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M&A Academy

What are real estate assets really worth?

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Agenda

The meaning of value

The definitions of Market value

The methods to assess value

The current state of the Real Estate Market and the future anticipated trends

Sustainability aspects and their influence on value

Conclusion

The meaning of value

The difference between cost and value

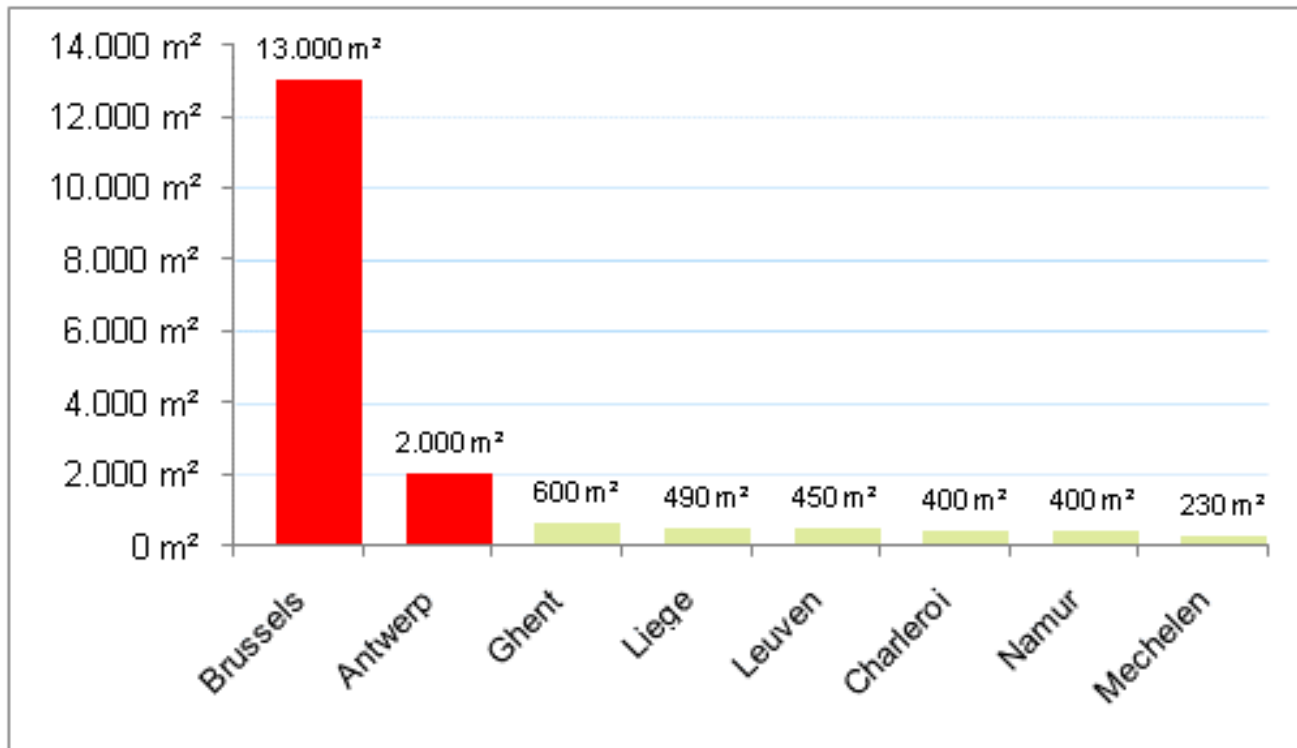
The importance of the marketability of the asset / Liquidity

Key Characteristics influencing the value

- Location, location, location
- Timing → The Market
- The rental contract (duration...)
- The quality of building (incl. sustainability)

Location, location, location

The office stock in '000 m²



Industrial Properties

Location, location, location

- Accessibility
- Proximity to a logistic cluster



The meaning of value

2 very important parameters used when valuing a property

The rent = Cash flows

The yield = The multiplier

$$\text{Market value} = \frac{RI}{(1+i)} + \frac{RI}{(1+i)^2} + \frac{RI}{(1+i)^3} + \dots \text{Over an infinite period} = \frac{RI}{i}$$

Where:

RI = Rental Income

i = Yield

The meaning of value

Prime rents in Belgium

Occupation	2008	2009	2010	Forecast
Office	275 €/m ² /y	265 €/m ² /y	265 €/m ² /y	→
Retail - High street	1,625 €/m ² /y	1,600 €/m ² /y	1,620 €/m ² /y	→
Retail - Shopping center	1,100 €/m ² /y	1,400 €/m ² /y	1,400 €/m ² /y	→
Retail - Warehouse	150 €/m ² /y	160 €/m ² /y	170 €/m ² /y	→
Warehouse	50 €/m ² /y	46 €/m ² /y	52 €/m ² /y	→

Source : CB RE 2008, 2009, 20010; C&W 2010

The meaning of value

The Yield

Gross yield = Annual Rent / Property Value

Example:

Annual rent: 5 000 €

Property Value: 100 000 €

Therefore the gross yield = 5%

The meaning of value

The Yield

Net Yield = (Annual rent – Annual Op.Costs) / Property Value

Example:

Annual rent: 5 000 €

Maintenance, insurance, etc.: - 400 €

Property Value: 100 000 €

Therefore the gross yield = 4.6%

Double net leases / Triple net leases

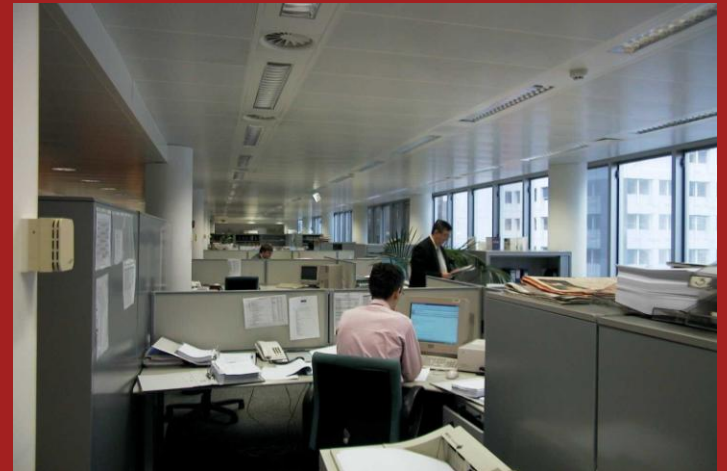
The meaning of value

Prime yields in Belgium

Occupation	2008	2009	2010	Forecast
Office	5.75%	6.25%	6.20%	→
Retail - High street	5.00%	5.25%	5.00%	→
Retail - Shopping center	6.00%	6.25%	5.50%	→
Retail - Warehouse	7.00%	6.75%	6.25%	→
Warehouse	6.00%	7.60%	7.75%	→
Residential	3.00%	3.00%	> 3.00%	→

Quality characteristics of the Office building

- HVAC / Airco system
- Lighting
- Clear Height
- Raised floors
- Divisibility /multi-tenancy
- Number of Parking spaces
- Sustainability



Characteristics of the Quality of industrial buildings

- Ratio offices/ warehouse
- Clear height
- Span width
- Floor load
- Loading bays/quays
- Manoeuvrability
- State of maintenance
- Fire security
- Age of the building



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The definition of Market Value

The **estimated amount** for which a property **should exchange**

on the **date of valuation** between a **willing** buyer and a **willing** seller

in an **arm's-length transaction** after **proper marketing** wherein the parties

had each acted **knowledgeably**, prudently and **without**

Compulsion. (RICS, 6th Edition)

Gross investment value vs. net investment value

The gross investment value = Investor is willing to pay

The net investment value = proceeds to be received by the seller.

Difference ?

Registration duties + Notary fees

Example

Annual rent: 5 000 €

Property Value: 100 000 €

Gross investment value vs. net investment value

Example

Annual rent: 5 000 €

Property Value: 100 000 €

100,000 € is the amount the investor is willing to pay because he is looking for a return of 5%.

However in this amount are included the registration duties and the notary fees. The vendor therefore will receive:

Flanders (10%) registration fees: $100.000 * (1 - 1/(1+10\%)) = 9\ 091$

Less Notary fees: 2 700

Net proceeds 88 209

Gross investment value vs. net investment value

Example

Annual rent: 5 000 €

Property Value: 100 000 €

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However in this amount are included the registration duties and the notary fees. The vendor therefore will receive:

Brus. & Wal.(12.5%) registration fees: $100.000 * (1 - 1/(1+12.5\%)) = 11\ 111$

Less Notary fees: 2 700

Net proceeds 86 189

Is it possible to reduce this big tax burden ?

