Global Real Estate: Similarities & Differences

ERES 2010: Plenary Session

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International Director & Head of European Strategy
24th June 2010
How do Real Estate Markets Work?

Source: Higgins adapting Archer & Ling 1997

The most local
Supply Side: what can be different?

- Market Transparency
- Liquidity
- Taxation
Transparency
Real Estate Transparency Index - Methodology

The survey includes 33 questions designed to measure real estate transparency as objectively as possible.

2010 Index covers 81 markets, which were rated against 5 transparency tiers.

The questions address five categories of transparency:

1. Investment Performance Indices (7)
2. Availability of Market Fundamentals Data (5)
3. Listed Vehicles Financials (3)
4. Regulatory and Legal Factors (11)
5. Professional Standards and Transaction Process (7)

Source: Jones Lang LaSalle, LaSalle Investment Management 2010
The 5 Sub-Indices of Real Estate Transparency

**Investment Performance Measurement**
- Availability and time series of public and private investment indices
- Property valuation frequency and credibility

**Market Fundamentals Information**
- Accurate time series of supply, demand, rental rate and yield data on all property types in major markets

**Standardized and Efficient Reporting of Listed Vehicles**
- Financial disclosure meeting international standards
- Corporate governance meeting international standards

**Fair and Efficient Legal Regulatory System**
- Enforceable contracts
- Secure title
- Tradition of property rights
- Taxes and fees administered efficiently & fairly
- Zoning and building codes administered efficiently and fairly

**Open and Fair Transaction Process**
- Availability of pre-sale information, and fairness of bidding/negotiating processes
- Professional standards of service providers
- Transparency of service charges and management fees
- Availability of information on debt and role of regulators

Source: Jones Lang LaSalle, LaSalle Investment Management 2010
2010 Real Estate Transparency Index – Key Enhancements

- Enhanced Questions on Debt Addressing:
  - Availability of information on commercial real estate debt
  - The role of bank regulators in monitoring and publishing information on real estate debt

- New Geographies
  - North Africa and the Levant

- New Transparency Website
  - www.joneslanglasalle.com/Transparency

Source: Jones Lang LaSalle, LaSalle Investment Management 2010
Real Estate Transparency Index 2010 – Key Findings

- Slowdown in progress in real estate transparency over past 2 years, bucking the long run trend
- Transparency of the transactions process has been most compromised by the real estate downturn
- Availability and quality of market fundamentals data continues to improve
- Transparency of real estate debt markets rising in significance
- One-third of markets register no change or deterioration
- Australia ranks as world’s most transparent market
- Notable improvers – Turkey, China, India
- Deterioration in some MENA markets

Source: Jones Lang LaSalle, LaSalle Investment Management 2010
Supply Side: what (else) can be different?

- Market Transparency
- Liquidity
- Taxation

- Lease terms
  - Impact on cash flows

- Attitudes to land / Operation of the land market
  - Public good or private property
  - Effect on supply elasticity, market volatility & land values
  - Required Returns

- Terms of trade between investors & developers
  - Risk sharing affects availability of development finance

*Your ideas*
The Importance of Institutional Frameworks

- John Kay ‘The Truth about Markets’
- Similar institutional frameworks in US & UK
  - market economies with some government intervention
  - legal system based on ‘common law’ with emphasis on ‘precedent’
  - Anglo-Saxon culture towards property rights
- Real Estate only recently taught as an international subject but is there recognition of the different Institutional Frameworks around the world?
- Recognised over 40 years ago by Donald Denman, first Professor of Land Economy
Typical Lease Durations – Major Markets

- **France**: 5 years (1st Tenant's Break), 10 years (Lease Term)
- **Germany**: 5 years (1st Tenant's Break), 10 years (Lease Term)
- **Japan**: 1 year (1st Tenant's Break), 5 years (Lease Term)
- **UK**: 5 years (1st Tenant's Break), 10 years (Lease Term)
- **USA**: 5 years (1st Tenant's Break), 10 years (Lease Term)

**Review mechanisms**

- **France**: Annual indexation to const costs
- **Germany**: Annual indexation to CPI > threshold
- **Japan**: None
- **UK**: 5 yearly upward only OMV rent review
- **USA**: None

*Source: LaSalle Investment Management*
Effect of different national lease terms: gross rent to NOI

Source: IPD Multinational index
Operation of the Land Market

- Systems for land zoning:
  - Prescriptive plan, or
  - Administrative/political decision making

- Attitudes to land development
  - Utility to sacred status (Needham)
  - Local v national decision making
  - Importance of local tax base

