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SOFTWARE

An Altus Group company

**MEETING THE CHALLENGES
OF GLOBAL COMMERCIAL
PROPERTY VALUATIONS**

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MEETING THE CHALLENGES OF GLOBAL COMMERCIAL PROPERTY VALUATIONS

Introduction



WITH THE EVOLUTION OF GLOBAL COMMERCE and communication over the past few decades, demand for office, industrial and multifamily developments has grown exponentially around the world.

During that time, there has been significant growth in new markets, which has increased demand for investment opportunities in places such as Brazil, Mexico and East Africa along with China and Hong Kong.

While the emergence of these new high-growth markets has opened up significant opportunities, they also bring considerable challenges in terms of currency, measurements and other aspects of property valuations.

Valuation Methods

Meeting the varied accounting and reporting requirements of different countries can be a challenge, especially when managing a global portfolio.

Perhaps one of the most obvious challenges faced when comparing properties across the globe is the wide variety of valuation methodologies employed in these different regions.

In the United States and parts of Asia, direct capitalization and discounted cash flow analyses are generally the most common methods.

However, it can be difficult to judge those results against the traditional valuation techniques used in the United Kingdom or the market capitalization techniques used in Australia, complicating side-by-side comparisons.

Different countries also have varied accounting and reporting requirements. Meeting these requirements can be a challenge and tedious, especially when managing a global portfolio.

Language Variances in International Leases

Interoperability is necessary so managers and potential transaction partners are able to evaluate different properties using the same financial model, while adjusting to the terms and conditions of those remote markets.

Managing an international portfolio requires not only the use of different currencies and measurements, but also different languages and local terms used to describe aspects of various properties.

However, the type of translation necessary in the industry goes well beyond simple word for word translation, since each country has specific lease terms and requirements which must be accurately conveyed to investors, service providers and others.

That kind of interoperability is necessary so managers and potential transaction partners are able to evaluate different properties using the same financial model, while adjusting to the terms and conditions of those remote markets in addition to currency and measurement differences.

Lease Structuring Variances

In addition to the language barrier, there are different leasing conventions which vary from country to country that can complicate managers' ability to evaluate them equally. The regulations for reporting cash flow line items, such as leasing fees, interest income on security deposits or improvements by tenants, vary widely by location and must be accounted for in financial reporting.

For example, in many parts of Japan, it remains common practice for tenants to pay a non-refundable key money deposit in order to secure a lease. This payment is generally equal to one to two months' rent, and may be paid up-front or spread over the lease term.

In the United Kingdom and Australia, mid-lease rent reviews present property owners an opportunity to adjust their tenants' lease rate based on changing market conditions, which can result in significantly higher long-term rent return projections if the market is moving upward. These reviews can also be structured as upward-only to prevent a downward rent adjustment.



Lease Structuring Variances

- Key money in Japan
- Mid-lease rent reviews
- Different rent indexation methods
- Treatment of fixed service charges

For properties in Germany and Australia, complicated rent indexation measures, such as the older step-up indexation method, can impact market data and make comparisons more complicated. Also, value-added taxes, in place in various countries, create additional line items during property purchases and resales, and vary from country to country.

Other examples of variances for which portfolio managers must account for are the varying conventions in which fixed service charges are treated in relation to operating expenses. While they are generally passed on to tenants on a net pro-rata basis or above an expense stop in the U.S., their handling differs elsewhere.

Shifting Market Conditions

Next to the property itself and its location, another of the most important factors affecting property valuations are current market conditions. Current demand, vacancy rates and new developments can have a significant impact on valuations.

In established markets, some of those factors may be largely set, although significant events can upset a market's balance. However, in emerging economies, the dynamics of local supply and demand are consistently changing, shifting the relative value of properties there and around the globe. Investors and property managers need to be able to incorporate these conditions into their assessments when considering potential transactions.

Challenges of Global Commercial Real Estate Met by ARGUS Valuation - DCF

While the development of global commercial portfolios does come with significant challenges, it also allows those who can manage these difficulties to take advantage of the opportunities created by the emergence of new markets. ARGUS Valuation - DCF (ARGUS DCF) provides solutions for the challenges of a cross-border commercial property market, allowing investors, real estate agents and asset managers to evaluate properties around the world in like terms.

ARGUS DCF allows for the easy communication of transactional data between buyers and sellers, both in terms of financial and currency differences, along with the variations in lease structuring or market conventions that affect property valuations. It supports both direct cash flow and direct capitalization methods of property valuations to allow for more effective comparisons.

The different languages supported by ARGUS DCF (English, French, German, Spanish, Japanese and Chinese) also allow for the comprehension of market data by partners in different regions. In addition to having the capability to create varied default language settings, the different versions allow for data to be easily read by partners using other languages, satisfying the needs of all parties

involved. This gives investors and managers the capability to create custom Excel spreadsheets to calculate investment values and returns and share high-level asset data.

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both global and local market conditions into account, investors are able to see the long-term value of any potential assets.

To satisfy varied accounting standards, ARGUS Software has board representation within Open Standards Consortium for Real Estate (OSCRE) International, an organization focused on creating greater efficiencies for the analysis and exchange of real estate asset data. This participation helps to ensure solutions are developed to meet international standards. In terms of the new IFRS accounting standard, ARGUS DCF can be used to support IFRS valuation and reporting requirements.

ARGUS DCF automatically allows investors to compare their assets' performance against the market at large through ARGUS Software's unique partnerships with Real Capital Analytics and other leading data providers to account for local market conditions. ARGUS DCF measures each potential transaction or investment against solid market data, such as capitalization rates and market pricing from local providers. By taking

Languages supported by ARGUS DCF

- English
- Spanish
- French
- Japanese
- German
- Chinese



The Road Ahead

With the various tools provided by ARGUS DCF, investors, lenders, real estate agents and others are able to quickly understand the realities of the current market and any risks involved. With that data, it becomes easier to quickly analyze various transactions, and better develop marketing plans, leasing strategies and business models to take advantage of current conditions.

Moving forward, the continuing growth of cross-border commercial investments will only increase the need for flexible and complete solutions to the challenges of managing, purchasing or financing properties around the globe.

Even in the wake of the global financial crisis, cross-border commercial real estate investments continue to grow. According to Jones Lang LaSalle, global investments in 2011 will reach US\$440 billion, with the potential for further growth as the industry continues to reach and develop new markets worldwide. This is in concert with the goals of ARGUS Software: to create efficiencies that allow our users to realize and enjoy the successes they seek. ■

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