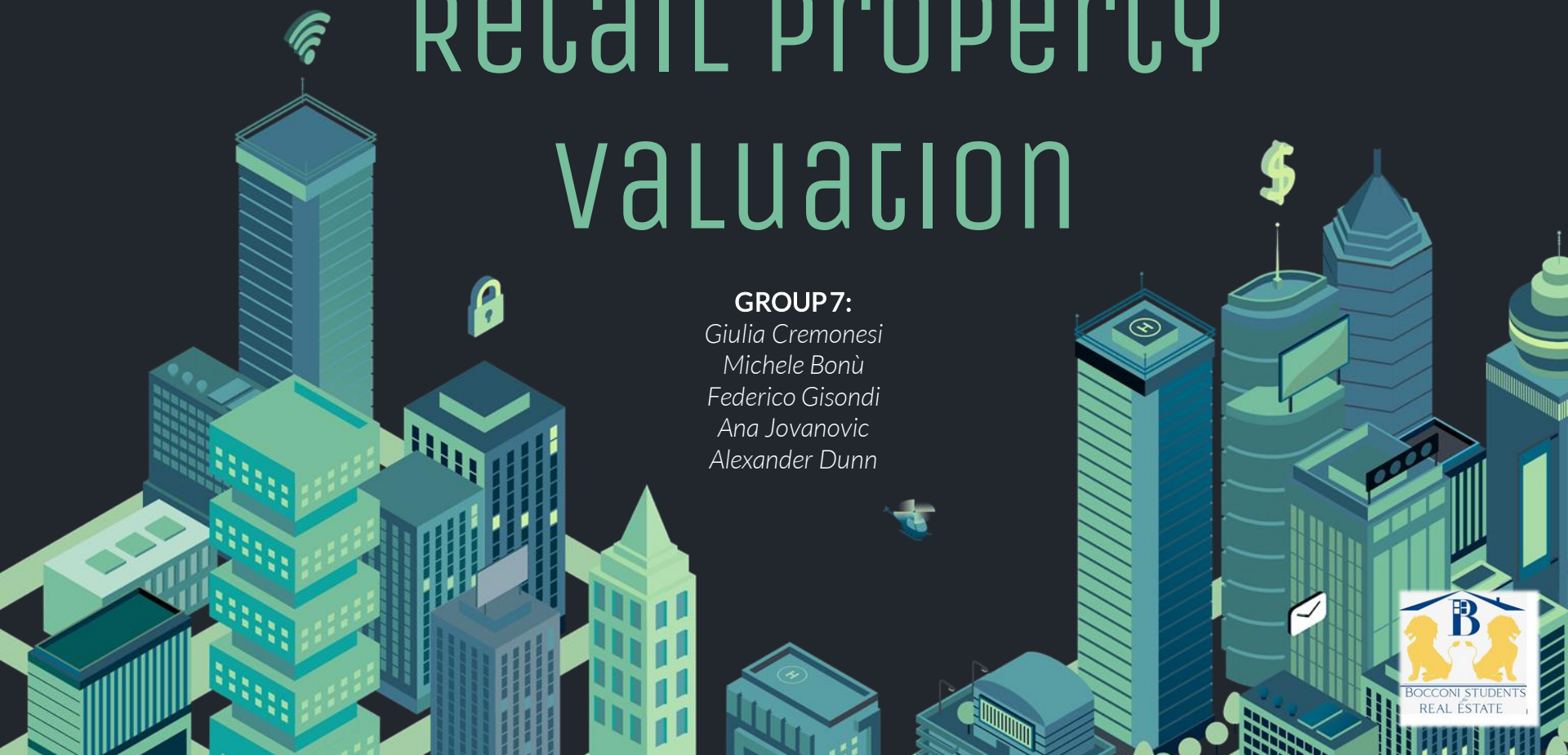
Retail Property Valuation

GROUP 7:
Giulia Cremonesi
Michele Bonù
Federico Gisondi
Ana Jovanovic
Alexander Dunn



agenda

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Introduction

What is Retail Property and Sector trends

2

Valuation

Methods for Property Valuation

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Steps/Formulas to Valuation

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SUMMARY

Conclusion

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Introduction

What is Retail Property

Retail property is a classification of zoning for property that is used for a **store, shopping center or service business**. Real estate is another word used interchangeably with retail property.
Commercial property is any non-residential **property** used solely for business purposes and it includes office **buildings**, medical centers, hotels, malls, retail stores, farmland, multifamily housing **buildings**, warehouses, and garages.
In many states, residential **property** containing more than a certain number of units qualifies as **commercial property** for borrowing and tax purposes.

