South Africa

Opportunities and barriers to inbound construction

G20 rankings & data

<table>
<thead>
<tr>
<th>G20 heatmap rankings</th>
<th>Overall G20 Attractiveness Rank for Inbound Construction Activity: 9</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Construction industry health</strong></td>
<td></td>
</tr>
<tr>
<td>Construction industry value</td>
<td>19</td>
</tr>
<tr>
<td>Construction industry, real growth</td>
<td>6</td>
</tr>
<tr>
<td>Announced spend on construction in next 3 years</td>
<td>8</td>
</tr>
<tr>
<td><strong>Country financial health</strong></td>
<td></td>
</tr>
<tr>
<td>Budget balance</td>
<td>5</td>
</tr>
<tr>
<td>Overall announced fiscal stimulus</td>
<td>12</td>
</tr>
<tr>
<td>GDP/Head</td>
<td>14</td>
</tr>
<tr>
<td>Credit ratings rank</td>
<td>6</td>
</tr>
<tr>
<td><strong>Ease of doing business</strong></td>
<td></td>
</tr>
<tr>
<td>Doing business overall rank</td>
<td>9</td>
</tr>
<tr>
<td>Dealing with construction permits rank</td>
<td>7</td>
</tr>
<tr>
<td>Business transparency rank</td>
<td>9</td>
</tr>
<tr>
<td><strong>Tax regime</strong></td>
<td></td>
</tr>
<tr>
<td>BDO overall tax rank</td>
<td>6=</td>
</tr>
<tr>
<td>World bank – paying taxes rank</td>
<td>3</td>
</tr>
</tbody>
</table>

Financial metrics

- **Total fiscal stimulus announced**: -
- **Announced spend on construction in the next 3 years including fiscal stimulus to construction**: £43.9bn
- **Construction industry value – 2009**: £5bn
- **Main corporate tax rate**: 29%

Construction sector metrics

<table>
<thead>
<tr>
<th></th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>Construction industry value, £bn</td>
<td>4</td>
<td>5</td>
<td>5</td>
<td>6</td>
<td>7</td>
<td>8</td>
<td>-</td>
</tr>
<tr>
<td>Construction industry, real growth, per cent y-o-y</td>
<td>19.2</td>
<td>12.6</td>
<td>8.2</td>
<td>8.7</td>
<td>5.2</td>
<td>5.8</td>
<td>-</td>
</tr>
<tr>
<td>Construction industry, per cent of GDP</td>
<td>2.7</td>
<td>2.8</td>
<td>2.9</td>
<td>3.1</td>
<td>3.2</td>
<td>3.3</td>
<td>-</td>
</tr>
</tbody>
</table>

BDO review of tax

- Tax rates, thin capitalisation levels and tax depreciation policies are all around the G20 median levels
- Tax incentives, including green measures, are quite wide-ranging
- Tax depreciation rates are among the more generous within the G20
- Significant tax incentives are available in defined tax favoured special areas

Overall scoring: 6/10

BDO ease of doing business

There are some significant barriers for inbound construction activity however it is possible to get round these

<table>
<thead>
<tr>
<th></th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Very easy</td>
<td>Quite easy</td>
<td>Average</td>
<td>Quite difficult</td>
<td>Very difficult</td>
</tr>
</tbody>
</table>

Top construction firms

- Aveng
- Basil Read
- Group 5
- Murray & Roberts
- Stefanutti Stocks
- Wilson Bayly Holmes-Ovcon

This creates a barrier to entry. However, if inbound construction companies can bring specialist skills to the table that do not exist in South Africa, then they can overcome the barrier to entry. An example is the Gautrain Rapid Rail system that is being constructed between Johannesburg and Pretoria – there are elements of the project that local companies did not have experience and expertise in, and so international companies were brought in (namely: Bouygues and Bombardier).
“South Africa’s opportunities abound, with the construction industry expected to grow at 15 per cent CAGR to 2012. Inbound construction companies will need to consider how they comply with BEE.”

Richard Kelly  
Partner, Head of Construction

“Tax incentives targeted at sustainable development provide opportunities for the construction sector despite the inevitable complexity to operate these schemes. The corporate tax rate is reasonably competitive.”

