

The three yields, on one page

Chapters 1, 6 and 24. The same building, the same price, the same day. Only the third one is a return. Put all three on the first page of the paper.

Building		Prepared by	
Date		Price and basis	

Line	EUR	How it is built
Passing rent		
Less non-recoverable costs (per cent of rent collected)		
Less void costs on the empty area		
Net operating income		
Price including acquisition costs		
Net initial yield		

Line	EUR	How it is built
Market rent on the whole area		
Less non-recoverable costs: stabilised net income		
Reversionary yield (on the price including costs)		
Cost of the re-letting cycle, per m2 a year x area		
Capital-adjusted net income		
Capital-adjusted yield (on the price including costs)		
Ratio: capital-adjusted over quoted		

One cycle, one m2, expiry to expiry	EUR/m2	Note
Rent collected over the years the space pays		
Less non-recoverable costs		
Less void holding costs		
Less category A fit-out		
Less letting agent and legal fees		
Net over the cycle, and per year (divide by the cycle length)		
Income cliff: fit-out at which the cycle nets nothing		

Calderon House: 6.00, 7.39 and 3.20 per cent, a ratio of 0.53. The cycle costs 160.04 per m2 a year against 282 of net rent. The income cliff is 1 121 per m2, 2.7 times today's 420. The 3.20 per cent is on the price including costs (45.8 million), not on the 43.0 million headline.

The rent roll, the lease profile and the condition

Chapter 2. Years are to the earlier of expiry and the tenant's break. Four observations, each of which will cost or earn money later.

Building		Prepared by	
Date		Price and basis	

Unit / tenant	Area m2	Rent EUR/m2	Rent a year	Market rent	Over / under	Years to break or expiry	Covenant, evidenced

Observation	Finding	Cost or value
Over-rented? Passing rent against the same space at market; when does the premium end?		
Shape of the expiry profile: share of rent expiring within 2.5 years (the mean hides the wall)		
The vacancy as an invoice: fit-out before the first euro, the void, the letting fee		
The dated obligation: energy standard, date, engineer's costed plan		
Measurement basis: net lettable throughout? (Appendix D)		

Two rents	EUR/m2	Evidence (three lettings, achieved, not quoted)
Space brought back to a modern institutional standard		
The same space let as it stands, second-hand		
The gap: the price of the specification		

Calderon House: 12 000 m2, four leases and 2 160 m2 empty, 3.3 per cent over-rented, 54 per cent of the rent expiring within two and a half years, 1.9 million of energy works within four years.

Headline to net effective, and total occupancy cost

Chapters 3 and 4. Ask two questions of every comparable: how many months free, and when is the break. Then compare buildings as the occupier does: on the total.

Building		Prepared by	
Date		Price and basis	

Comparable letting	Headline	Months free	Term certain (to break)	Fit-out by landlord	Fees	Net effective
1.						
2.						
3.						
This building, proposed						

The inverse, before the negotiation	Value
Net effective rent the model needs	
Rent-free, term certain, fit-out and fees the market gives	
Headline required: $(NER + \text{fit-out}/\text{term}) / ((\text{months paid} / \text{months committed}) - \text{fees}/\text{term})$	
Concession package in months of headline a year: fit-out, rent-free, fees	

Total occupancy cost, EUR/m2 a year	This building	Competitor 1	Competitor 2	Competitor 3
Rent				
Service charge (certified, last three years)				
Property taxes and local charges				
Total occupancy cost				
Difference against the cheapest: deduct from market rent				

Nine months free on a five-year term certain, 420 of fit-out and 12 per cent of fees turn 300 into 163.8 (45 per cent). Over ten years it would be 231.9: the break is worth 817 200 a year on this building. A service charge 15 above the competition costs 2 506 667 of value at a 6.75 per cent exit yield.

The re-letting cycle, dated

Chapter 5. Not a worst case: the ordinary course of business. Date every step for every unit that expires in the hold.

