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# Real estate is a critical component of economy, says Capitas Group CEO

*From an initial idea to evaluation of feasibility, formation of a development plan, management of design and through to construction and hand-over, great real estate projects must be managed with a guiding vision and great discipline. The ultimate result of this approach is fair return to investors and space that fits the needs of end users, explains Naveed Siddiqui, CEO of Capitas Group International. "This focus on investor return, or even on whether a project will be able to pay back a financing package, needs to go hand-in-hand with determining the type of space that is being developed and technical process of development of real estate," Siddiqui told Khalil Hanware of Arab News in an exclusive interview in Jeddah. Real estate is both a physical asset and a financial asset. Both aspects need to be optimized. Otherwise, capital sourcing becomes challenging, he said and emphasized the role of the development manager in rigorously evaluating the financial and technical aspects of development. "There are a host of development risks which must be managed as well as opportunities to maximize value across the development life cycle," he said.*

Following are excerpts from the interview:

**Despite the positive outlook, many private investors hesitantly invest in real estate projects. Why?**

There is wide consensus that the real estate sector in Saudi Arabia is a promising investment segment. Population growth, a trend toward smaller households, a stable economic outlook, and sizable government investments in infrastructure are some of the reasons why conventional wisdom points to opportunities in this sector. In spite of this positive outlook, however, private investors hesitantly invest in real estate projects, banks keep strict credit standards for real estate project financing and land owners hold the bulk of their land banks rather than to pursue development opportunities. The disconnect among real estate project stakeholders has to do with the way projects are executed rather than whether the opportunity exists in the first place. Often times, the multiple layers of inputs and decision making for a given project are not properly centralized and streamlined. For example, most projects are planned and executed through multiple consultants who work within silos.

A market study firm is retained to produce the feasibility study. This is followed by multiple vendors (architects, engineers, quantity surveyors) who are hired to conduct the technical works. Along this process, a project management firm is brought in to manage the technical activities. More often than not, this common approach leads to issues such as misalignment between business vision and technical master plan, late realization that the project does not fit bank financing criteria, investment in technical infrastructure that cannot be justified by its associated revenue or delays due to re-design.

**How can development management help to win investor confidence?**

To address the pitfalls of development and to win investor confidence, development managers direct the commercial, technical and legal aspects of development with a 360-degree view. Development management expertise is built on the experience of seeing projects through from concept through completion. At concept, development managers have the ability to create value by setting a positive direction for the development. As the project's feasibility is evaluated, development managers must make an objective assessment of the opportunity and find innovative ways to maximize it. This role continues into design where development managers must ensure that the work of technical consultants is aligned with the development plan, space usage is optimized and value engineering is conducted, among other consideration. Across each successive stage, the development manager guides the direction and key decisions. Given our experience with real estate in the Kingdom of Saudi Arabia, the discipline of development management will result in improved project execution, which, in turn, is what it takes to win investor confidence.

Naveed Siddiqui, CEO of Capitas Group International, speaks to Arab News.

**Who are the key stakeholders involved in any real estate project?**

The key stakeholders involved in any real estate project are land owner(s) and investor(s). While one might assume that both parties begin a project with the same outlook, this couldn't be more untrue. Because time is a critical factor, investors look at the IRR (internal rate of return) to decide if the investment makes sense. For them, it's not just the amount invested and earned that is important. They also look at when cash returns are earned. On the other hand, land owners are not necessarily motivated by time considerations. They instead consider ROI (return on investment). This is basically the cash collected versus the value of the investment, which in this case is their land. Whether a land owner inherited the property or invested and held it for a period of time, they tend to see things in a more 'matter of fact' way. For them, the issue is simply that they want to get the maximum cash payback for their land. Given that the alternative to development of the land is to keep it as a land bank, the time taken to complete development is not as significant as a factor when compared to the investor that placed cash into the project.

**What is the difference between ROI and IRR in real estate? Why do stakeholders use two different measures to measure returns from a project?**

Computing the ROI is quick and easy and involves only two values — one, the original cost/value of the investment and two, the new price/value of the investment. Compared to the ROI, the IRR is a more complex metric, because it not only takes into consideration the increase of the investment value, but also the timing of the cash flows. A development manager would take each of these views to achieve alignment of interests between the land owner and the investor, along with his understanding of how to manage vendors and technical real estate issues, to align project concept and delivery to the interests of all parties. A critical part of this involves managing the planning and execution of the project to maintain the alignment of all parties and the deliverables of multiple vendors.

> **Development managers are experienced real estate professionals who understand the financial and technical aspects of developments and have delivered projects from start to finish.**

**Can you shed light on capital sourcing for real estate projects?**

In the region, development projects are usually design-biased, i.e. they start with an identification of a space need and its fulfillment. Therefore, capital sourcing begins an afterthought. Capital sourcing, however, depends not just on whether the space need is being fulfilled but whether investors would get a fair return. This focus on investor return, or even on whether a project will be able to pay back a financing package, needs to happen early. Real estate is both a physical asset and a financial asset. Both aspects need to be optimized. Otherwise, capital sourcing is challenging.

