

Large scale Real Estate Investment– a summarised roadmap

As with any investment it is critical to ask some key questions when evaluating transactions. Here are some thoughts for you to consider.

Question	Some key points
What are the options for investing in Real Estate?	<ul style="list-style-type: none"> The range of Real Estate related investments is expanding from traditional areas (office, retail, industrial) to areas such as logistics, hotels and residential (Private Rented Sector, Affordable Housing, Student Accommodation) and serviced offices
What is the preferred investment style?	<ul style="list-style-type: none"> Direct vs indirect; Core, Value Added (e.g. some restructuring of leases on a property) or Opportunistic (e.g. distressed assets) How returns are achieved will be influenced by the types of investors e.g. passive investors in income generating assets, developers, Private Equity, traders
What is the Macroeconomic and political environment?	<ul style="list-style-type: none"> Real Estate values are sensitive to the underlying macroeconomic environment so understanding the macroeconomic cycle, the impact on financial markets (e.g. interest rates) and adapting the investment approach is key. Political events (such as Brexit) will also potentially have an affect on Real Estate valuations
What will be the impact of Sector and social trends?	<ul style="list-style-type: none"> Impact of technology on the retail sector; environmental protection (energy efficiency)
Who are the parties involved?	<ul style="list-style-type: none"> Growing role of Investment Funds, often with sponsors with a Private Equity background, both equity and debt related
What are the key risks; what could go wrong and how have the risks been mitigated?	<p>The following are the main risks that should be taken into account in evaluating and structuring Real Estate Investments</p> <ul style="list-style-type: none"> Macroeconomic and political Construction and development Technology Environmental Interest rates and investment yields FX rates Liquidity Vacancies Payment obligations (rents and rent reviews, business taxes, repairs, insurance, break and termination clauses, fitting out costs and rent free periods) Tenant credit quality Insurance coverage and exclusions Returns on alternative investments Tax effects and investment incentives Legal and legislative

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What is the basis of Valuation of a property?	<ul style="list-style-type: none"> • Based on comparable transactions or discounted cashflow approach or a combination? • Basis of valuation – Open Market Value or another approach? • Valuation of individual properties vs valuation of a portfolio • Asset valuation vs company valuation • Land values are highly sensitive as the land price represents the “residual value” after deducting development and financial costs from the expected sales price • Valuation approaches for hotels / hospitality and other operating entities such as care homes will reflect that they are businesses rather than just Real Estate
Evaluation of Commercial Real Estate Companies	<ul style="list-style-type: none"> • There are a range of measures of performance, such as <ul style="list-style-type: none"> • Net Asset Value • Net initial Yield • Reversionary Yield • Dividend Yield • Price / Net Asset Value • FFO Yield • Recurring earnings • Rental income growth • Weighted Average Lease term • Portfolio Vacancy • Debt servicing capacity and capital structure • Exposure to development risk • In hotel sector, Net Operating Income and RevPar
Valuation of Real Estate companies vs single Real Estate assets	<ul style="list-style-type: none"> • Valuations based on a DCF of a limited number of forecast years and capitalisation of a Terminal Value will be very sensitive to the Terminal Value
Capital structuring	<ul style="list-style-type: none"> • Theoretically debt will be considered cheaper than equity but in practice capital structure should take into account the stage of the economic cycle • Legislative limitations on the amount of debt that can be raised by REIT
Debt financing options	<ul style="list-style-type: none"> • Increased role of non - bank lenders • Capital Adequacy requirements and impact on debt maturities and attitude to risk • Debt vs equity investments according to the stage of the economic cycle

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	<ul style="list-style-type: none"> • What is your approach to leveraging instruments? • Sources of funding and financing terms (maturity, repayment structure, pricing, leverage, covenants and collateral) • Refinancing plans
What is the equity investors' perspective?	<ul style="list-style-type: none"> • Form and amount of investment – equity, subordinated debt, contributed assets • What is the forecast equity IRR/ NPV; what will affect it and can the risk be managed, and at what price? • How will the returns be achieved? • What are the exit routes for the investors? • What is inter – relationship between the project company and the equity investors; is cash being extracted by the “back door”? • How much support is being provided by the sponsors to the project company?
How have the project risks been mitigated?	<ul style="list-style-type: none"> • Who is assuming the construction / completion risk? • Operating risks – who is the operator • Technical risks – manufacturers' warranties • Financial (interest and / or currency sensitivity) • Market risks – voids; rent free periods • Tenant credit risk
Investment Fund terms and conditions	<p>Issues to be considered include</p> <ul style="list-style-type: none"> • Investment objectives and portfolio composition • Potential conflicts of interest and need for independent valuations/ monitoring/ reporting • Exposure to development risk • Target rate of return • Legal structure of fund and term • Waterfall of returns – preferred returns to LP, Incentives to GP, carried interest and clawbacks • Ongoing management of properties in the fund to maximise returns • Restrictions on redemption and liquidity
Is the documentation watertight?	<ul style="list-style-type: none"> • Choice of law / arbitration • Contractual arrangements between the various parties • Intercreditor agreements • Termination / break clauses in leases
What controls are there on an ongoing basis?	<ul style="list-style-type: none"> • Valuations • Financial reporting • Controls over disbursements • Lease negotiations • Property management