Construction and Real Estate

Sector strategy

In the construction and real estate sector, CDC investment intervention is relatively recent, yet diverse. This report provides insights into why this sector matters for us, and outlines our investment priorities.

01

Introduction

A flourishing Construction and Real Estate (CRE) sector is vital for economic development. Activities in the sector not only create social and business real estate infrastructure, they also enhance economic opportunities, support inclusive urbanisation and promote the environmental sustainability required for building a sustainable economy.

Population growth and the urbanisation trend is reshaping Africa and South Asia's economic and demographic landscape. These dynamics, along with other emerging long-term trends, are rapidly transforming cities in Africa and South Asia, and are expected to play a vital role in economic growth in CDC's focus countries. As cities evolve, they are exhibiting considerable demand for new real estate construction to support the transformation of economies towards productive industry and services sectors. However, most of our focus countries have been constrained by decades of under-investment in the sector. This means that the current CRE sector landscape is not only underdeveloped but is also burdened with inferior quality and inadequate real estate facilities that fail to meet the growing demand. Growth in the sector has the potential to impact the required transformation to support inclusive and sustainable economic development.

Contents

It is not surprising that opportunities arising in the CRE sector have been constrained by its present fragile development landscape. The key barriers undermining development activities in the sector include its fragmented nature and its large base of sub-scale development partners – many of which are largely unorganised and lack technical and financial capabilities, with negligible use of technology, innovation and the international best practices required for efficient construction processes.

As a vital economic enabler, the CRE sector provides underlying infrastructure which is critical to support activities across different spheres of the economy.

Overcoming this obstacle to economic, inclusive and sustainable development in Africa and South Asia requires significant investment in the CRE sector. It necessitates investments that address the sustained demand-supply gap and promotes best practices in construction methods and materials, energy efficiency, safety and social inclusion.

CDC's focused engagement in the sector is relatively recent. However, as an impact investor we have a greater risk-return flexibility and patient capital approach. This means we are well placed to support long-term partnerships with relevant market stakeholders, to augment the required development in the CRE sector across Africa and South Asia.

CDC's focused engagement in the sector is relatively recent. However, as an impact investor we have a greater risk-return flexibility and patient capital approach.

Our strategy is built on six key themes that support market-oriented growth in the sector and close the gap between demand and supply. Our engagement brings international best practices to our markets in the areas of development and commercial operations, as well as climate sustainability and environmental, social and governance (ESG) standards. And we also endeavour to mobilise capital from market stakeholders, with a view to building a commercially sustainable CRE sector.

By advancing the CRE sector of the African and South Asian countries we cover, CDC helps to support widespread economic growth, as we move these countries closer toward achieving the United Nations' Sustainable Development Goals (UN SDGs).

02

What problems are we trying to solve?

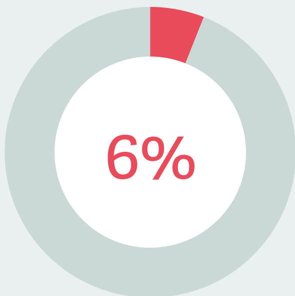
Investments in the CRE sector play a large role in determining whether cities become centres of sustainable, climate resilient and inclusive growth, or whether they continue down a path of resource-intensive, unplanned and inequitable expansion.

On the demand side, growth momentum in the CRE sector will be powered by distinctive macroeconomic trends. These long-term dynamics will favourably affect overall demand and supply levels, and create additional requirements for CRE investments in cities across Africa and South Asia. Moreover, CRE sector investments in cities determine urban form and also lock in economic, social and environmental performance for years to come. The key mega trends include:

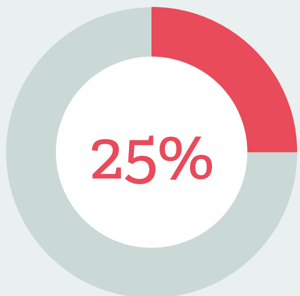
- **Demographic shift**
  The population of Africa is expected to double to two billion by 2050, and although the growth rate in South Asia has slowed over the last 20 years, it remains positive. These growing populations are simultaneously urbanising. By 2050, 55 per cent of Africans and South Asians are expected to live in cities, and these regions will contain 30 of the world's 50 largest cities by population. These unprecedented demographic shifts – such as rising migration, burgeoning middle-class populations and employment growth – will generate demand for far more real estate facilities and construction to address, not only basic housing needs but also match expanding workspace requirements.