- Use of SPV's
 - No registration duties on shares
 - However, it needs to be structured properly → risk of requalification
- Sale of a erfpachtrecht/droit d'emphytéose
 - Between 27 and 99 years
 - 0,20% registration duty
- Use of a split structure
 - You sell a erfpachtrecht/droit d'emphytéose to one entity of the group
 - You sell the “naakte eigendom/nue propriété” to another entity

The definition of Fair Market Value

... is the amount for which the property could be exchanged between knowledgeable, willing parties in an arm's length transaction.

“In Belgium, the most likely sale value **for buildings above 2,500,000 EUR**, excluding transaction costs, corresponding to the fair value, following the IAS/IFRS references, can be obtained by **deduction of 2.5% of the investment value.**” (Annual report Cofinimmo)

The definition of Worth

(Value in use/operational val.)

Worth, or Investment Value, is the value of property to a **particular**

owner, investor, or a class of investors, for identified investment

objectives. This **subjective** concept relates specific property to a **specified**

investor, group of investors, or an entity with identifiable investment

objectives and/or criteria.

In this context investment includes the **benefits of owner occupation**

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The methods to assess value

Different methods to assess value

1. ERV Capitalisation Approach
2. Income Capitalisation Approach
3. Discounted Cash-Flow Approach
4. Market Comparables Approach

The methods to assess value

ERV Capitalisation Approach

The principle is to:

capitalize the estimated market rent rather than the passing rent.

Why ?

Because the passing rent can be substantially **above** or **below** the estimated market rent and since the rent can be adjusted at the next break...

For which properties ?

Typically for offices and industrial properties

The methods to assess value

Income Capitalisation Approach

The principle is to:
capitalize the passing rent.

Why ?

Because from a legislative/market practice point of view,
it is very difficult to adapt the passing rent to the market rent

For which properties ?

Typically for retail properties

The methods to assess value

Discounted Cash flow Approach

The value of the property is derived from:

its capacity to generate positive cash flow (rents), and
to meet negative flows/expenses (structural repairs, ...)

Sum of the discounted cash flows over a certain period (typically between 7 and 10 years) with an appropriate discount rate + exit value.

Major challenge:

1. To determine the exit value
2. To agree on the discount factor e.g. long leases to the Belgian State

The methods to assess value

Market Comparables Approach

The Value of an asset is based on the principle

that any well-informed potential buyer

will not pay more than the prices

that were paid for similar properties sold in the recent past period

→ *Strongly demanded for retail and residential valuations*

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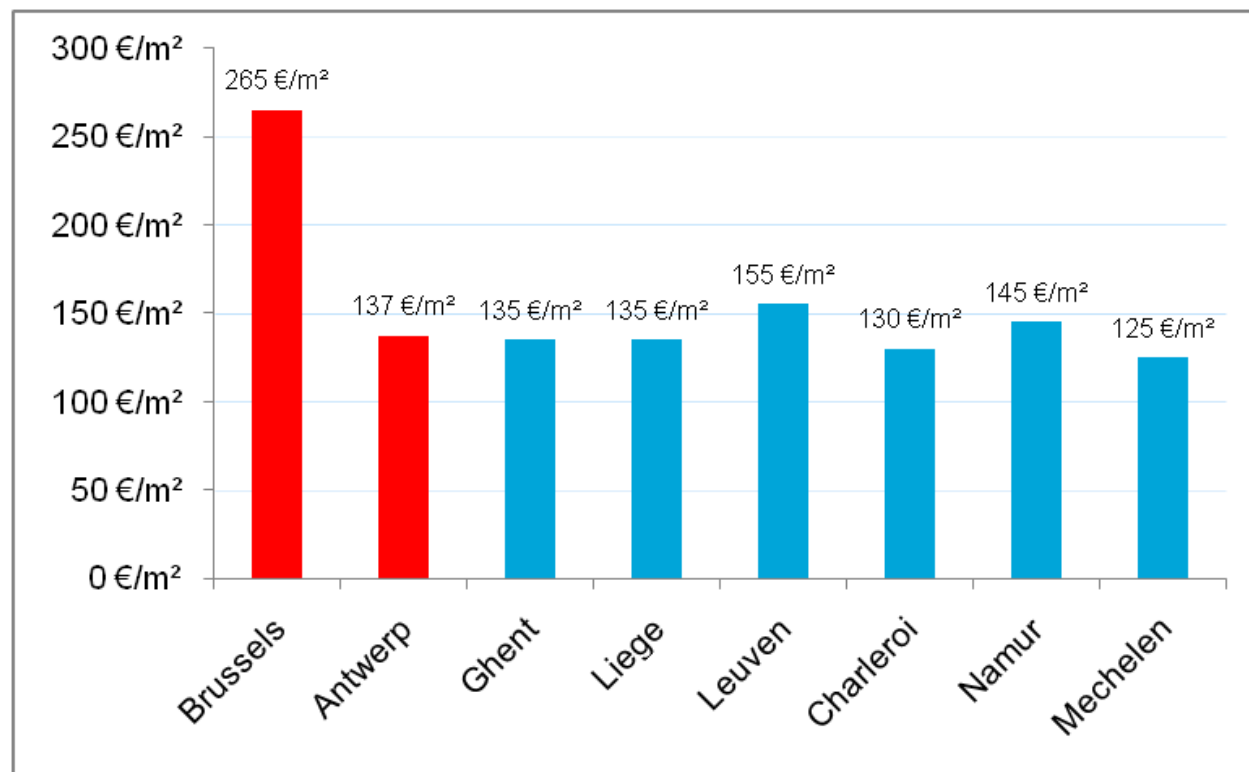
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The office rent

