Guide to valuations

How properties are valued

Understanding valuations

Under the requirements of each Fund's loan facility, all properties within Centuria's portfolio are required to be valued independently by an external valuer on a regular basis.

In order to calculate the value of an investment property, two primary approaches are widely adopted by valuers: the capitalisation approach and the discounted cash flow analysis.

Capitalisation approach

This method involves capitalising the fully leased net income from the property at an appropriate investment yield or capitalisation rate. The capitalisation rate is derived from recent sales of similar properties. Below is an example of how the capitalisation rate is derived:

ANNUAL NET MARKET INCOME	$1,500,000
SALE PRICE	$20,000,000
CAPITALISATION RATE	**$1,500,000/$20,000,000**

Capitalising is a method used to drive the valuation of a porperty based on the income the property produces. For example, a property which produces income of $10, if capitalised at 10%, would be valued at $100.

The capitalisation rate adopted reflects the inherent risk associated with the property. For example, if the lease expiry profile of a particular property is short, the capitalisation rate is likely to be higher to reflect additional risk to income. The higher capitalisation rate then reduces the valuation of the property. Below is a simple example of how to calculate value using the capitalisation approach:

Example 1

NET LETTABLE AREA	10,000 square metres
NET MARKET RENT	$350 per square metre
ANNUAL NET MARKET RENT	10,000 x $350 = $3,500,000
MARKET CAPITALISATION RATE	9.00%
CAPITALISED VALUE	$3,500,000/9.00% = $38,888,889

Example 2

NET LETTABLE AREA	10,000 square metres
NET MARKET RENT	$350 per square metre
ANNUAL NET MARKET RENT	10,000 x $350 = $3,500,000
MARKET CAPITALISATION RATE	10.00%
CAPITALISED VALUE	$3,500,000/10.00% = $35,000,000

Various capital adjustments are then made to the core value, in order to account for future costs associated with producing income. These costs may include leasing costs, incentives, and short to medium term capital expenditure.

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Discounted cash flow analysis

The Discounted Cash Flow approach allows an investor or owner to make an assessment of a property's current value based on a set of assumptions over an assumed investment horizon, which is generally 10 years.

A wide range of assumptions are made including a target internal rate of return or discount rate, rental growth, letting up allowances, renewal probability, capital expenditure and transaction costs.

In adopting an appropriate discount rate a comparison is made with returns from alternative investments. The most common comparison is the 10 year bond rate, considered to be the 'risk free' rate. A premium is then applied to reflect the inherent risk of the property investment when compared to the 'risk free' rate.

Each year's net operating income is discounted to arrive at the present value of expected future cash flows. The property's anticipated sale value at the end of the period (which is derived by capitalising the final year's net income with the adopted terminal yield) is added to the discounted income stream to arrive at the total present market value of the property.

Direct comparison approach

This approach is usually only used as a check method. The valuation of property is compared with recent sales evidence of comparable properties in surrounding locations. The sales evidence compares the nature and condition of each property, location and tenancy profile, relevant to the subject property being valued.

The adopted value is generally a reconciliation of the two primary approaches, with the Direct Comparison approach providing a 'sanity check'.

Directors' valuation

If a property is not independently valued, we will value the property internally via a Directors' Valuation. The Directors' Valuation uses the same valuation methodology and metrics as independent valuations.

Where a Directors' Valuation produces a material variance (usually +/- 5%) to the previous adopted valuation, an independent valuation may be required.

Know your risks

As with any investment, there are risks to investing - and these should be understood. Some factors to consider when investing in listed and unlisted property funds include, but are not limited to, stock market volatility, the liquidity of the fund, the gearing of the properties in the fund and understanding the individual properties held by the fund and their characteristics (e.g. tenant demand, property valuation metrics, cash flow sustainability etc).

It's important that you have a manager who has experience managing and mitigating risks where possible. A critical part of the success of property investment is the quality of the ongoing management of tenants and the physical aspects of the property, both of which we consider to be strengths within our business. In addition, capital gain potential is maximised by ensuring the most efficient use of space, conducting services upgrades, building refurbishment and assessing potential re-development. The majority of our portfolio is managed by our in-house property division. Our team is comprised of experienced property professionals with backgrounds in leasing, agency and valuation. Any property managed externally is managed by hand-picked experts in their locations and asset types.

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FURTHER INFORMATION

For further information on Centuria's property offerings and to aid your clients in their property investing decisions visit **centuria.com.au** or speak to a member of our property team on **02 8923 8923.**

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