Sharing effect of favourable economic growth to underpin real estate sector. Urbanisation & demographic shift will be major incentive for upward trends in demand for real estate fundamentally.

As of 2017



SHARE OF WORLD GDP



SHARE OF GLOBAL URBAN POPULATION

In 2017, CDC focus countries together accounted for 6% of world's GDP and 25% of total global urban population – registering growth of over 1% since 2010.

- **Favourable economic expansion**
  As economic factors reinforce these demographic trends, several key progressive factors – including a rising middle class, growth in disposable income, incremental employment and cities evolving as future growth epicentres – will underpin growth in the CRE sector. Arguably, demand levels led by urbanisation and economic growth will vary in our focus countries. However, the growth generated by expanding industrial, trade and services industries will drive changes in demand for economic and social real estate infrastructure –such as industrial parks, business parks, hotels and housing.
- **Technology and social disruption**
  Expanding digitisation and formidable technology disruption have been key facilitators of growth in developed countries over the past decade or more. These new trends have not only rapidly changed consumer and business behaviour but have also disrupted numerous elements of the CRE sector. Some of the most notable trends include improved construction processes driven by innovation, integrated developments on the back of the 'live, work and play' concept, smart and sustainable developments (including green buildings), e-commerce, digitisation of data, and information tied to ESG practices. These patterns are still premature in most of CDC's focus countries and remain relevant as inevitable long-term trends. As expanding cities embrace technology to improve services and infrastructure, these trends will positively impact demand and development dynamics in the CRE sector across South Asia and Africa.

In response to strong megatrends supporting demand growth, the CRE sector in Africa and South Asia is fundamentally underdeveloped and underserved on the supply side. Current activity levels vary significantly across countries and have arguably exhibited development disparities – with accelerated growth witnessed in select real estate segments, largely focusing on few cities and benefiting the more prosperous sections of their populations.

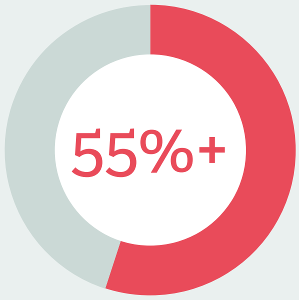
Some of the key challenges which continue to put constrain on development opportunities and require a long term structured approach include:

Demand-supply imbalance: These favourable macroeconomic trends underpin good long-term fundamentals. However, most countries remain undersupplied with quality real estate. While the number of well-funded private sector-led developments have increased, most have been in the premium segment. This has caused development disparity and large-scale supply backlogs; particularly in sustainable housing and efficient business real estate facilities.

Underdeveloped private sector capacity and value chain gaps: Most domestic developers, contractors and operators lack the technical expertise required to build best-in-class developments. They have minimal experience in developing and managing quality assets and make little use of efficient construction practices and innovative technologies, such as efficient sustainable designs, cost-efficient materials, building management systems, and renewable energy.

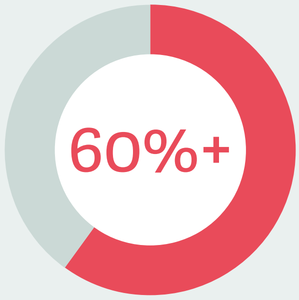
Lack of access to long-term financing: Private sector investment in CRE have traditionally been low in the countries CDC covers, deterred by a plethora of challenges. The industry is unorganised and fragmented, with few credible private sector partners with scale. Challenges have been further accentuated by the sustained currency risk and slow progress of (often inadequate) infrastructure, which typically extends the business lifecycle, making it less attractive to institutional investors.

By 2050



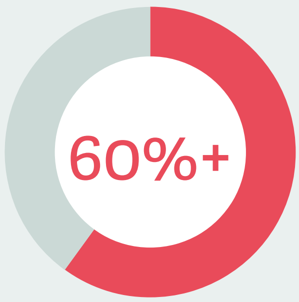
URBAN POPULATION

Share of urban population for SSA region (58%) and South Asia (54%)



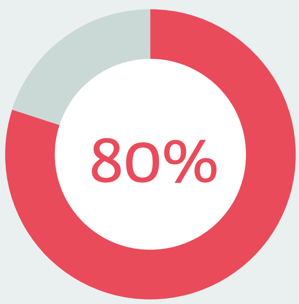
POTENTIAL WORKFORCE

Share of working age population (15-64)