The development manager's responsibility is to rigorously evaluate both aspects and then to assess return projections and financing options from the onset and to make development decisions on the type of asset, quantity and its staging with input on its compatibility with project financing. Other considerations such as selection of projects, which can be better phased or accurate assessment of off-plan sales as a capital sourcing option, are also key responsibilities of the development manager. Each of these decisions juxtaposes an understanding of commercial aspects with a broader command on the myriad of technical issues.

**Many investors and developers are challenged by the question of 'spend now or pay later.' Can you provide your perspective?**

This is a common issue. The developer's choice of materials and design (Capex) directly impacts ongoing cost of maintenance (Opex). This very basic question is a necessary part of planning a real estate development and ultimately entails sophisticated cost-benefit analysis, typically done in the form of an NPV analysis. Capex increases the cost, but Opex reduces benefit, as asset value decreases if the Opex to operate the asset is higher. In all cases, the ongoing maintenance cost can be best managed during the development process rather than afterward. As the development manager has the ownership of the entire life cycle (from idea conception, to lease-up to operations etc), finding this balance is a crucial part of the decision-making. While all developments should be designed to optimize between the upfront capital expenditures and ongoing operating expenditures — the arithmetic is especially important in the context of whether the investor plans to build and sell or to build and hold the asset. Advising project sponsors on where to allocate their money — up front or during operations — requires a management approach that understands how this type of investment decision will affect the development and how these will translate into financial returns for the investors.

**What are the risks associated with real estate projects in Saudi Arabia and how can they be managed?**

Risks identified with real estate projects in Saudi Arabia are typically associated with bureaucratic delays or materials' costs. But in reality there are a host of development risks that a project can face, including land value risk, environmental issues, construction risk, revenue risk, regulatory risk, partner risk, and legal risk. It is inconceivable that a set of disparate consultants would be able to see all these risks and plan accordingly or address risks as they arise. Consider an example of a project where the market uptake of residential units is unknown. In the case of a vertical multi-story development, the investor has limited options in altering the cost of development or quantity of development once the project gets off the ground. On the other hand, a horizontal development of villas presents opportunities to adjust based on market input. In addition, the typical developer in Saudi Arabia and the broader region often transitions from being strictly an asset owner to becoming an asset developer. Hence, their appreciation of the development risk is often biased. Development is an inherently riskier undertaking than an investment in an asset. This is simply because development risk also evolves over time and an asset owner does not have the ability to recognize or anticipate the issues that can arise. A refined development manager would bring this appreciation to the table, and his/her analysis and decision-making would account for it. Development managers would address these types of risks early in the planning stage to target a development with high likelihood of uptake as well as including potential options for adjustment in case unforeseen risks are faced.

**What is the overall role of a real estate development manager?**

First, development managers are experienced real estate professionals who understand the financial and technical aspects of developments and have delivered projects from start to finish. Drawing on this expertise, the development manager's role is to manage projects across its stages, anticipate and mitigate issues and provide insights which quantifiably add value. This value will be in increased revenue, reduced costs or shortened timelines. In that sense, development management is different from project management in that it measures itself by the ultimate value that is created. One way it does this is by involvement early in the process in both the financial and technical aspects. I described the role of the development manager within each phase — from developing the project concept to evaluating its feasibility, raising of funds, managing design and through to overseeing construction. Across each stage, the development manager does not take the place of consultants such as the architects, engineers, quantity surveyors and other key experts that are involved. Rather, the development manager ensures that the work done by the consultants are aligned and the right decisions are made. Another important aspect of the development manager's role is to ensure that the right capital is in place for investors and financiers. The focus on investors is a central part of the development manager's role.

Capitas Group International's (CGI's), development management service (DMS) works with private land owners, developers, investors, municipalities and government sponsored organizations. The broad array of expertise within the firm allows us to tailor our services to the specific needs of each partner. The DMS practice is jointly offered with international partners Opus of New Zealand and Malaysia and Surbana of Singapore.

**Why is CGI showcasing DMS practice at Cityscape Jeddah?**

Real estate is a critical component of the economy and we think it's important to help define the way forward in tackling some of the common problems faced by sponsors of projects in the Kingdom. DMS represents a highly effective way to creating viable solutions that benefit all stakeholders, from investors to government to end users. Cityscape Jeddah and similar events are a perfect venue for promoting the type of information sharing, discourse and debate among industry stakeholders that is needed to foster innovation and reach consensus on the best paths to follow.

Naveed Siddiqui, CEO of Capitas Group International.