Building		Prepared by	
Date		Price and basis	

Step	Month	Cost / EUR	Owner	Date for unit ...
Lease ends; dilapidations served (a recovery against fit-out, not income)	0			
Strip-out and category A works	0-4			
Void: marketing, holding costs (rates, insurance, landlord's service charge)	0-9			
Heads of terms: headline agreed, concession in months and fit-out	8			
Completion: letting fees due, rent-free starts	9			
First rent	18			

One full cycle, per m2 a year	EUR	Share
Category A fit-out		
The void: rent lost and costs borne		
The rent-free period		
Letting agent and legal		
Total cost of the cycle		
Net income kept, and the share the cycle consumes		

Lever	Effect on the cycle cost	Evidence
Lengthen the term certain (spreads fit-out and fees, shrinks the empty share)		
Reduce the fit-out specification (priced in Chapter 14)		
Shorten the void (the one thing asset management controls)		

Calderon House: 18 months from cash out to cash in, 456 per m2 before a euro arrives; on Tenant A's 4 200 m2, 3 805 200 of spending and rent forgone. The cycle consumes 57 per cent of net income: fit-out 46, void 27, rent-free 23, fees 4.

The valuer's number and the bridge to the cash flow

Chapters 7 and 9. Do not argue that the valuation is wrong. Agree it, then walk the bridge line by line.

Building		Prepared by	
Date		Price and basis	

Unit	Years left	Bottom slice: market rent in perpetuity	Overage: excess over the unexpired term	Signed overage (under-rented units)
1.				
2.				
3.				
4.				
Vacant: deferred by the void, less fit-out				
Total, gross; net of acquisition costs				

The bridge	EUR	Evidence
The layer method, as the valuer runs it (net)		
Rung one: each unit charged at its own expiry with fit-out, lost and free rent and fees (the vacant floor: rent-free and fees only; its void and fit-out are already in the layer value)		
Value after rung one		
Rung two: every later cycle, the dated capital call, the exit		
The cash flow value		
Gap, and the share of the price that depends on the next buyer's omission		

Calderon House: 42.8 million by layers against 32.6 by cash flow. Rung one is 7.1 million and rung two 3.1 (the book first charged the empty floor its void twice: 7.6 and 2.6). The overage is worth 213 645; in perpetuity it would be 1 519 001, seven times more.

Review clauses, breaks and dilapidations

Chapters 8 and 22. Reviews shape the income inside a lease; the re-letting cycle decides how much income there is. Settle these points first: they go to whoever asks.

Building		Prepared by	
Date		Price and basis	

Item	Answer	Source document
The review clause		
Family: open market (upward-only or two-way), indexed, fixed		
Open-market assumptions: fitted or shell, term, incentives disregarded or not		
Indexation: index named, national, published; fallback if discontinued		
Cap without a collar? Price it as rent, a shorter review period or a smaller incentive		
Review dates fall well before any break date		
The break		
Who holds it, notice period, conditions within the tenant's control		
Value of removing it: net effective rent to expiry against to break		
Regear offer: currency (rent-free, contribution) against value gained		
Dilapidations		
Schedule prepared by a surveyor, served on time		
Assessed cost per m2 and settlement sought		
Argument that "the space is being refurbished anyway" answered		
Settlement, and percentage of assessed cost		

Lease	Review basis	Cap / collar	Next review	Break date	Value at stake	Action

A 3.0 per cent cap at 4.5 per cent inflation costs 36 per m2 of present value over five years, 431 544 across the building. On a 1 000 m2 floor with a 120 per m2 reinstatement obligation, a waved-through claim costs 120 000, 43 per cent of a year's income.

The ten-year cash flow, summarised for the paper

Chapters 11 and 12. Read the capital column before the income. Then find out how much of the value is the sale, and run the valuation for the year-ten buyer.