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Here are some of the **emerging trends** on the horizon that investors should keep an eye on.

Convergence of Retail and Living Spaces

For all retail types, more bankruptcies and store closures are expected as companies try to realign physical footprints with e-commerce.

Developers have traditionally built retail spaces in areas where there's a significant **residential community**—a phenomenon reflected by the common trend, **"retail follows rooftops."** Now, developers are taking this trend further by building under the rooftops, converting apartment lobbies in high foot traffic areas into public retail space.

Changes for Offline Retail

Offline retail continues to experience a cultural shift. Although human connection and personalization for many retailers—and shoppers—is essential, many larger brands still need a **strong identity for successful omnichannel execution.**

Retail Real Estate is undergoing a huge **transformation**. Store closures were at record levels with over 105 million square feet in 2017 and 145 million square feet in 2018. American retailers have already announced **6,000 store closures this year**. That's more than all last year.

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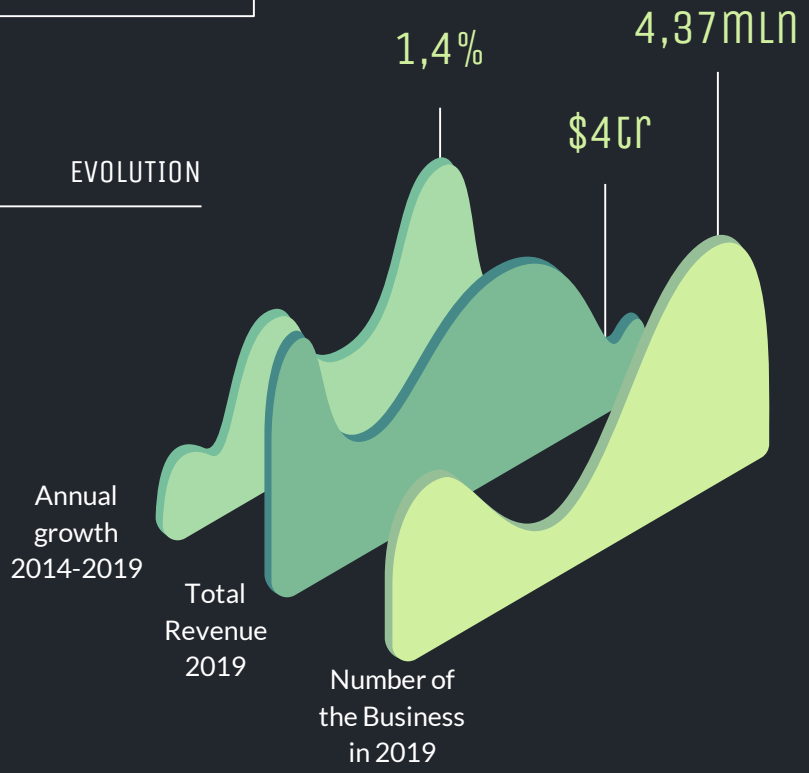
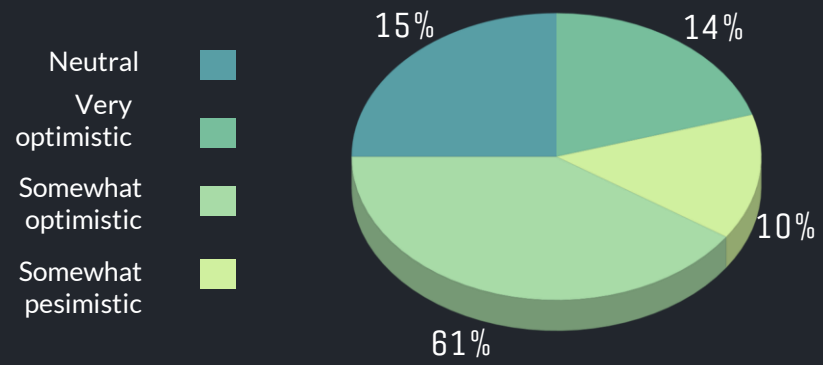
Retail properties global overview