Stephen Herring  
Tax Partner, Real Estate and Construction

Opportunities and barriers

Ranked 9th overall in our G20 heatmap, there are great opportunities, despite challenges such as a labour shortage and currency volatility.

South Africa’s construction industry is emerging from decades of decline into a period of significant growth and increasing opportunity that has been fuelled by the government’s commitment to infrastructure, and by increasing levels of public and private sector investment, according to government officials.

The South African government plans to spend £2.9bn on construction during 2006-2010. However, there have been cancellations and delays in large public projects due to budget problems. A major factor hindering the performance of the industry was the shortage of skilled labour. South Africa has struggled to attract foreign direct investment and the currency volatility over the past years had also hampered industry planning.

In its 2008 budget the South African government outlined a program to spend a cumulative £43.9bn over the next three years on infrastructure. A large portion of this spending will go to power generation, with the revamping of power stations and two new coal fired power plants. £5.84bn will go to transportation, including the improvement of rail infrastructure, expanding harbours and ports and the construction of a liquid fuels pipeline. Investments will also be made in the construction of roads, clinics and schools.

The country’s construction industry is expected to grow in the coming years fuelled by government spending and activity related to the 2010 World Cup. Development programmes planned ahead of the tournament include the Gautrain mass transit system and a number of hotel projects.

A weak and under-funded power sector constitutes a serious problem for companies doing business in the country. Improving power infrastructure will be a key to the governments planned 3 year £43.9bn spending program. The first of three new power plants will come online in 2013. Transportation will also be a priority with funding going to rail, expanding harbours and ports.

In January 2008 Transnet Port Terminals (TPT) began construction work to expand the capacity of Cape Town Port – South Africa’s second-largest port. The Port of Ngqura (Coega) is also undergoing expansion via a five year £572m development plan.

Early PPP projects emerged between 1997 and 2000 in sectors such as roads, prisons and water. A Strategic Framework for PPPs was put in place in 1999. In 2000, the Treasury issued the Public Finance Management Act and established a dedicated PPP Unit. In 2004 the National Treasury’s PPP Unit released updated guidelines.

Reasons South Africa is attractive for inbound construction activity

- Despite cutbacks and budget problems, South Africa’s government still plans to spend heavily on infrastructure in the next few years.
- There are almost no restrictions on the form or extent of foreign investment, and incentives include preferential tax treatment as well as those targeting small and medium enterprises, strategic industrial projects and exporters.

Barriers/challenges to construction activity

Compliance with Black Economic Empowerment needs to be considered:

- BEE is driven by legislation and regulation. An integral part is a scorecard, which measures companies’ empowerment progress. This scorecard is defined and elaborated in the BEE codes of good practice.
- Private companies must apply the codes if they want to do business with any government enterprise or organ of state – that is, to tender for business, apply for licences and concessions, enter into public-private partnerships, or buy state-owned assets.
- Because government is the big infrastructure spender in South Africa, compliance with BEE for construction companies is critical.
- Inbound construction companies will need to identify suitable parties and tender jointly on projects.

BDO viewpoint and advice

Pitfalls to avoid when doing business in South Africa

- Not having an understanding of the myriad of legislation affecting the industry.

Practical advice for inbound construction activity

- Form relationships and alliances with local companies to meet BEE requirements.
- Ensure local experts are engaged to understand local market conditions.

Useful tax and other incentives for inbound construction activity

Main depreciation rates:

- Buildings – 5 per cent per annum.
- Machinery factories and equipment – 25 per cent per annum.

Other incentives:

- These cover large strategic industrial projects, greenfield and brownfield industrial policy projects, infrastructural assets, urban development zones, low cost residential units, renewable energy assets, hotels, buildings which house manufacturing processes and commercial buildings.
- The incentives include accelerated depreciation rates relative to a development’s useful life plus allowances in excess of cost for certain projects which enjoy preferred status.
- Other forms of incentive include exemption of government grants, user friendly rules for public private partnerships and certain import tariff exemptions.

Sources: