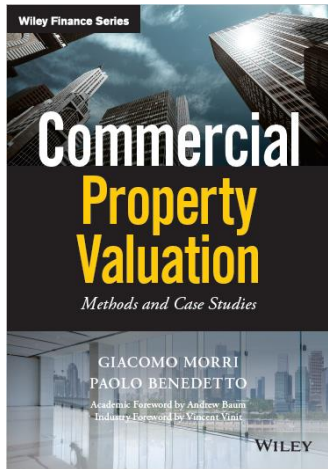


Commercial Property Valuation

Giacomo Morri & Paolo Benedetto

WILEY, 2019



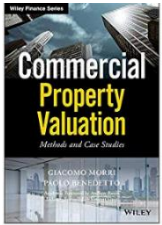
Market Analysis

Chapter 3



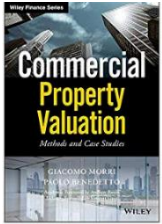
Index

- **Economic Analysis**
- **Analysis of the Property Market**
 - Comparative Data and Valuation Method
- **Characteristics of the Comparative Factors and Information Sources**
- **Information Sources**
- **Gathering and Processing Information**



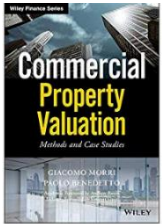
Economic Analysis

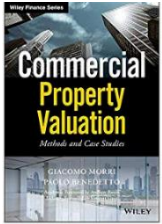
- The market analysis starts with an **economic overview** to highlight the dynamics of the main factors, such as Gross Domestic Product, expected economic growth rate, inflation rate, unemployment level, etc..
- **Functions:**
 - Allows to define the overall scenario
 - Allows to choose the economic variables (such as the risk free rate or the growth rate)
- **Sources:**
 - Reports published by the main institutional, economic and political sources
 - Using consistent data is essential



Analysis of the Property Market

- The Property Market must be analysed both at a global and local level
- **Peculiarities of the Property Market:**
 - **Delay in the availability of the data:** differently from securities market, where data are public and immediately available, in the property market there is a delay required for processing the data, as well as some difficulties in collecting the data themselves
 - **Lack of transparency:**
 - Each property, unlike securities, is unique and hardly comparable
 - The quality of the information varies depending on the market cycle
 - Transactions data are mainly confidential
 - Transaction values could be recorded at prices that do not consider all the elements of the transaction
 - Low number of transactions

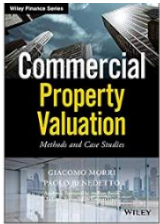




Analysis of the Property Market

- As mentioned before, the **quality of the information** varies depending on the market cycle:
 - During expansionary phases, there is an initial increase in volume followed by a rise in property sale prices
 - The opposite occurs when the market contracts
- A **change in market conditions** has a different effect on sale prices and volumes, with the latter presenting a higher reactivity to changes than the former
- For this reason, in order to determine the market cycle phase, it is important to analyse the **number of transactions or the volume of investment** rather than the price level alone, as, given the uniqueness of the assets, the latter is less reliable due to the aforesaid measurement difficulties

Analysis of the Property Market

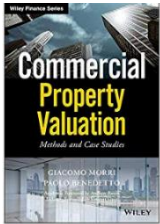


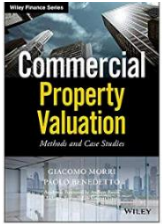
Comparative Data and Valuation Method

- According to the method chosen, different data must be used:
 - **Sales Comparison Methods**
 - Sale prices of comparable properties
 - **Income Capitalisation Methods**
 - Yield rates of comparable assets (Investment Market)
 - Rents (Space Market)
- Furthermore:
 - Also **property costs** and, therefore operating expenses, must be compared
 - In the case of **Trade-Related Properties**, it is essential to carry out market analysis of the activity performed in the properties themselves in order to verify the sustainability of the rents for tenants (effort rate)

Characteristics of the Comparative Factors and Information Sources

- Information can be collected in several ways and at different times depending on the type of valuation performed and the sources of information available
- Regardless of all this, however, the comparative factors must fulfil the following requirements:
 - **Reliability**
 - **Recentness**
 - **Uniformity**
 - **Specificity**



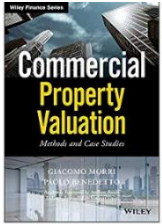


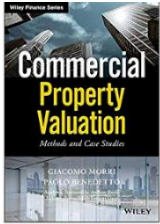
Information Sources

- The property market lacks a central and organized structure like a stock exchange, therefore it is possible to find many information providers
- It is possible to distinguish two types of sources:
 - **Direct sources:** consist of players who participate directly in the process of exchanging data, including buyers, sellers, real estate brokers and advisors
 - **Indirect sources:** includes all the players who, while not participating directly in the transaction process, collect and process information available on the market
- The valuer must carefully analyse how the data was obtained, analysing the data collection and processing methods

Information Sources

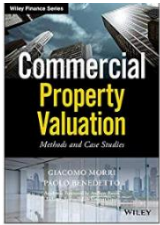
- The primary indirect sources generally consist of databases and observatories that collect and process economic data systematically to map property values geographically
- The final output consists of regular market reports which differ from direct sources because they provide aggregate information by property segment, resulting from the processing of elementary economic data
- **Indirect sources are beneficial in the valuation process because they provide quotations**





Gathering and Processing Information

- Gathering data from transactions through **direct and indirect sources**
- Carry out additional researches among a sample of **real estate brokers** to gather the opinions of players who have better visibility of the market
- The raw data after being processed and normalised, through statistical methods, can provide a **general opinion**
- This sample is then used to generate **various kinds of information**, such as the average price, time of sales, rents, vacancy rates, leasing time and yields



Gathering and Processing Information

- **Ideally (but it depends on the availability of data), a valuer should choose at least three or four comparable transactions**
- In some periods (typically the stagnant ones) it can be impossible to collect the data. In these cases, valuers are forced to use asking prices and to apply a reduction factor to account for the average discount between asking price and actual price at which transactions are closed
- Some secondary sources process this type of data, but the valuer must be extremely careful, because the sales ads can refer to a different past market scenario or prices can be irrational and significantly far from the actual prices at which transactions are actually closed



Property Finance

Real estate books, resources and links

<http://www.propertyfinance.it/it/home-english/>

Giacomo Morri, Ph.D. 

giacomo.morri@sdabocconi.it

www.linkedin.com/in/giacomo-morri-0596b2



Associate Professor of Practice & Faculty Deputy of
Corporate Finance & Real Estate

SDA Bocconi School of Management

Professor of Real Estate Finance, Finance Department

Bocconi University

Milano – Italy



Paolo Benedetto 

paolo.benedetto@unibocconi.it

www.linkedin.com/in/paolobenedetto



SDA Fellow of Corporate Finance & Real Estate

SDA Bocconi School of Management

Academic Fellow of Real Estate Finance,
Finance Department

Bocconi University

Milano – Italy

www.sdabocconi.it/realestate