Foreword

Property valuation is a field of professional practice that has been consistently challenged by academics over the last fifty years. The UK, in particular, has seen a continuing battle between proponents of simple income capitalization methods, which are perfectly appropriate in simple cases, and critics of these methods, who have observed the mathematical and logical errors which creep in when the case becomes less simple. The complications which have kept us busy include leasehold interests, over-rented property and reversionary (under-rented) assets.

In 2019, there are a lot more complications to be dealt with. The simplest of simple cases that gives comfort to the traditional valuer is a property let to a single tenant at a market triple net rent on a long lease. The cash flow begins immediately: there are no deductions to be made, there are no upward or downward shocks to be anticipated for a long time. The relationship between the cap rate, the required return and a simple rent growth rate is complicated only by the periodicity of rent reviews – and not complicated at all if they are annual. In such cases the "implicit" cap rate approach – while relatively useless in providing information – does a perfectly good job as a measure of value, and there is no need for a laborious explicit DCF approach.

But such cases have become rarer. Leases have become shorter. Buildings have become bigger and are more likely to be multi-let. There are more likely to be irrecoverable expenses. There are likely to be fitting out contributions or free-rent periods to support supposed "market" rent levels. Shorter leases increase the chances of a rent re-set within reasonable hold or analysis period. Retail rents may be turnover-based. The co-working generation has pushed the underlying revenue model for business space closer to the hotel revenue model, which is much less predictable. "Space as a service" implies a more complex EBITDA model for real estate, which starts to look more like a business than a bond.

The result is that explicit DCF-based valuations are now essential in the majority of cases. Computer-based valuation packages remove much of the labour needed to build such models, and we can observe a significant switch in the issues which underlie any debate or instruction about valuation.

First, black boxes are inevitable but dangerous. As property occupation becomes more short-term and more service based, the variations to a standard model become greater in number and risk, and it is essential that students and practitioners of valuation understand the theory and practice of building a solid, explicit cash flow model without reverting to an off-the-shelf package. Second, data is essential. If leases are shorter and space is a service, what is the likelihood of re-letting the space? And at what cost? After what period of vacancy?

This book is a very welcome and timely contribution to this switch. It is focused on a thorough understanding of the inputs into both implicit and explicit valuation methods and uses a set of highly practical examples for readers to follow. An examination of hedonic pricing prepares us for a world of automated valuation models in the residential for sale market, and it is great to see examples focused not on New York or London but in continental Europe.

Oxford, May 2019
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Foreword

For any real estate market player, landlord, investor, or lender, knowing the probable value of a real estate asset is fundamental. Why is it so crucial? It is of such importance as it enables quick move for arbitrages, reduces decision-making bias, avoids mistakes, and better manages and mitigates investment risks. In the end, understanding the true value of the assets we have in our hands makes all the difference between a profitable and losing investment – this is also the reason why I deeply believe valuation is an instrumental part of any real estate asset risk assessment.

Thanks to a didactic approach, the authors, in the first part of the book, provide all the keys related to the real estate valuation theory. Whilst they primarily focus on commercial real estate, they also include some colour on residential properties. This book being well balanced about delivering concepts and examples, its second part encompass rich and detailed case studies (office building, high street retail, hotel and residential development) that are presented as a concrete application of the theory.

After a reminder of the main standards of our industry, the economic characteristics of the real estate assets, and the various risk factors inherent to real estate investments, the authors focus on property valuation. They introduce a simple and well-structured framework for the analysis and valuation of real estate assets – both in a rigorous academic approach and at the same time in business logic, resulting from long experience with key stakeholders of the real estate business sector.

This book also offers a new classification of the valuation methods. The authors provide deep and meaningful insights on each of them, with reminders when necessary of the specifics of the real estate market (and the uniqueness of each asset) vs. that of the securities market. They ensure always to clarify the central notions, illustrating them with many concrete examples of application that help to better apprehend the valuation concepts, the methods, their characteristics and uses, their advantages and limitations.

Rather than providing the reader with lots of formulas, the book concentrates on giving the reader the right inputs to choose the best valuation approach to be applied in each specific case. While the authors make it clear "why the choice of a valuation method is fundamental to making a correct estimate of the market value", they also explain the reasons why applying different models at the same time, for other purposes than those of control, may not be relevant and "would only contribute to deviating from the correct value" in the case of significant differences emerging in the estimated value. It is also worth noting that the authors place more emphasis on the economic and financial valuation methods than on the other ones made less efficient in view of the evolution of the markets – these latter being used rather as tools for verifying the results of the former. Furthermore, the authors pay particular attention to key but somewhat grey concepts, such as the discount and cap rates. They remind us that, amongst the many variables to consider, the paramount importance of understanding and setting these metrics properly when using them as small changes up or down on these assumptions can lead to a great impact on the value.

In the end, this book will interest, of course, every real estate professional who wishes to deepen their knowledge on real estate valuations. But beyond that, this book brings for sure a welcome and worthwhile contribution to our industry and, more broadly, to the economy, as it shows the way to raise the bar of valuation practices thanks to a sophisticated and rigorous but always pragmatic approach. This can only reinforce trust in the real estate business sector; a fundamental aspect in the ever turbulent markets.

Paris, May 2019
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