strategy&
Formerly Booz & Company

Unearthing value from dormant land in the GCC

Five approaches for governments and private owners

Strategy& is part of the PwC network

Contacts

Beirut

Bruno Wehbe
Principal, Strategy& Middle East
+961-1-985-655
bruno.wehbe
@strategyand.ae.pwc.com

Dubai

Karim Abdallah
Partner, Strategy& Middle East
+971-4-436-3000
karim.abdallah
@strategyand.ae.pwc.com

Ramy Sfeir
Partner, Strategy& Middle East
+971-4-436-3000
ramy.sfeir
@strategyand.ae.pwc.com

About the authors

Karim Abdallah is a partner with Strategy& Middle East, part of the PwC network. Based in Dubai, he is a member of the family business, investments, and real estate practice in the Middle East. He has more than 10 years of consulting experience and four years of industry experience acquired through various engagements in North America, Europe, and the Middle East. He leads the real estate platform in the Middle East, focusing on real estate developers, governments, and corporations with significant real estate portfolios, offering support in strategy setting, organization design and restructuring, business planning, and feasibility studies for mega projects.

Ramy Sfeir is a partner with Strategy& Middle East. Based in Dubai, he leads the family, investments, and real estate and the deals platforms in the Middle East. He works mainly with family conglomerates, investment companies, sovereign wealth funds, and real estate developers, advising on topics related to corporate and investment strategy, corporate transformation, and governance, as well as M&A and post-merger integration.

Bruno Wehbe is a principal with Strategy& Middle East. Based in Beirut, he has more than 10 years of consulting experience focused primarily on real estate. He specializes in corporate strategies, mega-project concepts and feasibilities, and operating model redesign and full-fledged implementations for the region's largest real estate developers, family businesses, and government departments.

Executive summary

Land in the Gulf Cooperation Council (GCC)[1] countries has traditionally been a means of safeguarding wealth. Both public- and private-sector owners held property, often undeveloped, for decades. Its value increased, yet they had little need to unlock that value. Today, lower oil prices, fiscal pressure on state budgets, and geopolitical instability are encouraging governments, institutions, family businesses, and other owners to tap into dormant land holdings as a source of capital. New taxes on dormant land are an additional factor for private owners.

There are five principal approaches to unlock value from such holdings:

1. mortgaging the property or selling it and subsequently leasing it back
2. leasing the property under a long-term, build-operate-transfer (BOT) arrangement
3. selling the property outright
4. contributing land to a development project with a partner
5. contributing land and equity to a development project, and potentially operating the project

The internal rate of return (IRR) for these options ranges from 2 percent to 15 percent or more. However, with increasing potential gains come increasing risk and complexity. Some of these options are more relevant for private-sector owners (such as outright sales), yet all require a clear strategy and an understanding of the capabilities that an owner can bring to the transaction.

Thus far, some owners have begun to raise capital through their land, yet most have applied an ad hoc solution, evaluating individual investor offers as they come in. Instead, owners need to be far more proactive and strategic about looking at their entire land bank. They also need to take their time, find the right partner and deal, structure arrangements to retain control, and consider all financing mechanisms and exit strategies.

Growing economic pressure

Throughout the countries of the GCC, large swaths of land have been dormant and underexploited by the governments and private entities that own it, accruing value that has yet to be unlocked. That kind of buy-and-hold mind-set made sense in the past, but current economic conditions in the region call for a new approach: unlocking value from those holdings.

For the private-sector owners of land banks in the region, primarily large family businesses and conglomerates, land has been used for speculative trading, as collateral for debt to fuel their core businesses, or to accumulate and safeguard wealth. Similarly, governments have treated land as a vehicle for building the country or for meeting the needs of constituents. For example, governments often grant land to national developers, which then build housing, schools, hospitals, or other infrastructure needed for their growing populations.