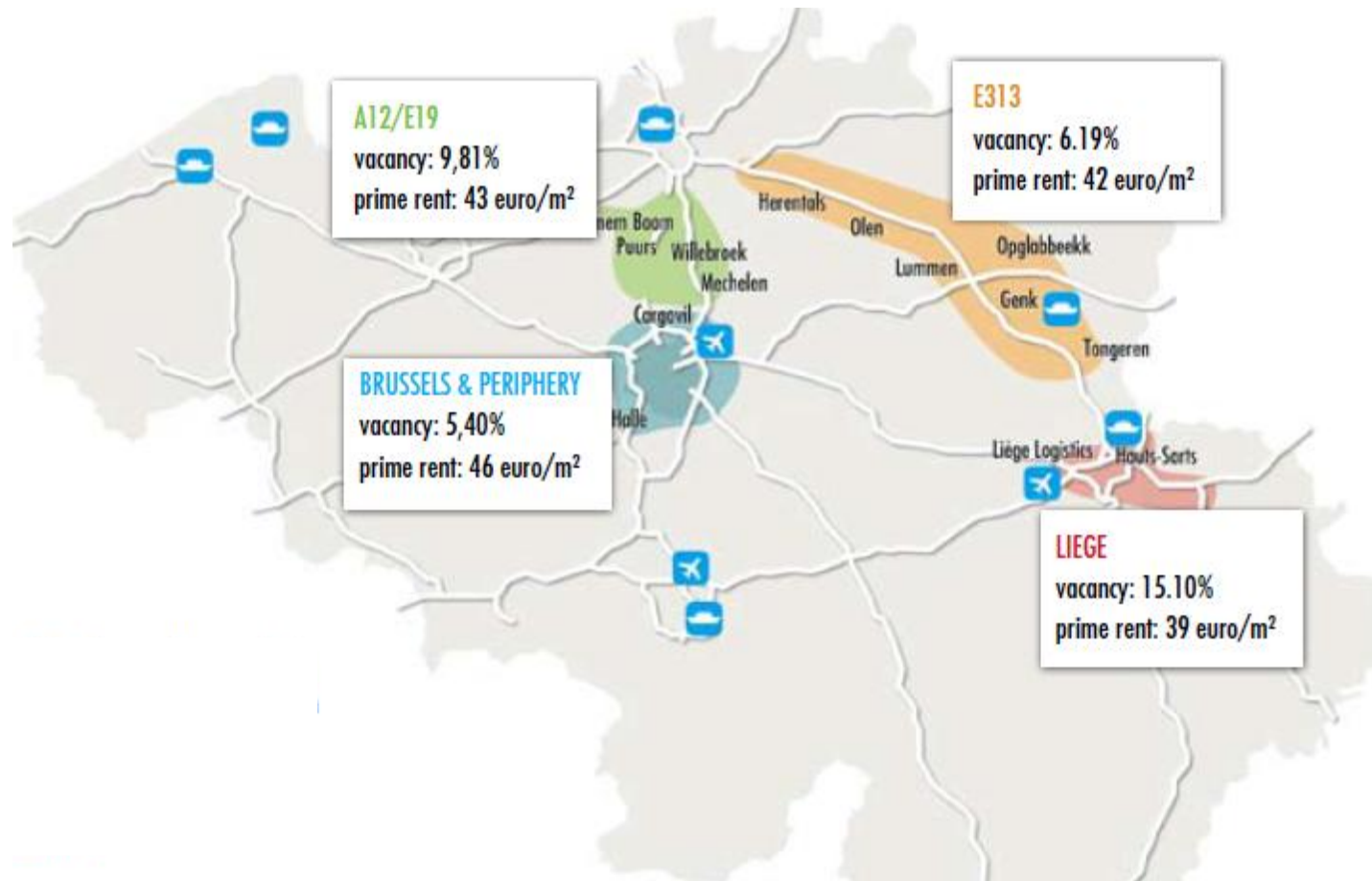


The Investment market

- Investment volumes have dropped :
 - from 5.3 billion (2007), 2.9 (2008), 1.5 (2009) to 1.13 (2010 ytd)
- Bank finance is less available and therefore focused on core+
- Some German open-ended funds are closed or in liquidation
- Some Irish investors in difficulties and therefore less active
- Domestic investors are the most active in the market place

- **Risk-averse** decisions are on the rise
- There is definitely a **flight for quality**
- **Yield compression** for good products: 5% or below

The Warehouse market



Anticipated Real estate trends across Europe

- Continued pressure on Banks
- Financings coming for renewal
- Existing funds reaching maturity → Liquidation ?

- Liquidity issues currently with German Funds
- Increased regulatory environment
 - Life Insurance Solvency II in 2013
 - AIFMD – Dodd Frank
 - Accounting for leases, for greenness
- Green regulation increasing → 2-tier market
- Increasing taxes in Europe → Emphasis on Green
- Race amongst cities → specialization, cluster

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Sustainability aspects and their influence on value

Driving factors

CSR,SRI



