Valuing Yesterday's Office Buildings

Introduction

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Topics of Discussion

- Valuing Yesterday’s
- Managing Today’s
- Understanding Tomorrow’s

Topics of Discussion

- Will return's from non-green buildings plummet?
- How should today's green buildings be managed?
- What will be the influences shaping office buildings of tomorrow?

Valuing Yesterday's

Age (Yrs Since Construction)	No of Buildings	Proportion of Total Stock
<10	7	2%
10-25	66	20%
26-50	95	29%
>50	158	49%
Total	326	100%

Melbourne CBD Office Buildings According to Age
Source: Reed and Wilkinson (2008)

Valuing Yesterday's

Decreasing value of yesterday's office buildings

Property Type	Lease Length	Refurbishment Frequency	Current Exposure to Obsolescence	Anticipated Effect of Changing Perception of Sustainability**
Office	Medium	Medium	High	Medium*
Retail	Short	High	High	Low*
Industrial	Long	Low	Low	Low
Residential	Short	Varying	Low	Low-Medium

* would vary in other sectors
** would vary according to net or gross leases and which stakeholder (e.g. tenant, owner)

Sustainability, Depreciation and Obsolescence - High Level Review
Source: Reed and Wilkinson (2007)

Valuing Yesterday's

- Decreasing value of yesterday's office buildings
  - Relative utility
  - Accelerated depreciation
  - Cohorts and vintages
  - Concepts of economic life

Valuing Yesterday's

- Yesterday's office buildings - valuation issues

- Discounted cash flow
- Rental rates
- Outgoings rates
- Growth rates
- Leasing, lease renewal, vacancy rates
- Capex allowances
- Terminal capitalisation rates
- Discount rates

Managing Today's

- Ability
- Education
- Evidence

Managing Today's

Valuation Methods

- Do we need new methods?

or

Should we just use the existing tools better?

- **DCF**
- Capital Expenditure
- Rental growth – no longer a generic input
- Terminal yield – what has the current market got to do with it?

Managing Today's

Inverse of increasing value of green buildings?

Improved working environment	**Reduced building operating costs**	**Reduced facilities maintenance costs**	**Greater capital cost**
▼	▼	▼	▼
Greater demand for space	Lower operating expenditure	Lower operating and/or capital expenditure	Causes lower initial return on capital
▼	▼	▼	▼
Higher rents, less vacancies	Increases the net income	Increases net income or decreases capital	▼
▼	▼	▼	▼
Positive impact on value	**Positive impact on value**	**Positive impact on value**	**Negative impact on value**

Understanding Tomorrow's

Will occupiers pay?

- Will landlords "pass on" the building savings
- Will tenants use the building to a "sustainable" level
- Are there extra business costs offsetting the property savings in operating in a "green" environment

Understanding Tomorrow's

Key Benchmarks

- Initial yield
- Running yield in years 3 to 5 of the 10 year cash flow
- Total Return
- Capital value per square metre

Havelock Street, West Perth

- A real life example

What This Means

- Valuation is an opinion
- Based on market conditions at the time
- In accordance with Market Value definition
- Interpretation of the Market

Going Green

- Future proofing your asset from economic obsolescence

Going Green

- Sustainability on property is dynamic. The rate of change is rapid
- Tenants are driving the demand for green
- Green rating is important in reaching an investment decision, but financial return cannot be compromised
- Investing in green buildings makes good business sense
- Investors are selecting assets based on their green credentials
- Buildings, which due to their design, utilise high volumes of utilities (water, power etc.), are at risk of being adversely affected in value

Going Green

- Not all tenants are willing to pay more to lease green buildings
- Tenants, including the Govt, are mandating minimum ESD standards as they relate to accommodation choices
- Are investors are prepared to invest in green buildings, even though they might demonstrate a short term loss?
- The key value drivers of green buildings are long term rental growth rates, tenant retention, future proofing and operational cost savings
- The DCF approach is the best valuation method