Over the past several years, however, growing economic pressure is changing the context. The GCC has been hit by lower oil prices, which are currently stabilizing at levels that are too low to support historical government spending. In addition, political uncertainty has risen, due to ongoing conflicts and geopolitical shifts. These forces require that local landowners, governments, and private institutions alike start generating more value from dormant land banks.

Growing economic pressure is changing the context.

Among governments, that value resides in the means of generating income, as well as in the potential for developing land to better meet the needs of its citizens, such as social infrastructure projects, mega-transportation initiatives, or other large-scale objectives. In Saudi Arabia, for instance, the government is consolidating all its strategic land holdings to be used in major government-led development projects. Municipalities and other government agencies are also setting up land investment divisions and planning projects, either on their own or through public–private partnerships (*see "Two examples of land management," page 5*). Transportation authorities and agencies in Doha and Riyadh are also looking to extract value from land adjacent to new metro lines. A common theme with these projects is that governments will rely heavily on private-sector partners.

For large family businesses, conglomerates, and other institutions that own land, the goal is the same: to commercially exploit and develop dormant land. However, they are doing so to solve different underlying problems. These players need to offset or hedge against slower growth of their core businesses, diversify their portfolios, and avoid taxes on dormant or underexploited land. In Saudi Arabia, for example, a "white land tax," introduced in March 2017, charges owners 2.5 percent of the land's value unless they develop it within 12 months.

Two examples of land management

In 2010, the U.K. government set up a Government Property Unit (GPU) to capitalize on idle or underutilized land and property across civil service facilities. The unit has central oversight over all government land and property, and it works collaboratively with other government departments to improve the efficiency of state-owned real estate, sell off or lease surplus property, boost economic growth, and create new housing.

Under the program, the GPU helped raise £1.4 billion (US$2.3 billion) by selling off surplus property, and it reduced the operating costs of the government's portfolio by £625 million ($1 billion) a year between 2010 and 2014. The unit has even launched the Government Property Finder,[2] a site that allows the U.K. government to more efficiently market its surplus buildings and land to potential buyers or lessors.

Similarly, in Western Australia, where the state owns 92 percent of all land (other than freehold property owned by residents), the government set up a Department of Lands with some 200 employees and a mandate to oversee all property in the government's portfolio. For example, the department can sell surplus land and buildings to unlock capital and reduce state debt. It can also acquire land for residential, industrial, conservation, and community needs, or to develop transportation corridors.

In September 2014, the department identified the 20 most significant assets to divest as part of the government's broader strategic needs. By prioritizing in this way, the program generated AU$133.2 million ($124 million) in revenue in one year by selling some of those assets.

Five approaches to extract value

Landowners can extract value from their portfolios through five principal approaches, which offer a range of potential returns and corresponding levels of risk (*see Exhibit 1*).

1. Mortgaging property or selling and then leasing back

The first option, and likely the least attractive for most owners, is to securitize their holdings, either by mortgaging the land in return for annuity debt payments or selling the property and then leasing it back. This is the fastest means of releasing capital. It requires limited capabilities or capital, and it transfers all risks of the property to the buyer. However, it eliminates the opportunity to create long-term value from the property. The gains from any future development or improved use of the land would accrue to the new owner.

2. Leasing the property under a long-term, BOT arrangement

The second approach is for the owner to lease the land to an investor on a long-term basis (usually 15 to 25 years), in return for a specified fee. The investor then develops real estate on the plot and retains the income from the property over the period of the lease. When the lease matures, the ownership of both the underlying land and the developed asset revert back to the landowner.

The annual fee to the landowner depends on several variables, including the nature of the asset to be built, the current spot lease rates of vacant land in the vicinity, and the investor's target returns. For instance, landowners will likely accept a lower annual fee on the land if the asset to be built on it is a hotel rather than a residential building. If the asset is very attractive, some landowners completely forgo the annual fee.

Exhibit 1
There are five methods for creating value from land banks

Low risk and return → **High risk and return**

	Mortgage or sale/ leaseback	Long-term lease BOT	Outright sale	Development plays	
				Land contribution	Land and equity contribution
Returns	Not applicable	2-5% IRR	2-10% IRR	8-12% IRR	15+% IRR
Revenue volume	Not applicable	◔	◑	◑	●
Funding requirement	Limited	Limited	Limited	Minor	Significant
Key required capabilities	- High-level portfolio management - Transaction sourcing and support function	- High-level portfolio management - Transaction sourcing and support function	- Advanced portfolio management - Land valuation and feasibility - Transaction sourcing and support function	- Advanced portfolio management - Land valuation and feasibility - Deal and investment structuring and monitoring	- Advanced portfolio management - Land valuation and feasibility - Deal and investment structuring and monitoring - Design oversight - Project management oversight - Operations oversight
Key risks	- Mortgage-holder risks related to possibility of payment default - Land sales risks relating to buyer availability, market prices	- Tenant risks related to possibility of lease default - Demolition risk with underperforming property at maturity	- Land sales risks relating to buyer availability, market prices	- Tie-up risk - Market risks (buyer availability, prices) - Tenant risks - Operator risks	- Tie-up risk - Development risks - Liquidity risks - Market and tenant risks - Project management risks

○ Low
● High

Note: BOT = build-operate-transfer, IRR = internal rate of return.

Source: Strategy&

This approach is very popular for both public- and private-sector landowners in the GCC, particularly for the development of income-generating property such as hotels and malls. The approach generates predictable, recurring income for the duration of the lease (an IRR of 2 to 5 percent), requires limited capabilities and funding, and preserves long-term usage rights for the owner. Yet it also has several disadvantages: It requires a longer-term horizon for the realization of value and cash, and success ultimately depends on the investor, in both the construction and operational stages of the development.

3. Selling property outright

The third option is to sell the land outright. Historically, this has been the preferred strategy of large institutional landowners: buy opportunistically, hold as long as possible, and sell as needed. It required little in the way of capabilities, practically no funding or maintenance costs (beyond the initial land acquisition), and it yielded returns that exceeded those of most local fixed-income and equity assets. However, because this strategy was so popular, there was limited real estate investment and development activity in the region. It is a key reason behind the housing shortage in countries like Saudi Arabia. Expanding portfolios of undeveloped land were also the main reason why that country's "white land tax" was instituted, to stimulate housing supply.

The core consideration that landowners should take into account in an outright sale is determining an accurate value for the land. The most common valuation method in the region has been to look at comparables — a third-party appraiser or surveyor sets a value by looking at similar transactions in the vicinity for properties with the same zoning or usage levels. A more advanced approach is the "residual value method," which stipulates that the fair land price is the one paid by the investor that would still allow them to achieve their minimum target returns. This is more accurate for land to be developed, as it is linked to the nature and success of the asset that will ultimately get built on the plot.

The advantages of an outright land sale are that it delivers immediate cash to the seller (an IRR ranging from 2 to 10 percent), requires limited capabilities and funding, and transfers risk to the buyer. However, as with the first approach, a sale eliminates any future usage or rights to the asset for the seller, thereby limiting the value creation potential of the land. Notably, outright sales are limited to private landowners, as the sale of government-owned lands in the GCC typically requires rigorous approvals — including, in some cases, royal decrees.

4. Contributing land to a development project with a partner

Under the fourth option, the landowner partners with an investor in the development of his land. The landowner contributes the land as equity in kind, in return for partial ownership of the project, and the investor puts in the capital required for building the property. These are usually structured through a stand-alone company or special-purpose vehicle explicitly for the project. When the property starts generating income, the landowner and investor (or investors) split proceeds based on their respective ownership levels.

The relative ownership levels can change during the development process, depending on the location of the property and the scope of the project. In prime spots, such as in the holy cities of Makkah and Madinah where land values dwarf the cost of building the property, landowners are nearly full owners of the property regardless of what gets built. However, in most other parts of the region, where land values are lower, landowners end up acting as passive investors, particularly if needed to entice investors to enter the deal. In either case, an accurate valuation for the land is critical — many land-in-kind transactions in the region have failed due to valuation disagreements.