“We believe that a responsible, sustainable approach to real estate investment management is the only strategy which both protects and enhances the value of our clients' assets, now and into the future. Therefore our principles of Responsible Property Investment (RPI) are fully integrated within all our activities (Hermes)”

« Le développement durable est au coeur des métiers et des activités du groupe Caisse des Dépôts. Pionnier dans l'économie du changement climatique, engagé dans la promotion de la ville durable, investisseur responsable et actionnaire engagé: le développement durable est ancré dans nos actions au quotidien.(Caisse des Dépôts) »

“GE approach to citizenship is a full-time commitment with the same goals that drive any other parts of our business. Our goals are to make money (strong, sustained economic performance), make it ethically (rigorous compliance with financial and legal rules), and make a difference. (GE)”



FTSE4Good

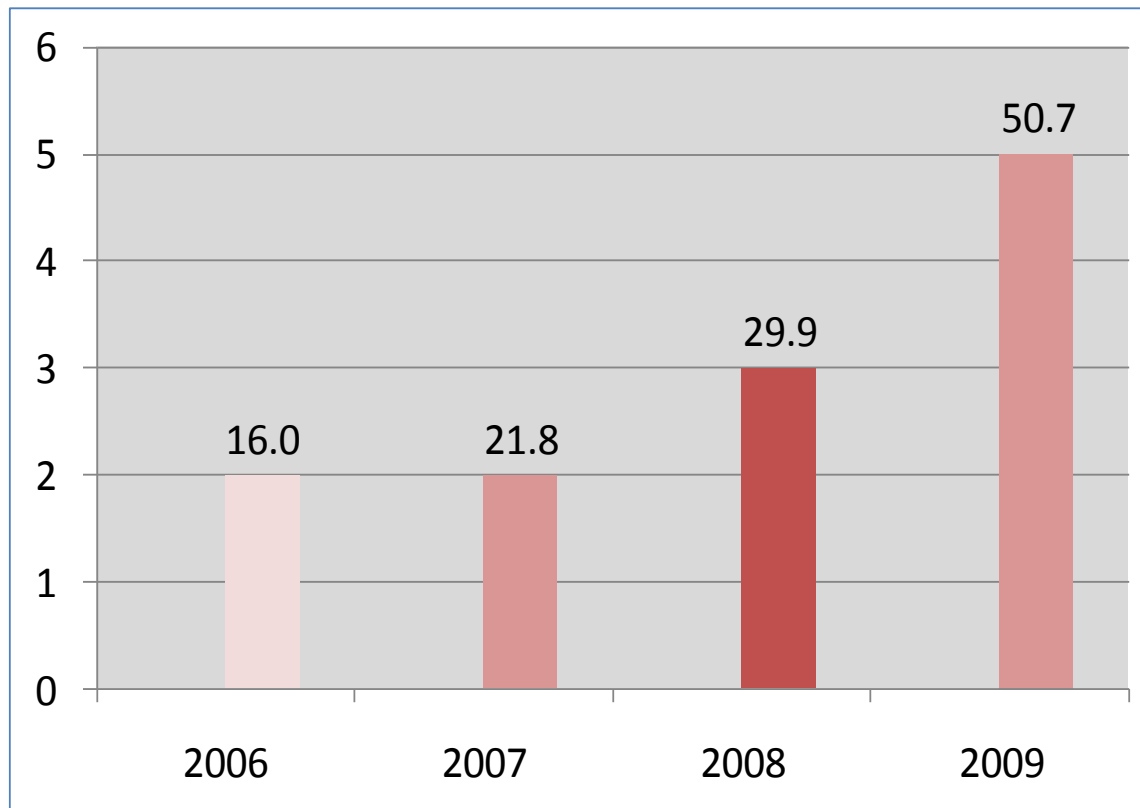
“We define sustainability broadly at P&G to include both environmental sustainability and social responsibility (P&G) Deliver an additional 20% reduction (per unit production) in CO₂ emissions, energy consumption, water consumption and disposed waste from P&G plants, leading to a total reduction over the decade of 50%. P&G”