TOP CITIES

Approx, 30 cities (within top 50) with over 2 million population globally will be from Africa and South East Asia



TOP URBAN CENTRES

UN projctions indicate that India will have added 416 million urban dwellers and Nigeria 189 million (from 2018) – one of the two most dense urban economies

These impediments to economically viable development deter institutional investors and other potential suppliers of capital from getting involved. As a result, development activities have historically been largely concentrated in those CRE sub-sectors with relatively short development cycles and higher returns on investment. The property development that would do most to enhance economic opportunities, support inclusive urbanisation and promote environment sustainability – for example, industrial and logistical real estate, housing and budget hotels – are mostly starved of capital, ensuring the large gap between demand and supply persists.

Sustainable Environment and Climate change: Building and construction is responsible for 39 per cent of all greenhouse gas emissions, making the CRE sector key to achieving the net zero target by 2050. Developers in emerging markets have so far had a limited focus on the introduction of environmental sustainability practices, such as green building principles, resulting in high energy and water consumption. However, this transformation is now unavoidable and calls for a systemic transition towards low carbon CRE landscape across our focus countries.

Access to credible information: Additionally, the size and quality of the investable opportunity set for institutional investors and other potential development partners has been deterred by limited availability of credible data and business transparency. These chronic gaps both creates and increases risk and uncertainty, and constrains investment in the sector.

Our impact objectives

As an impact investor, CDC can provide the long-term capital required to support development that narrow the gap between supply and demand. Our investments in the CRE sector are aimed at making an impact through the following three pathways, which also support progress towards achieving several of the UN SDGs by 2030 (see Figure 1).

1. **Economic opportunity:** Creating high-quality jobs and improving livelihoods by enabling expansion of economic activities, and contributing to greater economic productivity.
2. **Inclusive urbanisation:** Enabling more inclusive access to social and economic benefits, and the safety and health of everyone in a city.
3. **Environmental sustainability:** Improving energy and resource efficiency, land use, emissions reduction and climate resilience.

8 DECENT WORK AND ECONOMIC GROWTH

8. Decent Work and Economic Growth

Promote sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all

- Sustain per capita economic growth
- Achieve higher levels of economic productivity

11 SUSTAINABLE CITIES AND COMMUNITIES

11. Sustainable Cities and Communities

Make cities and human settlements inclusive, safe, resilient and sustainable

- Adequate, safe and affordable housing
- Inclusive and sustainable urbanisation
- Reduce per capita environmental impact of cities

9 INDUSTRY, INNOVATION AND INFRASTRUCTURE

9. Industry, Innovation and Infrastructure

Build resilient infrastructure, promote inclusive and sustainable industrialisation and foster innovation

- Advance economic competitiveness, industrial growth, increased trade and technological progress
- Support integration of SMEs and their clusters into regional and global value chains

12 RESPONSIBLE CONSUMPTION AND PRODUCTION

12. Responsible Consumption and Production

Decouple economic growth from environmental degradation, increase resource efficiency and promote sustainable lifestyles

- Reduce waste generation through prevention, reduction, recycling and reuse

13 CLIMATE ACTION

13. Climate Action

Take urgent action to combat climate change and its impacts

- Promote energy efficient technologies and low-energy building designs
- Ensure resilience and adaptive capacity to climate-related hazards and natural disasters

Figure 1: CRE and The United Nations' SGDs

03

Our investment themes and strategy

To pursue our impact objectives in the CRE sector, our investment strategy is built on six key investment themes, which fall under the two pillars of the sector: Sector Development and Market Strengthening (see Figure 2 below):

