional economies (22%).

Net percentage of sector businesses expecting to see profits rise in 2014



Source: Grant Thornton IBR 2014

The labour market

The real estate & construction labour market has held up well considering the devastating impact of the financial crisis. A majority of businesses shed workers in 2010 but hiring patterns have improved since and 22% of sector businesses took on new workers last year, the same as the all-sector average.

Improvements in labour markets tend to lag recoveries as businesses work off excess capacity and wait for uncertainty to subside before hiring new people. So it is reassuring to see that 30% of sector businesses globally expect to hire workers in 2014, marginally above the all-sector average. Businesses in the emerging markets of Latin America (38%) and Asia Pacific (33%) are most likely to take on extra people, with North America (30%) and the Nordics (29%) not far behind.

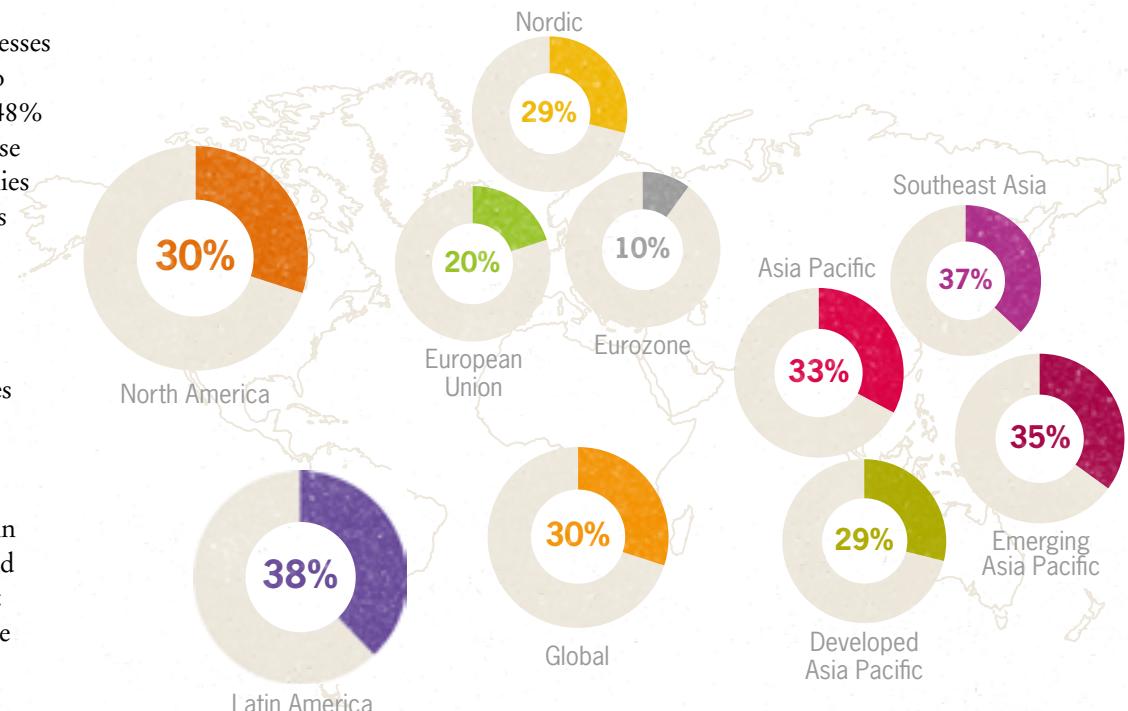
Elsewhere in Europe the situation remains nuanced with UK & Ireland businesses particularly bullish about taking on new workers while those in southern Europe still expect their labour forces to contract in 2014.

Globally, 66% of businesses in the real estate & construction sector expect to offer pay rises to their employees in 2014, only marginally below the all-sector average. Workers in North America are most likely to get a pay rise over the next

12 months: with 86% of businesses expecting to raise salaries. This is slightly above Latin America (81%) where inflation rates are running much faster. In the EU, employees in 68% of businesses can expect salary rises in 2014, rising to 81% in the Nordics. By contrast, just 48% of businesses in Asia Pacific plan to raise wages, with those in emerging economies (53%) slightly more hopeful than peers in developed economies (38%).

Interestingly, this paucity of wage rises in Asia Pacific is not being driven by oversupply of skilled labour in the sector. More than two in five businesses across the region are struggling with a lack of talent (43%), compared to around one in three across the globe (35%). North America (37%) and Latin America (35%) also cite a lack of skilled workers as a constraint on growth, but Europe, where unemployment rates are at record highs, remains relatively untroubled (17%).

Net percentage of sector businesses expecting to hire workers in 2014



Source: Grant Thornton IBR 2014

Business growth constraints

With the global recovery still tepid, the eurozone crisis still far from resolved and tapering in the US adding to emerging market volatility, it is perhaps no surprise that economic uncertainty is the chief concern of business leaders in the real estate & construction sector.

Almost half of sector businesses cite uncertainty as a constraint on growth plans over the next 12 months, slightly above the all-sector average (42%). This concern is highest in Asia Pacific (54%) where developers may well be nervous about efforts by the Chinese Government to cool the housing market and slow investment. In Europe, 47% of business leaders in the eurozone cite uncertainty, a figure driven up by Southern Europe. However, businesses leaders in the Nordics and UK & Ireland are relatively unconcerned, especially in comparison to their peers across the Atlantic in North America (41%).

Bureaucracy is the second biggest concern for businesses in the sector. With health and safety measures ever more keenly implemented and planning limitations in many economies, especially on greenfield sites, 38% of sector leaders cite regulations and red tape as a constraint

on growth, again slightly above the all-sector average (34%). Businesses in emerging markets tend to rank bureaucracy issues much higher: 53% of sector business leaders in both Latin America and emerging Asia Pacific cite regulations and red tape as a constraint on growth. This compares to 34% in developed Asia Pacific, 30% in North America and 29% in the EU.