In some cases, the partnerships can have maturity terms similar to BOT agreements, at which full ownership of the asset and the land revert back to the landowner. This is mainly the case for government landowners that cannot forgo full land ownership but mainly contribute the right-of-use over a certain period.

This approach can generate significant value to landowners (an IRR of 8 to 12 percent) with few cash requirements or advanced capabilities — mainly it needs an investment analysis. It can potentially safeguard usage rights for the owner, determined on a case-by-case basis. The disadvantage is that the approach features no guarantee of returns, and it can introduce significant risk due to the owner's lack of control over the developer.

5. Contributing land and equity to a development project

The final option, and the most complex, entails the landowner shifting from a passive investor to an active developer. In addition to the land, the owner also contributes equity in return for a larger share of the development proceeds. Many of the region's cash-rich family businesses and conglomerates have opted for this approach as a way to increase their exposure to real estate, rather than simply sitting on large cash balances. It offers the highest potential returns (15 percent or more) but also the greatest risk.

This approach also requires the capital needed to make the equity investment, and the widest range of capabilities across the value chain, including in some cases operating the property once the development is complete. Some owners opt to build development capabilities in-house (or through a separate dedicated entity), while others contract with an established developer for a fee.

The core consideration that landowners should take into account in an outright sale is determining an accurate value for the land.

Key success factors

Unlocking value from dormant land is not easy. Based on our experience with development projects in the region, there are four key success factors that landowners should consider.

Be proactive and think strategically
A common issue in the region is that landowners often merely react to investment offers as they come in. This kind of passive approach limits value creation, in that it constricts the owner's options to the offer at hand, and only for the property in question. Instead, owners need to be far more proactive and strategic. They need to look at their entire portfolio, choose the highest-value holdings (in most cases, the bulk of the value exists in a few large plots), determine the highest and best use of that land, and identify the right approach to create value, factoring in local market conditions. In this way, owners can negotiate with potential investors from an informed position of strength.

There is no one optimal land bank strategy for all situations, but rather an optimal one for each landowner depending on the underlying objectives and drivers behind value creation (*see Exhibit 2*).

Do not rush — find the right deal and partner
These are significant decisions with significant value at stake, and it is critical not to rush. Many landowners are racing to cash out and/or avoid tax payments because real estate investment activity is slowing across the region, and land taxes on dormant plots are looming. Investors in the region today are capitalizing on owners' rush to exit, leading to sub-optimal deals.

Exhibit 2

Land bank strategy derives from the landowner's objectives and the drivers of value creation

Driver/venture capital plays	Mortgage or sale/leaseback	Long-term lease BOT	Outright sale	Land contribution	Land and equity contribution
Diversify income				X	X
Avoid taxes	X		X	X	X
Generate liquidity to deploy in other opportunities	X	X	X	X	X
Generate quick profits			X		
Generate long-term sustainable profits				X	X

Note: BOT = build-operate-transfer.

Source: Strategy&

Instead, owners need to carefully assess the full benefits and risks of any deal they see, and ensure that the terms preserve their fair share of the value. Similarly, owners need to choose partners wisely. Depending on the terms of the deal, these partnerships could last decades, and selecting the wrong partner for a project is one of the key reasons this type of venture fails. Each value approach requires a specific type of partner, ranging from asset managers to property managers, brokers, developers, and other players. Ambitious owners with large land banks may consider building up some capabilities in-house, to ensure that they can operate independently, maintain control over their projects, and save on fees.

Structure the agreement to align incentives and retain control
Even with the right deal and partner in place, it is imperative to structure the agreement in a way that aligns incentives between the owner and the developer. For example, the most common fee structure is a fixed percentage of the total construction cost (typically 2 to 4 percent), paid when the project is complete. This kind of flat structure, by itself, does not give the developer any incentive to meet budgets or schedules, yet those metrics are critical for the owner to hit target return rates.

Service-level agreements (SLAs) and penalties are still fairly limited in the region (except in facility management contracts), yet owners should consider linking fees to specific SLAs and establishing BOT rewards and penalties to ensure that partners have the right incentives. In addition, owners should structure deals to give themselves control over major decisions throughout the development life cycle, including approval over feasibility studies and budget, concept design reviews, lead architect and contractor appointments, business plan deviations that exceed predefined IRR and capital expenditure thresholds, sales and pricing plans, and other aspects of the project.

Consider all viable financing mechanisms and exit vehicles
In the past, GCC landowners, developers, and investors have relied on three basic financing schemes: debt (corporate and project level), their own equity, and joint ventures. However, the finance sector is maturing in the region with many countries rolling out regulations for real estate investment trusts (REITs). Given this shift, landowners should explore other means of financing projects, such as real estate funds, club deals, or REITs (*see Exhibit 3*).

Exhibit 3
There is a wide range of real estate financing options

	Debt	Own equity	Joint ventures	Private real estate funds	Club deals	REITs
Definition	Raise financing from banks	Finance project from own equity	Set up a joint venture usually consisting of a single “money” partner and an operating partner	Set up a commingled fund to raise capital (debt and equity) from investors	Club deals are a hybrid of a real estate fund and a joint venture	Set up a REIT that owns or finances income-producing real estate through property or mortgages (mostly listed, but private REITs exist)
Implications	- Bear full risk alone - Maintain full control over the project - Decrease cost of capital - Can limit future cash flows and impede growth	- Bear full risk alone - Maintain full control over the project - Increase cost of capital - Can use future cash flows and invest in growth	- Invests only in properties that have been preapproved by the money partner - The money partner has veto rights over financings, business plans, etc. - Management fees and performance compensation vary considerably	- Typically has a large number of investors - The general partner or investment manager purchases, finances, manages, and sells a portfolio of properties that it selects at its discretion according to the investment strategy - Fund manager is paid in fees and incentives	- Clubs typically contain a handful (2–4) of sophisticated, similarly situated, institutional investors that are funding larger amounts of capital ($50 million–$100 million or greater) - Invest in a pre-identified portfolio of assets - When capital is available, the manager may have “discretion” with much more detailed parameters than a commingled fund	- Access a larger pool of investors, and transmit risk to them - Benefit from special tax considerations - Distribute higher dividends (roughly in excess of 90% of profits distributed)
Applicability in the GCC	Developed	Developed	Developed	Underdeveloped	Underdeveloped	Underdeveloped

Note: REIT = Real estate investment trust.

Source: Strategy&

Conclusion

Long gone are the days when governments and private-sector entities could buy land and leave it dormant. Economic pressures, new taxes on undeveloped land, and other challenges are pushing these owners to exploit their land banks in order to raise capital. Rather than sitting back and waiting for offers from investors, landowners should adopt a more proactive and strategic approach. They have many options, and those that take the time to explore every avenue will generate far greater value.

Endnotes

[1] The GCC countries are Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates.

[2] Government Property Unit, "Find government property and land to rent or buy" (https://www.gov.uk/find-government-property).

Strategy& is a global team of practical strategists committed to helping you seize essential advantage.

We do that by working alongside you to solve your toughest problems and helping you capture your greatest opportunities.

These are complex and high-stakes undertakings — often game-changing transformations. We bring 100 years of strategy consulting experience and the unrivaled industry and functional capabilities of the PwC network to the task. Whether you're charting your corporate strategy, transforming a function or business unit, or building critical capabilities, we'll help you create the value you're looking for with speed, confidence, and impact.

We are a member of the PwC network of firms in 157 countries with more than 223,000 people committed to delivering quality in assurance, tax, and advisory services. Tell us what matters to you and find out more by visiting us at strategyand.pwc.com/me.

www.strategyand.pwc.com/me