- Effects:
  - Differing levels of ‘natural vacancy’ (Sanderson et al.)
  - Variation in price of urban land
  - Cost of regulation (Cheshire & Hilber)
  - Differences in Required Returns
Office vacancy rates around the world

Office vacancy rate % 2010 Q1

- **Americas 17.2%**
  - Mexico City
  - Toronto
  - Sao Paulo
  - New York
  - Washington DC
  - Los Angeles
  - San Francisco
  - Chicago

- **Europe 10.2%**
  - Paris
  - London
  - Madrid
  - Brussels
  - Frankfurt
  - Amsterdam
  - Moscow
  - Dubai

- **Asia-Pacific 12.4%**
  - Hong Kong
  - Mumbai
  - Singapore
  - Tokyo
  - Sydney
  - Shanghai
  - Beijing

Source: Jones Lang LaSalle (regional vacancy rates based on 52 markets in Americas and 24 markets each in Europe and Asia-Pacific)
Prime warehousing rents in Q4 2009 (year-on-year change)

- Prime rent (€/m²/pa)
- Rental decline / no change year-on-year*  

Source: Jones Lang LaSalle  
* Local currency unit
Office values in UK & Netherlands + EREGI 2009 Rankings

As at 31 December 2009

Capital values €/sq m

<table>
<thead>
<tr>
<th>City</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Birmingham</td>
<td>65</td>
</tr>
<tr>
<td>Amsterdam</td>
<td>18</td>
</tr>
<tr>
<td>Manchester</td>
<td>35</td>
</tr>
<tr>
<td>Edinburgh</td>
<td>48</td>
</tr>
<tr>
<td>Leeds</td>
<td>60</td>
</tr>
<tr>
<td>Utrecht</td>
<td>11</td>
</tr>
<tr>
<td>The Hague</td>
<td>26</td>
</tr>
<tr>
<td>Rotterdam</td>
<td></td>
</tr>
</tbody>
</table>

Sources: Jones Lang LaSalle & LaSalle Investment Management
### Risk premium from real estate differs by country

<table>
<thead>
<tr>
<th>Country</th>
<th>RE risk premium %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Australia</td>
<td>2.5 - 3.0%</td>
</tr>
<tr>
<td>Canada</td>
<td>3.0 - 3.5%</td>
</tr>
<tr>
<td>France</td>
<td>2.5 - 3.0%</td>
</tr>
<tr>
<td>Germany</td>
<td>1.0 - 2.0%</td>
</tr>
<tr>
<td>Japan</td>
<td>2.0 - 2.5%</td>
</tr>
<tr>
<td>Netherlands</td>
<td>3.0 - 3.5%</td>
</tr>
<tr>
<td>Sweden</td>
<td>3 - 4%</td>
</tr>
<tr>
<td>UK</td>
<td>2.5 - 3.0%</td>
</tr>
<tr>
<td>USA</td>
<td>3 - 4%</td>
</tr>
</tbody>
</table>

Source: LaSalle Investment Management
Three different Urban Forms: Where are land values lowest?

Source: SOLUTIONS research project
Terms of Trade between Developer & Investor

- Or how risk is shared in a development project
- Issue: symmetry of profit share between a successful & unsuccessful project
- Three examples – Standard JV, UK & France

<table>
<thead>
<tr>
<th>Key Terms</th>
<th>Standard JV</th>
<th>UK</th>
<th>France</th>
</tr>
</thead>
<tbody>
<tr>
<td>Name</td>
<td>Equity/Profit share</td>
<td>‘Profit Erosion’</td>
<td>‘VEFA’ *</td>
</tr>
<tr>
<td>Investor Price</td>
<td>Variable</td>
<td>Notionally fixed</td>
<td>Fixed</td>
</tr>
<tr>
<td>Developer Overage</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Developer capital</td>
<td>Yes, e.g. 10%</td>
<td>None</td>
<td>Land &amp; Construction</td>
</tr>
<tr>
<td>Developer max loss</td>
<td>Equity stake</td>
<td>Zero</td>
<td>Rent guarantee</td>
</tr>
</tbody>
</table>

* Vente en l’état futur d’achèvement (VEFA).
Three Equity Schemes for Financing Development: ....Risks & Returns

Developer Profile

- Downside
- Base
- Upside

Investor Profile

- Downside
- Base
- Upside

Index of Developer's Profit

Investor Capital Profit

Standard UK France

Downside Base Upside Scenarios

Scenarios

LaSalle Investment Management

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Institutional Frameworks Matter:

- Effect land & property prices
- Effect speed of supply response
- Effect market volatility
- Effect detail of returns (cash flow from lease & share of development profit)
- (as well as differing levels of transparency)

Scope for a significant new research agenda?
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References:


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