1 Create **socially inclusive and sustainable communities**

2 Promote **industrial space for production and distribution**

3 Develop **business-enabling infrastructure and ecosystems**

4 Strengthen and **build capacity of private sector**

5 Enable increased **capital mobilisation**

6 **Climate sustainability**

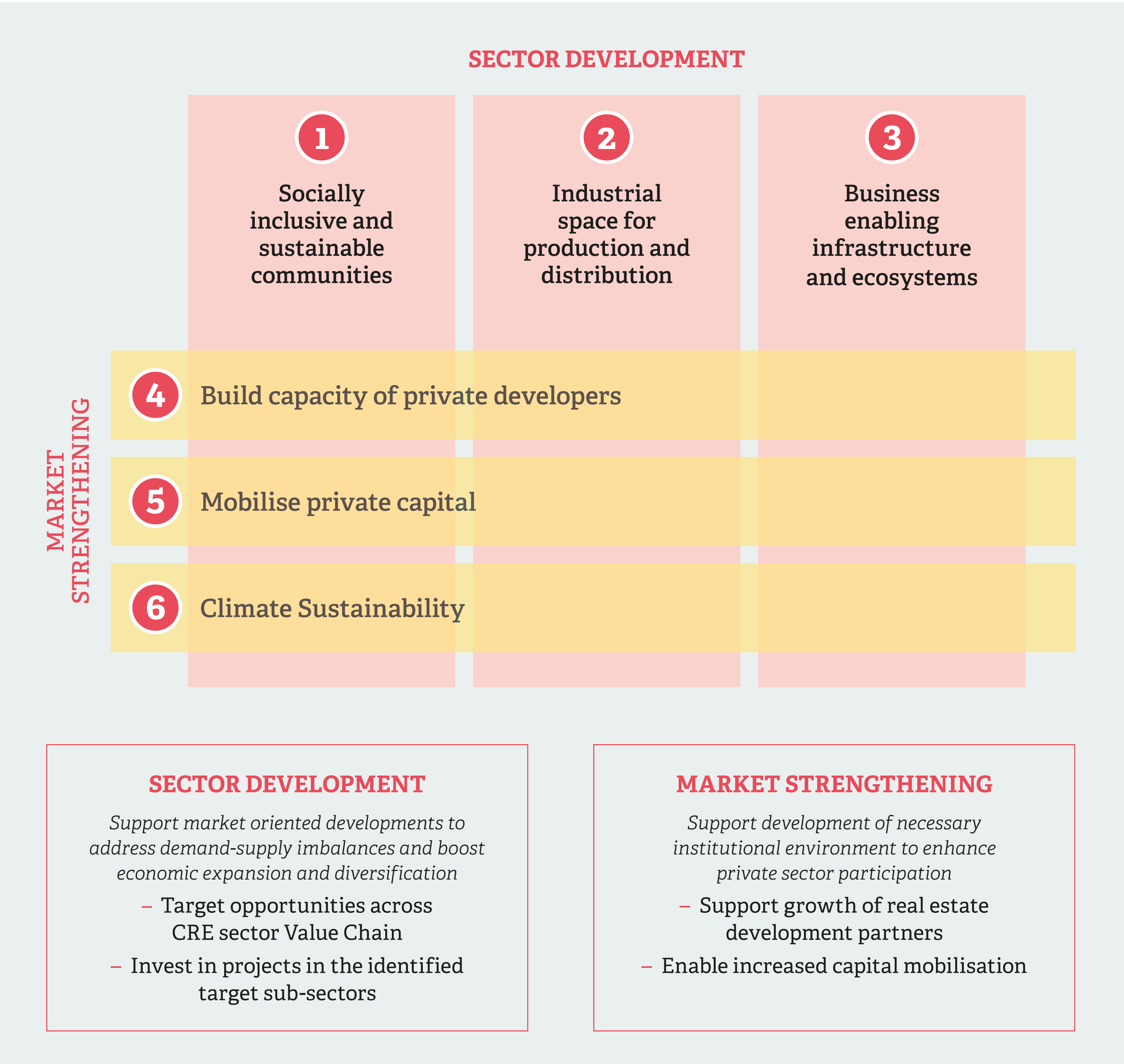


Figure 2: CDC'S investment themes and strategy

Sector development

1 Create socially inclusive and sustainable communities

Inclusive and sustainable social infrastructure reinforces economic growth. To this end, we support market-based mechanisms that help to address the need for safe and sustainable human settlements, enable economic inclusion and physical security, and catalyse the mix of developmental assets. This includes housing along with the other real estate needs of communities, such as convenience retail, hospitals, schools and student accommodation (see Kotak India Affordable Housing Fund case study).

2 Promote industrial space for production and distribution

Economic growth depends on industrialisation which, in turn, requires specialised real estate, such as industrial and logistical parks. By investing in the development of this kind of real estate, we can help to improve productivity and create economies of scale and specialisation, reducing the cost of consumer goods while creating jobs and lifting wages (see Africa Logistics Properties case study).

3 Develop business-enabling infrastructure and ecosystems

Businesses depend on real estate for their operations, and for interacting with suppliers and customers. CDC therefore invests in projects that develop business parks and budget or business hotels (see ONOMO Hotels case study). These projects help to connect regions and facilitate trade and investment. They are crucially important for advancing the services sector, for providing high quality jobs to men and women, thereby supporting human capital development.

Case Study 1: Kotak India Affordable Housing Fund

The Kotak India Affordable Housing Fund (KIAHF) is the first niche fund focused on affordable housing in less developed states in India. CDC has committed $46 million in investment to the fund.

KIAHF will play a catalytic role in promoting commercial investment in low-cost residential real estate in underserved Indian states. It will help to meet the demand for housing from India's increasingly urbanised middle class. Besides delivering much-needed housing, our investment is expected to mobilise private-sector capital and supply chain jobs. In addition, CDC's engagement with KIAHF encouraged it to adopt higher environment and social (E&S) standards and systems.

Case Study 2: Africa Logistics Properties

In 2017, we made a $25 million equity investment in Africa Logistics Properties (ALP), a warehouse developer focused on East African opportunities. CDC's investment funded the construction of the first modern Grade A logistics and distribution park in Kenya, thereby improving operational efficiency and regional trade.

The warehouse development has also gained an EDGE green building certification to develop comprehensive E&S systems. ALP tenants reported direct benefits to their business as a result of moving into the Grade A warehousing, in the form of lower unit storage costs, reliable utilities that supported more stable operations, better access to markets and reduced inventory losses through theft or damage. ALP is now in a stronger position to access financing for developing new opportunities.

Market Strengthening

4 Strengthen and build capacity of private sector

Development of the CRE sector in the countries that CDC covers has been constrained by the scarcity of private developers with sufficient scale and execution capacity. Our focus is to identify best-in-class partners and strengthen them, thereby supporting them to develop capacity and the technical, operational and financial competence required to address market challenges. We also aim to engage selectively with international developers to import best practices, leveraging their technical competencies and market know-how in a regional context.

5 Enable increased capital mobilisation

Inclusive growth in our markets requires not only the development of the CRE sector, but also of the capital market. The presence of a strong capital market increases investors' ability to participate in market development activities. Moreover, the existence of a deep and secure market in high-quality real estate environment is a critical prerequisite for both domestic and international investor interventions. For this reason, CDC aims to ensure the availability of long-term financing, and collaboration with other industry co-investors (including development finance institutions, private equity, banks, sovereign funds and pension funds), where possible.

6 Climate sustainability

Given the long-term horizon of climate change mitigation initiatives, and the profound challenges associated with implementing resource efficiency measures, the CRE sector is key for achieving net zero greenhouse gas emissions by 2050, as set out in our climate change strategy. Our memorandum of understanding with the International Financial Corporation (IFC), signed in 2015, shows our commitment to promoting the construction of green buildings (through IFC EDGE certification or equivalent) and the adoption of resource-efficiency measures across our markets. This commitment is exemplified by our investments in ONOMO (see case study 3) and ALP (B see case study 2). We also support our investees in the identification of climate change-related risks within their developments, and in the implementation of adaptation actions.

Case Study 3: ONOMO Hotels

CDC has made investment commitments of $54 million to ONOMO Hotels, one of the largest budget hotel operators in sub-Saharan Africa, to help address the shortage of business supporting infrastructure across the continent. Our goal is to scale up an integrated budget hotel investment platform to build a portfolio of modern hotel assets in select African cities. Our investment in ONOMO has created high quality jobs in some of the world's most challenged countries – Mali, Togo, Guinea, Cameroon and Cote D'Ivoire – with spill-over benefits for the local community who supply good and services to the hotels.

As with every CDC investment, it has been made with high ESG standards in mind. We required the incorporation of EDGE certification measures for enhanced energy efficiency. We are also working with ONOMO to reduce energy and water use, and to ensure new hotels are built using green design and construction principles.

Given the inherent flexibility in our strategy, we look to invest in CRE sub-sectors where an institutional approach could do the most to address market gaps and support the growth of social and business real estate. Our long-term view on investments allows us to evaluate opportunities across the CRE value chain.

To maximise holistic Sector Development, identifying and investing in opportunities that meet the current and evolving requirements of community and market will be key.

Primary Focus

- Industrial Parks
- Warehousing Parks
- Housing
- Budget and Business Hotels
- Business Parks
- Convenience Retail

Secondary Focus

- Logistics Buildings
- Student Accommodation
- Integrated Townships
- Shared Working Space
- Healthcare Real Estate
- Education Real Estate

Figure 3: Our sub-sectoral priorities in the CRE sector

04

How CDC invests in the CRE sector

We deploy a solutions-based, product-agnostic approach when investing across the CRE spectrum, focusing on the development needs of our markets.

Our long-term view on investments allows us to evaluate opportunities across the CRE value chain. This usually means greenfield projects but sometimes cover redevelopment and acquisition opportunities that also entail new development scope, if they match our impact criteria. The development partners that CDC invests in differ both in the type of real estate being developed and in their position along the CRE value chain, their maturity and the risks associated with their location or business plans.

How we invest depends on the specific circumstances of the investment opportunity. We apply best-fit capital sources (Growth and Catalyst) available within CDC to match the nature and risk profile of the opportunity (see Figure 4).

With capital intervention flexibility – in the form of equity, debt or indirect investments through fund managers – we can back best-in-class developers and other potential partners in diverse ways, as they seek to address development opportunities in our priority markets.

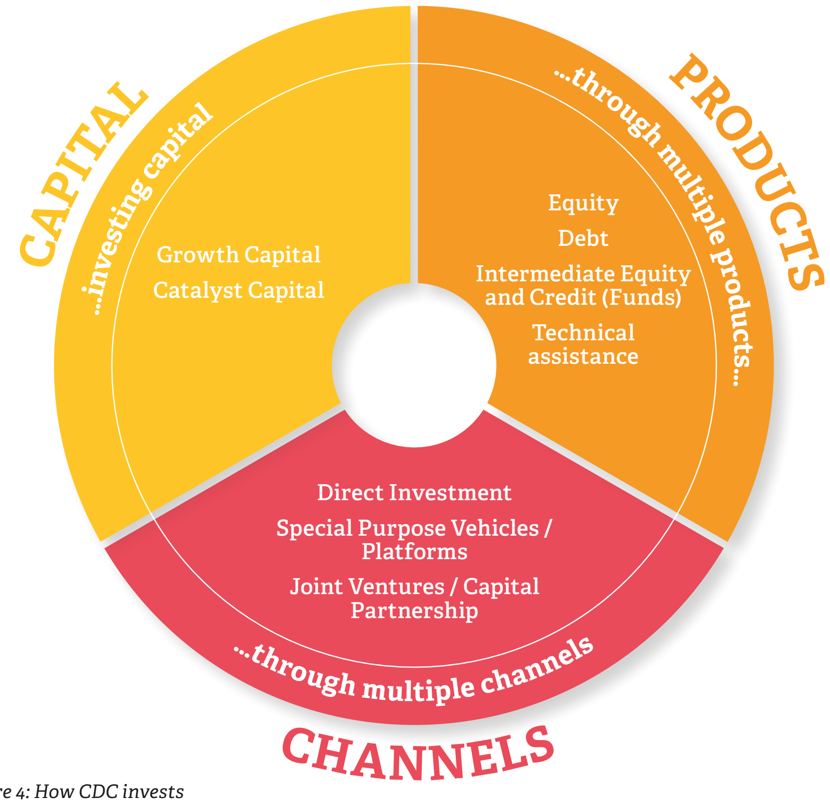


Figure 4: How CDC invests

Population growth, urbanisation and industrialisation require a massive expansion in the real estate supply in South Asia and, especially, in Africa. Yet the CRE sector landscape in these regions is generally underdeveloped is and failing to supply the required quantity or quality of construction. This is a roadblock to economic and social development, which CDC is committed to helping to remove. Our investments in the sector contribute to providing the construction needed today. Additionally, by building the capacity of domestic developers and other development partners, we are helping to create a more efficient CRE sector that can attract private sector capital. We see this as a decades-long endeavour, but one that is vital for the prosperity and wellbeing of the population we cover.

Creating economic opportunities, enabling inclusive urbanisation and fostering environmental sustainability

Over USD $600 million of cumulative CRE sector investments made, to date

10+ investment and impact professionals dedicated to the sector

This strategy encompasses the activities, motivations and ambitions of a large group of people at CDC who are dedicated to improving CRE sector landscape in our focus markets. This group includes investment professionals across three product teams (CRE Equity, Debt, Funds and Capital Partnership), and our impact professionals, who are thought leaders on the topics of development impact, ESG, business integrity, gender and climate change.

For further information:

- **CDC Group:**

  Saurabh Tiwari
  Sector Strategist
  stiwari@cdcgroup.com