EVOLUTION



CRE performance expectations for professionals in the CRE over the next 18 months



SOURCE: Deloitte Center for Financial Service Analysis

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Valuation: different approach

A market approach

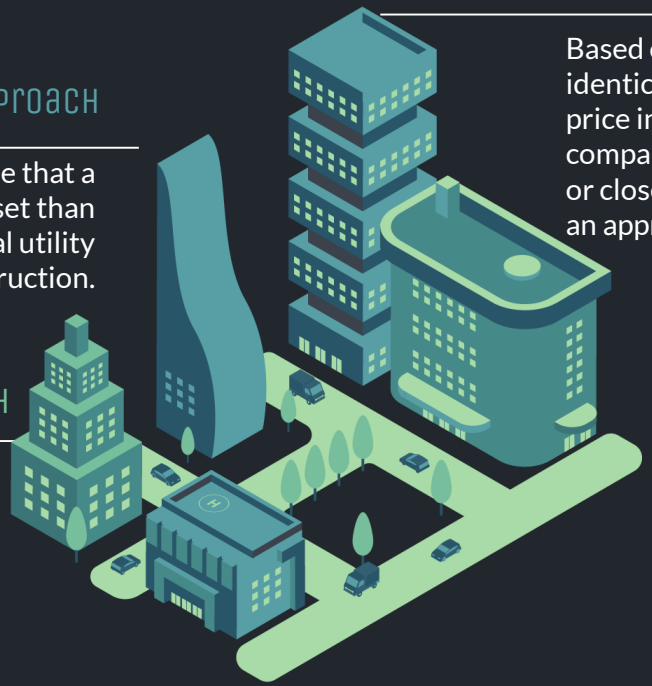
Based on comparing the subject asset with identical or similar assets (or liabilities) for which price information is available, such as a comparison with market transactions in the same, or closely similar, type of asset (or liability) within an appropriate time horizon

A cost approach

Based on the economic principle that a purchaser will pay no more for an asset than the cost to obtain one of equal utility whether by purchase or construction.

An income approach

Based on capitalization or conversion of present and predicted income (cash flows), which may take a number of different forms, to produce a single current capital value.



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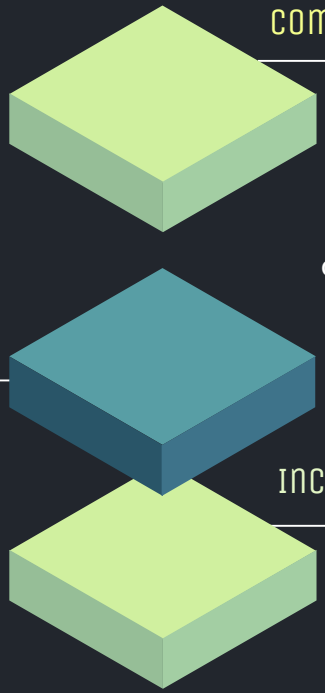
Different methods

Market Approach Methods (Sales Comparison Approach):

a) Direct Comparison Approach

b) Hedonic Pricing Model

c) Multipliers and Rules of Thumb



(Depreciated) Cost Approach Methods

a) Replacement Cost Approach

b) Reproduction Cost Approach

Income (Capitalization) Approach Methods

a) Direct Capitalization Approach

b) Discounted Cash Flow Approach (DCFA)

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Valuation requirements

Preliminary phase:

Determining the valuation requirement
Gathering and analysing the documentation and information required

1

Operational phase:

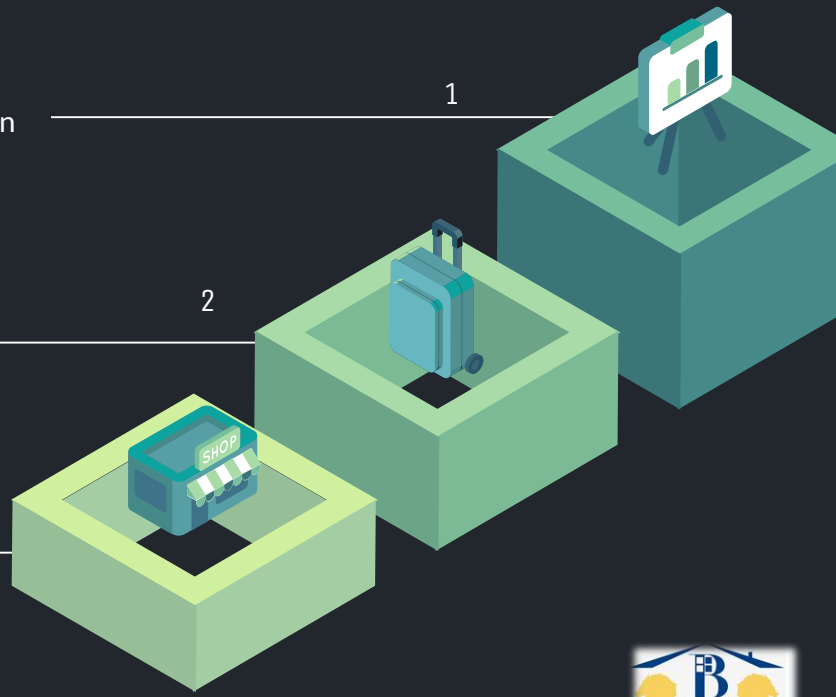
Inspection of the property
Identification of the applicable method
Gathering of market parameters
Calculation of the value
Writing of the valuation report

2

Conclusion:

Checking of results

3



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THE INCOME CAPITALISATION METHODS PROVIDE TWO APPLICATION MODELS BASED ON DIFFERENT MEASUREMENTS OF EXPECTED ECONOMIC BENEFITS AND RETURN:

DIRECT CAPITALISATION APPROACH

It is used to convert the forecast of an expected income of a single period in an indication of value, by dividing the estimated income at an appropriate cap rate.

The **cap rate** is the expected market income yield.

Given that real estate assets have an extremely long-life cycle, to perform the valuation we use the Present Value of a **perpetuity.**

SEE SLIDES 9 TO VIEW ALL FORMULAS

DISCOUNTED CASH FLOW APPROACH

It is used in order to convert all the future cash flows in a Present Value, by discounting all the expected economic benefits at an appropriate discount rate.

The discount rate represents the expected market Interest Rate of Return

The DCFA valuation steps:

1. Choosing the time horizon
2. Estimating every cash flows
3. Determining the Terminal Value
4. Discounting the cash flows and calculating the value of the Asset.

DCFA

1) Estimating the cash flows

The definition of relevant economic benefit is the cash flow, which is equal to the difference between all the income and expenditure arising from the property..

2) Choosing the time horizon

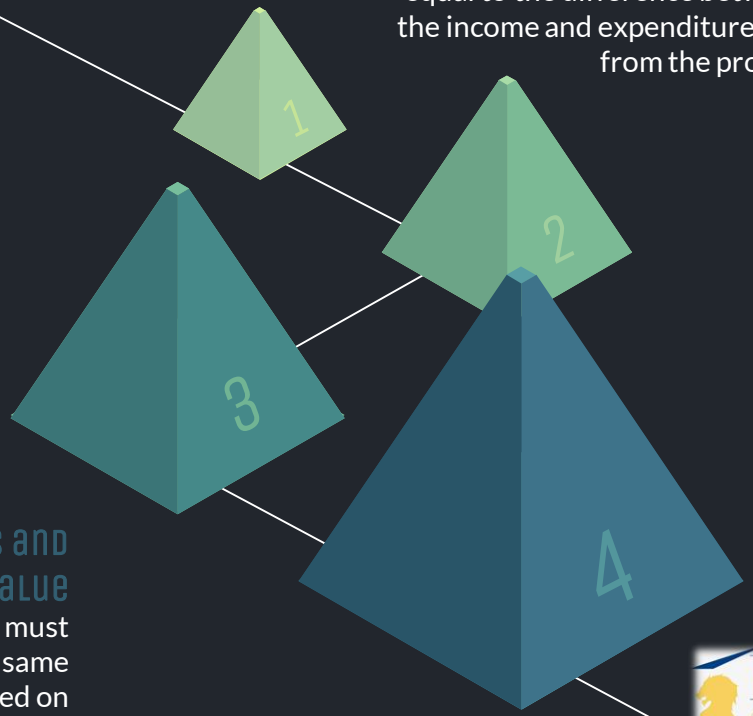
Valuer's forecasting capability is limited. In practice, a time horizon similar to the length of the existing lease agreement, or a fixed period of 10 to 15 years, is often used.

