

The valuation process at Akelius Fastigheter in Sweden

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Introduction

After the end of every financial quarter, the corporate development team at Akelius Fastigheter is responsible for assigning a market value to Akelius Fastigheter's current Swedish properties, approximately 370 in total. The process is thorough and takes approximately six to seven weeks in total, although the actual valuation takes approximately two weeks. A lot of parties are involved in the valuation procedure and besides the actual valuation process itself, careful coordination of the process is needed. The valuation practice involves several key people in Akelius Fastigheter's organization as well as external consultants. The process is important for the management because it results in important information on how the company is managing its core assets, its properties.

The management of a listed company gets information on how the business is managed by studying the stock quote, which at least in theory should reflect the theoretical real value of a company; in reality, it reflects a lot more. Akelius Fastigheter is not a listed company, and valuation information is provided first and foremost through the quarterly and annual reports, further reported to the board of directors.

The start up meeting

The actual valuation process starts with the corporate development team setting up a meeting with CB Richard Ellis. CB Richard Ellis give their second opinion on 1/12 of Akelius Fastigheter's properties every quarter, thus having gone through the total property portfolio every third year. Approximately 30 properties are audited every quarter. Before the meeting, the Akelius team creates a short description of each property. At the meeting, discussions are held about the current properties in focus and the areas of the municipality in which the properties are located. The demanded return, as well as the corresponding risk, is also discussed. The discussions are held to clarify different valuation stand points prior to CB Richard Ellis later giving their second opinion on Akelius valuations of the properties. After the second opinion is made, a valuation certificate is issued, stating that the market value of the properties is in level with the correct market value.

The valuation

Recently, the valuation model has been updated giving the corporate development team a faster and more efficient tool. The process is less time consuming and has an even higher grade of accuracy. The Akelius team has approximately two weeks, to finish the actual valuations. The process involves many steps, first and foremost controlling the necessary risk and return variables, thus giving an accurate picture of the most probable price that a sale of the property would result in. Therefore, an internal macro discussion regarding the general health of the economy and the risk and expected return of real estate investments, takes place. The economic status of each municipality is then discussed, as well as the expected return on each property. If a property has a lot of vacant apartments and the rent level is low, the investor needs to receive compensation for this added business risk, and the investor demands a somewhat higher return, to compensate. The value of the property is thus lower than another property with less vacancy and higher rent, all other things being equal. The demanded return is one of the most important parameters for calculating the value of the property. This parameter needs to mirror the present market level to be able to reflect the most probable price the property would sell for, if sold instantaneously. To arrive at this most probable price is the whole purpose with the valuation process.

The rent revenues are based on the current rent list on the day of valuation, for each property. The project leader almost always has a discussion with the local administration regarding the characteristics of a property. The discussion could involve sudden vacancies or a higher than average heating cost level, for example. All operational expenses in the asset manager's budget for the property should reflect a normal year's expenses. If not, this would for example overestimate the effect of the cold winter of the previous year, if basing the cost figures on the actual heating costs that year, thus assigning the property a too low value. The maintenance expense is standardized as default, but sometimes needs to be adjusted to reflect the correct age of the property. A property built 2007 probably does not have the same maintenance cost as a property built 1957. Property tax and site leasehold fee costs are withdrawn from the asset manager's budget for the period. Finally, administration costs are added to the calculation, a default cost per square meter is used.

The expected future normal vacancy level of the property is also discussed with the local administration. This level should reflect the average vacancy rate seen over time. The valuation model takes the rent revenue for the next 12 months into account. A rent increase within the next 12 months should be added to the

value calculation. This information about the property should be given by the local administration or the regional manager. In many cases, the information is not known at the time of valuation. An estimate then needs to be done. Other valuation adjustments could involve sudden operational expense changes, neglected maintenance, investment opportunities (an attic that is suitable for rebuilding as apartments) etcetera. One last adjustment that is very important for Akelius Fastigheter is to assess if the property has potential to be sold to a tenant association. Is the property situated in the right area? Does the property have financially stable tenants? These are the types of questions that need to be answered. This is an adjustment that could be quite tricky to assess; therefore, this value increasing parameter is used only when the questions are easy to answer. The expected surplus value or part of it, if selling the property to a tenant association in the future, should then be incorporated in the present value of the property at the time of valuation. The gross profit for the property is finally calculated and a present value of the profit is then assessed by considering the demanded return on the property in question.

CB Richards Ellis

A copy of the approximately 30 valuations assigned for audit, is sent to CB Richard Ellis. Their job is to control that the corporate development team's general assumptions and assumptions about costs are in accordance with their best knowledge. Their audit takes approximately one week. Akelius Fastigheter almost always receives suggestions for improving the valuations; both value decreasing comments, as well as value increasing comments. Discussions could for example be held regarding the current yield level of Akelius Fastigheter's properties in Svartöstan, Umeå. Akelius Fastigheter has done the valuation by assuming a yield assumption of 5.25 percent. CB Richard Ellis could argue in favor of a higher yield level of 5.50 percent, due to an increased risk for higher local unemployment due to SSAB having some financial difficulties, for example. After taking CB Richard Ellis's opinions into consideration, a final version of the valuations is sent to the valuation consultants for their final approval. The corporate development team always needs to take CB Richard Ellis's feedback into consideration to receive a valuation certificate on the properties audited. It is the actual purpose with the exercise. In the document, CB Richard Ellis states that the market value of the properties is in level with the correct market value. A vague statement one might say.

The valuation reports

The last thing that the corporate development team does is to produce one report containing a summary of the properties in the north of Sweden and one for the south, as well as one aggregate. In the report, and in a meeting with the corporate development manager, discussions about the current quarter's value development and M&A activity are held, for example. Interesting value changes are discussed thoroughly and questioned. After the meeting, agreed decisions about the report are carried out. The next step is to give the regional managers a copy of the current report as well as the aggregate report. The regional manager often has the complete picture and general feedback and comments are very valuable to have. After the feedback, if any, the final versions of the reports are sent to the CEO as well as the board of directors. Internally, the Akelius team locks the current quarter's valuations by the time a new quarterly period is almost halfway on the way. By this time the valuations of the properties in Germany should have arrived to the Swedish team. The only work remaining is to update ADW (Akelius Data Warehouse) with the new German property market values. The German team sends the market values as the last step of their internal valuation process. After this step, it takes six to seven weeks before the same process starts again. Akelius auditors receive the valuation certificate and usually attach it to the annual report of Akelius Fastigheter, if a fourth quarter audit has been made. One other usage example of the valuation certificate is when the mortgage level on properties needs to be increased. In theory, it strengthens Akelius Fastigheter in the eyes of the bank, to have a second opinion on the value of the properties, confirmed by one well known valuation consultants.

Head of accounting

Finally, the head of accounting analyses the current write off need, if any, taking into consideration the new market values, and also examines if there is a need for reversals.