Sustainability aspects and their influence on value

The French SRI market in 2009

EUR 50.7 billion up 70%



“SRPI means investment where social, environmental or ethical considerations are taken into account in the selection, retention and realisation of investments”



Sustainability aspects and their influence on value

Drivers Risk Management



Lower operating expenses

Energy / water price volatility & efficiency

Commercial

Impact on tenant demand

Potential for two-tier market

Future regulatory compliance

Current & Future Tax Incentives

CO₂ trading

Cost increases based on CO₂ / ton used to power asset

Sustainability aspects and their influence on value

Your Guide To Sustainable Development: influence on value

Creating Share Value

- Sustainable business strategy
- New markets and green investment strategy

Creating Operational Value

- Structural operational cost efficiency
- Long term human capital management

Creating Reputational Value

- Walk the talk: take the lead in responsibility
- Improve stakeholder management

→ Need for ***integral sustainable management approach***



Sustainability aspects and their influence on value

Certification systems

	Leed	Breem	DGNB	HQE	SB Tool
Origin	USA	UK	Germany	France	Canada
Year	1998	1990	2009	1996	2002
Criteria	Energy				
Low emissions		+	+		+
Renewable energy	+		+	+	+
Low Carbon	+	+	+	+	+
Refrigerant management	+	+	+	+	+
Criteria	Water				
Re-use / recycling		+	+	+	+
Water Consumption	+	+	+	+	
Criteria	Site	location			
Public transportation	+	+	+	+	+
Site Selection	+	+	+	+	+
Cyclist facilities	+	+	+		

Sustainability aspects and their influence on value

Certification systems

	Leed	Breem	DGNB	HQE	SB Tool
Criteria	Indoor Environment				
Air Quality	+	+	+	+	+
Daylighting	+	+	+	+	+
Acoustics		+	+	+	+
Thermal			+	+	
Criteria	Materials				
Material reuse	+	+	+	+	+
Waste management	+	+	+	+	
Robustness		+	+		
Criteria	Process & Management				
Planning			+		+
Construction phase		+	+		
Commissioning		+	+		

Source: Bopro

Sustainability aspects and their influence on value

Certification systems

	Leed	Breem	DGNB	HQE	SB Tool
Criteria	Economical	Issues			
Costs			+		+
Life cycle			+		
Value stability			+		
Criteria	Functionality				
Flexibility			+	+	+
Access Disabled persons			+		+
Safety and security			+		
Criteria	Innovation				
Innovation issues	+	+			
Criteria	Minimum requirements				
Yes	+	+	+		
Grades	<i>Certified , silver gold, platinum</i>	<i>Pass,good, Very good, excellent, outstanding</i>	<i>Gold Silver Bronze</i>	<i>Basic level , high level , Very high level</i>	<i>Minimum, Good practice Best practice</i>
Source: Bopro					

Sustainability aspects and their influence on value

9 sections analysed within BREEAM

1. Energy	19%
2. Health & Wellbeing	15%
3. Materials	12,5%
4. Management	12%
5. Land use & Ecology	10%
6. Pollution	10%
7. Transport	8%
8. Waste	7,5%
9. Water	6%

+ innovation



10%

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Conclusion

Get the proper attention
when you bring out a competitive bid
on a company
that owns real estate.

Contact

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