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ABSTRACT

RESEARCH TITLE

Drivers of direct commercial real estate returns: Evidence from South Africa

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ABSTRACT

Drivers of direct commercial real estate returns: Evidence from South Africa

Background – The South African (SA) real estate sector lacks transparency and there is limited research and robust data on the performance drivers of underlying commercial real estate assets in investment portfolios as opposed to the residential and listed property sectors in the SA context. SA real estate competes internationally and the rapid growth in emerging countries is creating new real estate players and growing competition for real estate investment opportunities (PwC, 2015). It is important for investors in the industry to understand the factors that affect the sector's performance to be able to plan, review investment strategies, allocate resources efficiently, understand past trends and manage future risks.

Purpose - The purpose of the study is to understand the performance of the SA direct commercial real estate sector and identify the key factors that drive the sector's total returns in the country. Literature review is conducted to identify factors that drive direct commercial real returns in other countries and the identified drivers are tested for relevancy in the SA market. The study applies SA annual commercial real estate returns published by the International Property Databank (IPD) over the past 20 years, from 1995 to 2014, as dependent variables.

Findings - Using Pearson's correlation analysis, the study tests for correlations between CRE returns and independent variables; macroeconomic indicators (exogenous factors) and property performance variables (endogenous factors). The study finds gross rental escalation and real Gross Domestic Product (GDP) growth rates to be highly positively correlated with direct real estate returns. The results provide evidence that gross rental escalation and real GDP have high explanatory values of commercial real estate returns. The study concludes that rental income growth and economic growth are the key drivers of direct commercial real estate total returns.

Value - The findings provide evidence of the correlations that exist between exogenous, endogenous variables and CRE returns and assist in understanding the behaviour of the direct commercial real estate sector. This study sets a basis for real estate investments analysis and the results can be applied in asset allocation strategies by guiding investors on the direction CRE returns could take based on performance of the widely published macroeconomic and property performance variables under study.

Limitations - The limitation to this study is that the dependent variables, SA annual commercial real estate returns, has time series data of 20 variables in its existence and this has restricted the quantitative methodology choice, hence the use of correlation analysis to quantitatively analyse the relationships that exist between CRE returns and the exogenous and endogenous factors. Further research in the topic would include regression analysis to test for causality. This study has implications on real estate investment decision making and contributes to real estate market literature in SA.