3) Estimating the terminal value

The Terminal Value has a fundamental impact on the accuracy of the valuation because it often constitutes most of the value of the asset, mainly when the discount rate is low and the time horizon short.

4) Discounting the cash flows and calculating the asset value

To compare the cash flows from different periods, they must be converted into equivalent flows measured at the same point in time, i.e. the valuation date. The DCFA is based on the Present Value formula (PV).



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Estmating the terminal value

a) The direct capitalisation approach

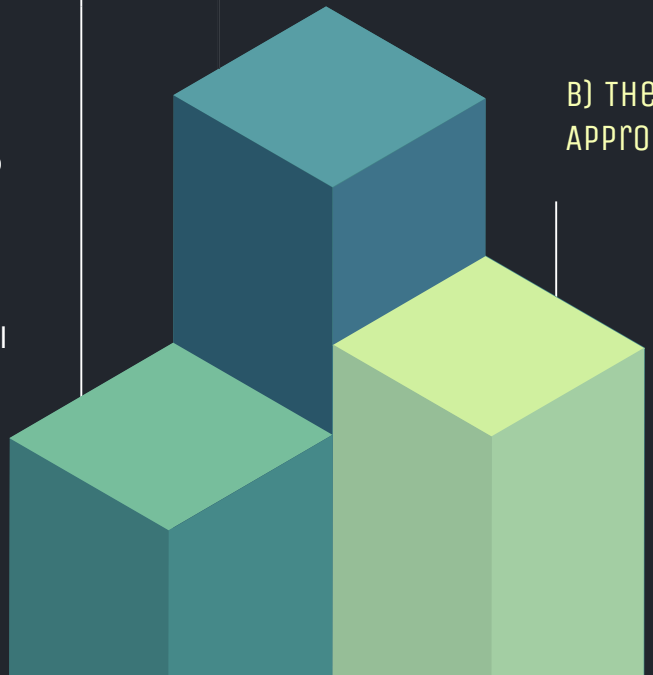
To be used in particular for Commercial Properties, it is applied considering the income expected at the end of the time horizon and the respective outgoing cap rate.

The last cash flow to be used in the DCFA may consider both the intermediate cash flow and the Terminal Value or the latter only.

$$V_T = \frac{R_{n+1}}{GOCR}$$

where:

- R = income
- GOCR = going-out cap rate
- T = time
- n = last period in the time horizon.



B) The direct comparison approach

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Value formulas for the 2 models

Direct capitalization approach

$$V = \sum_{t=1}^{\infty} \frac{I}{(1+k)^t} = \frac{I}{r}$$

$$V = \frac{I}{r}$$

where:

- V = value
- I = income
- r = cap rate

Discounted cash flow approach

$$PV = \frac{F_1}{(1+k)^1} + \frac{F_2}{(1+k)^2} + \frac{F_3}{(1+k)^3} + \cdots + \frac{F_n}{(1+k)^n} = \sum_{t=1}^{n} \frac{F_n}{(1+k)^t}$$

where:

- PV = Present Value
- Ft = cash flow at time t
- k = discount rate
- n = last period in the time horizon.

