Chapter 3 - Tailoring your valuation approach: Real Estate

Speakers

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Transcript

Andra:
In chapter three, we're going to look at tailoring your valuation approach for real estate businesses with Andrew McDonald, Head of Real Estate Finance at HSBC UK. So, what makes valuing a real estate business different from another industry?

Andrew:
So the difference between valuing real estate businesses and trading businesses can sometimes be the difference between an art and a science. For commercial investment portfolios, the valuation methodology is far more scientific. It'll be a capitalisation of the earnings potential of the portfolio or property against the yield. For trading businesses, it much more depends on whether the value of the underlying real estate is worth more as an investment or whether it's mission critical to the earnings potential of the business and therefore ascribes more value to the trading potential of that business.

Russell:
Is market liquidity a particular challenge for real estate businesses?

Andrew:
I think that's true. And in a market which is less liquid than others, timing is everything. It's particularly pertinent where you are holding investment assets that you can control the timing of disposal and the introduction of your asset to the market. I'd say one of the most important factors, however, is really establishing the buyer universe. Who's the buyer for the property? What is their interest in acquiring the underlying property? And what is it that they're looking to achieve in being the owner?

Andra:
We've explored the challenges of valuing real estate businesses in general, but how different are the valuation methodologies for commercial real estate and residential real estate businesses?

Andrew:
The valuation methodologies between commercial and residential properties can be vastly different, but I wouldn't look at it as to whether or not they're commercial or residential, rather, whether they're investment properties or owner occupied properties. If you look at these two markets, the commercial real estate market across the UK has declined by 20% and above in prime assets over the course of the last 12 months, while the residential market hasn't really moved at all*. The primary difference for that is the supply constraint in the residential market, but also one being an owner occupied market rather than an investment class.

*As of May 2024

Russell:
Another key thing with our business owners is that many businesses have freehold properties on their balance sheets, even though they may not be trading real estate businesses. So we asked Andrew, how does this impact the valuation?

Andrew:
So I think in maximising value, it's very important that business owners unpick the constituent parts of their balance sheet. What I mean by that is if you're selling a business on a 10 times multiple, but you have investment properties valued on a 5% yield, i.e. a 20 times multiple, it's important to ensure that you're able to maximise value and target specific buyer sets for each of the parts of your ownership.

Russell:
If you're looking at how to value your real estate business, Andrew has shared some really useful insights into the different areas to be mindful of in doing so. Next, we look at tailoring your valuation approach for technology businesses.

You can watch the remaining chapters in this episode on our **'Beyond Business Ownership'** series page.