More than a third of business leaders pinpoint a lack of demand (37%) as a concern for their expansion plans in 2014, although this is down from more than a half in 2010 (51%). This is a particular problem across Asia Pacific (53%) and is driven largely by China (incl. Hong Kong) and Australasia. Businesses in Europe (35%) are less concerned, although this rises sharply in southern Europe, while peers in North America (23%) and Latin America (16%) have comparatively few demand concerns in 2014.

Percentage of sector businesses citing issues as a constraint on potential expansion*



Economic uncertainty



Regulations and red tape



Low demand



Lack of skilled workers

Source: Grant Thornton IBR 2014

*only those regions with results above the Global average listed

Fraud and compliance

Fraud can take many forms and a recent Grant Thornton report¹ suggested that such practices could account for as much as 10% of global sector revenues. Fraud could be costing the sector almost US\$1 trillion, rising to US\$1.5 trillion by 2025. The IBR results show that while good governance practices to prevent fraud are more common in developed markets, there is an interesting split across the Atlantic with North American businesses far more active in this area than peers in Europe.

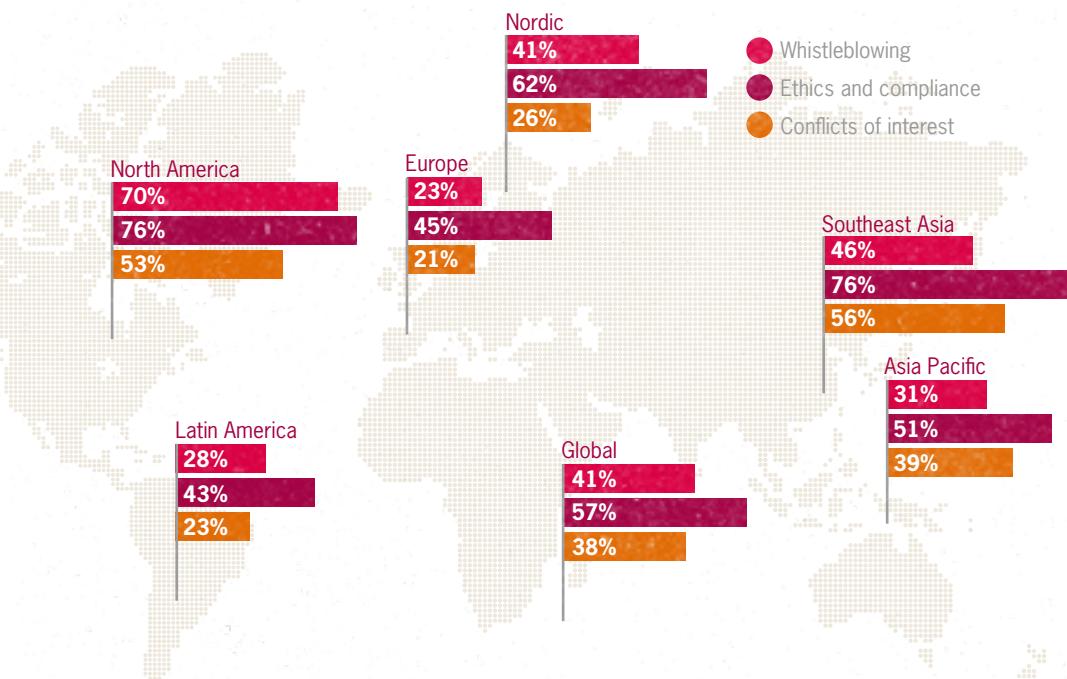
Globally, just 41% of real estate & construction businesses globally have measures in place to accommodate potential 'whistleblowers'. And there are some huge regional differences: 70% of North American businesses have such measures in place and 53% do across the G7. However, this drops to just 23% in Europe with even the Nordic nations, who are generally ahead of the curve on governance issues, only level with the global average. The Europe result is lower even than the Latin America average (28%). Whistleblowing measures are particularly uncommon in eastern and southern Europe.

A higher proportion of real estate & construction businesses around the world (57%) have a compliance and ethics programme in place which includes regular testing of internal controls. Again, North American businesses are most

active: just over three-quarters have a programme in place (76%). This compares to 51% in Asia Pacific - rising to 76% in southeast Asia. Europe is slightly lower (45%) with the Nordics (62%) leading the way.

There are also some interesting regional variations around conflicts of interest (where professional judgement with regard to a particular issue could be unduly influenced by interest in a second issue, for example financial gain or personal relationships). Just over a third of real estate & construction businesses around the world (38%) have implemented a specific programme to define and monitor conflicts of interest. More than half of North American businesses (53%) employ this type of programme, well above Asia Pacific (39%), Latin America (23%) and Europe (21%).

Percentage of businesses with specific governance structures around whistleblowing, ethics and compliance and conflicts of interest



Source: Grant Thornton IBR 2014

¹ Time for a new direction – Fighting fraud in Construction

IBR 2014 methodology

The Grant Thornton International Business Report (IBR) is the world's leading mid-market business survey, interviewing approximately 3,300 senior executives every quarter in listed and privately-held businesses all over the world. Launched in 1992 in nine European countries, the report now surveys more than 12,500 businesses leaders in 45 economies on an annual basis, providing insights on the economic and commercial issues affecting companies globally.

The data in this report are drawn from interviews with more than 700 interviews chief executive officers, managing directors, chairmen and other senior decision-makers in the real estate & construction sector conducted between September and December 2013.

To find out more about IBR, please visit: www.internationalbusinessreport.com.

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