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CONCLUSIONS

Preliminary phase:

1

Operational phase:

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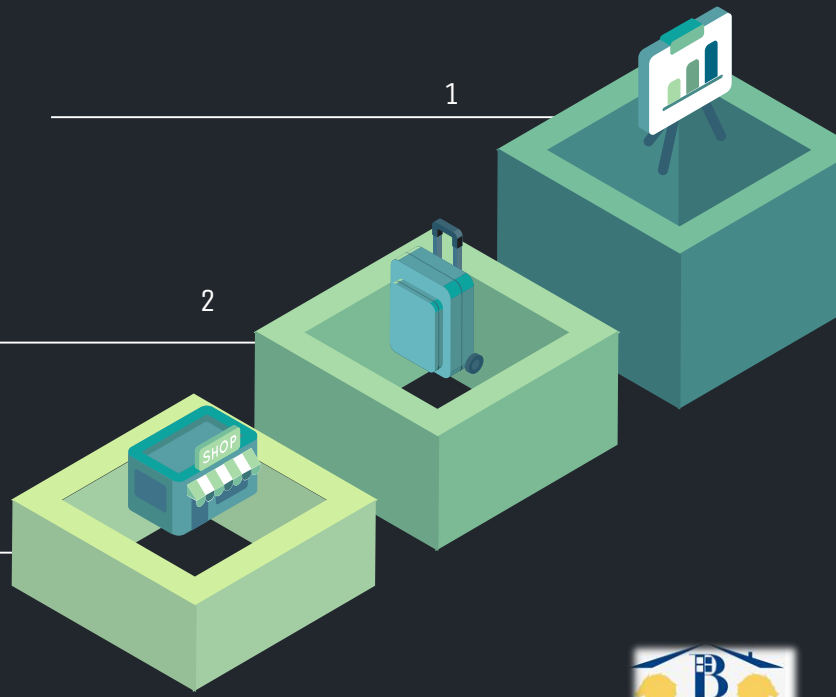

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Conclusions

What is Retail Property :

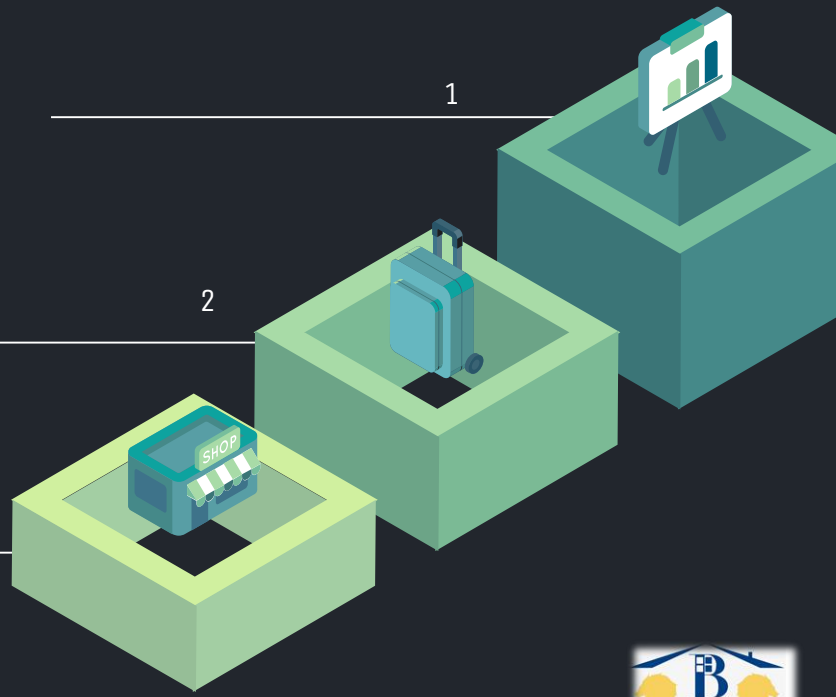
Stores, Shopping Centers, Service

Businesses Valuation Methods:

Discounted Cash Flow Approach &
Direct Capitalization Approach

Valuation Formulas:

Present value of future cash flows



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“The best investment on Earth is earth.”

—Louis Glickman

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Thank you for your attention

Does anyone have any questions?

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