PFA
Property Funds Association

PFA/ShineWing Webinar: Poll Results and Extra Questions answered

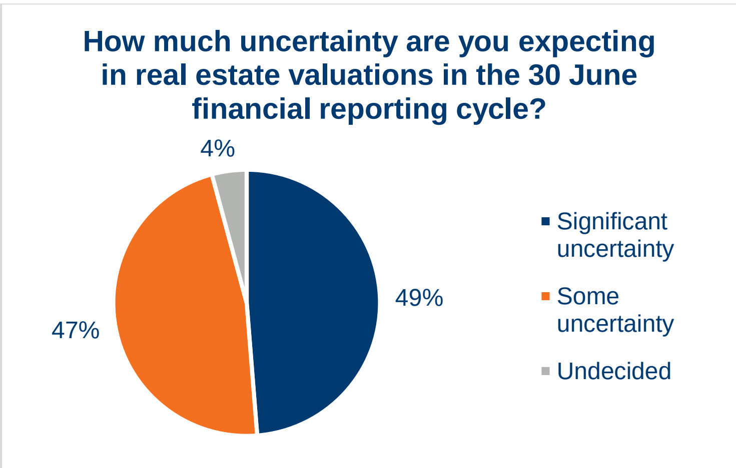
Our 30 April webinar hosted by ShineWing Australia, Dealing with Valuation Uncertainty, covered a significant amount of ground on this critical and evolving issue for commercial property.

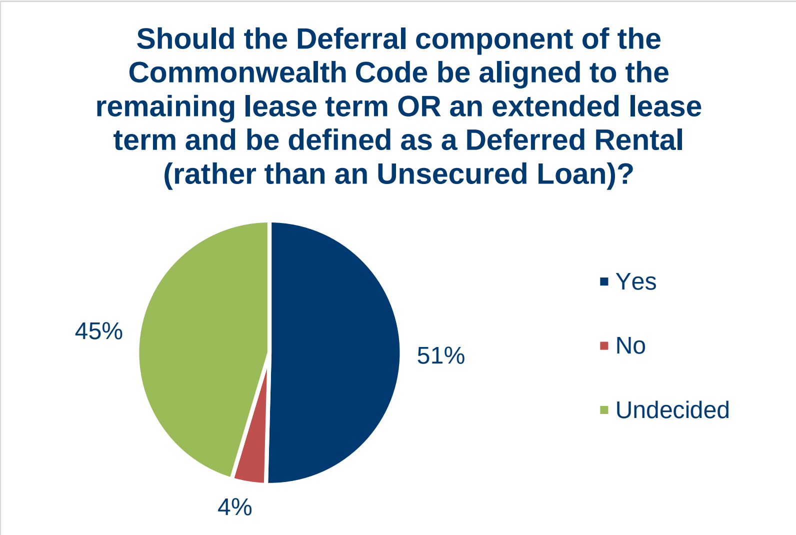
Greg Preston, Managing Director of Preston Rowe Paterson, covered the challenges of dealing with valuations in an unprecedented environment without comparable sales and leasing data. He covered relevant sections of the accounting and valuation standards and how the Commonwealth Commercial Leasing Code (Code) may interact with commercial leasing and state-based legislation.

Milton Cations, Managing Director of Property Dynamics, raised issues around government regulations, assessing tenant profiles, and how COVID-19 impacts market sentiment. Sentiment could place future tenant demand under threat, leading to softer demand and yields in many sectors, and greater disparity between prime and secondary yields.

Mark Pratt, Executive General Manager of Australian Unity Real Estate Investment, brought a fund manager perspective on issues such as frequency of valuations and negotiations with tenants. He also raised important issues around what valuations mean for investor equity – for example, ensuring NTA is accurate, whether you are running an open or closed-end fund.

Poll results (From 119 total responses)





Q&A

Here’s a selection of questions which were addressed post-webinar:

Q: What is a reasonable subsequent recovery period? Who determines this?

A: From my understanding the Commonwealth will determine this, however this is uncertain. It may be covered in the States and Territory’s ratification of the Commonwealth Code in State based legislation or Regulations to any existing legislation. It could also be the case that it is based on a tenants’ ability to recover in the post COVID-19 economy (hence the need to classify tenants re the Codes rental relief objectives etc.). The issue of estimating a “reasonable recovery period” is therefore significantly problematic in forecasting cash flows at this time.

Q: How regularly do the independent valuations need to be done, what is the requirement for the minimum time wise between independent revaluations, the requirements per the Corporations Act and per the Accounting Standards? Is it at least once every three years for example?

A: The fund manager's valuation policy and its compliance plan are likely to set out the frequency of independent valuations. Best practice is to seek independent valuations annually. In the current economic climate, seeking more frequent valuations best serves trustees and investors.

Q: Valuation Methodology Question: Would this possibly make sense? You use the pre-COVID-19 valuation (cash flows, cap rate and discount rate) as a starting point, then estimate lease cash flow adjustments, then capitalize those estimated lease cash flow adjustments using the same pre-COVID-19 cap rate and discount rate, then subtract that capitalized amount from the pre-COVID-19 valuation? Could this avoid an unresolvable debate on appropriate new cap and discount rates until market experiences new purchases/sales?

A: Your analogy is the proposition that we have developed at PRP. That is, a pre COVID-19 economy valuation should be completed in the first instance, and then a COVID-19 economy valuation is prepared, with a comparison between them serving to properly explain the necessary COVID-19 economy cash flow adjustments. This will meet both the requirements of valuation and accounting standards.

It is important in the time before a body of comparable COVID-19 economy sales and leasing transaction evidence becomes available. It is also important to exercise care in adjusting cash flows and not over adjusting capitalisation or discount rates at the same time that may represent a double dip.

The point I made about discount rate and in turn capitalisation rate considerations relative to a typical market participant's WACC is, in my opinion, highly relevant at this time when we are likely to be starved, for a period of time, of a body of COVID-19 economy sales evidence. This logic will need to be revisited however, once a body of COVID-19 economy sales are available.

Q: With regards to refinancing of bank debt, how are you seeing valuations impacting on loan amounts and what strategies are you taking to dealing with any shortfall needed to refinance.

A: At this stage I think banks, like everybody else, are waiting to see what the impacts on valuations might be. I am not aware of banks requesting / demanding revaluations of assets and, as such, if your facility is well within its various covenants; including ICR and LVR you should be fine. In saying that I would suggest that active scenario modelling of potential income and valuation impacts is important. Our approach is always to be proactive in communicating and providing information to our banking partners and I would encourage you to do the same.

For more information:

A copy of Greg Preston's webinar presentation is available here

PFA/PRP issues paper Dealing with Valuation Uncertainty available here

Visit PFA's COVID-19 page for further insights

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