Building		Prepared by	
Date		Price and basis	

Year	1	2	3	4	5	6	7	8	9	10	Total
Net operating income											
Capital: fit-out, fees, dated works											
Net cash											
Leases expiring											

Test	Value	Reading
Capital as a share of income over ten years		
Net cash a year as a share of the price		
Ten years of net cash, discounted: share of value		
The sale in year ten, discounted: share of value		
Exit yield against today's net initial yield (the building will be ten years older)		
Exit income growth: of which filling the building, of which market growth		
Value held in perpetuity, every cycle paid (no exit)		

The year-ten buyer	Value
Price paid, gross of selling costs	
Net initial yield they buy on	
Capital-adjusted yield they earn, measured as today's (full cycle at year-ten prices)	
Against the capital-adjusted yield this paper rejects today	

Calderon House: 25.75 million of income, 13.44 of capital (52 per cent), 12.32 of net cash. 74 per cent of the value is the sale. The year-ten buyer pays 55.2 million on 6.53 per cent and earns 2.73 per cent capital-adjusted, 47 basis points below the 3.20 rejected today.

The energy deadline, and refurbish or let as it stands

Chapters 13 and 14. The upgrade is a capital call with a date. The specification decision is six assumptions, not one.

Building		Prepared by	
Date		Price and basis	

Item	Answer	Source document
Diligence: do not accept the certificate		
Underlying assessment and its assumptions		
Regulatory minimum for letting, and the date of the next threshold		
Independent engineer's costed plan: plant schedule, lead times, tenant access		
Recoverability through the service charge, clause by clause		
Measured consumption against the modelled rating		
Compliance works and improvement works: two separate business cases		

Value	Upgrade done	Upgrade deferred
Market rent		
Void; term certain		
Exit yield		
Value net of acquisition costs		
Difference, after the works		
Works added back AS THE FIRST LINE BORE THEM (present value, net of costs)		
Value protected per euro of works		

Assumption	Refurbished	As it stands
Market rent		
Landlord's capital per cycle		
Void; rent-free		
Term certain		
Exit yield		
Value; cost of not refurbishing		

Calderon House: 32.6 million with the upgrade, 19.7 without; 12.8 million better off after paying. Added back at present value (1.4 million, not 1.9 nominal), 14.3 million protected, 7.5 times the works. Letting as it stands: 25.4 million, 7.1 million lost to save 3.96 million a cycle.

The two cliffs, density and the smallest lettable unit

Chapters 15 and 16. Compute both cliffs for every office, once a year, and record the distance. Then ask what the building can be cut into.

Building		Prepared by	
Date		Price and basis	

Threshold	Fit-out per cycle	Value	Headroom today	Last year
Today				
Income cliff: net income over a cycle is nil				
Value cliff: office value meets the alternative use				

At the income cliff	EUR	Share
Ten years of operating cash, discounted		
The sale in year ten, discounted		
Value gross of acquisition costs		

Space taken at each renewal	Value	Change	IRR at the price
Same area			
5 per cent less			
10 per cent less			
15 per cent less			
20 per cent less			

Floor	Plate m2	Cores / escapes	Smallest unit m2	Cost to sub-divide	Tenant exposure

Calderon House: income cliff 1 121 per m2 (37 per cent of the way), value cliff 1 970 (21 per cent). At the income cliff the model still values it at 20.1 million, all of it the exit. Fifteen per cent less space at each renewal costs 19.5 per cent of value.

Hold, strip back, reposition or convert

Chapters 17 and 18. The same discount rate for all four. Then the two thresholds that decide repositioning, evidenced before a euro is committed.

Building		Prepared by	
Date		Price and basis	

Residual land value	Input	EUR
Gross internal area (lettable / efficiency)		
Saleable area		
Gross development value		
Construction on gross area		
Professional fees		
Developer's profit (on value)		
Finance (rate x share financed x average drawn x programme)		
Sales and marketing		
Residual, gross; net of acquisition costs		
Residential price at which conversion overtakes the office		

Strategy	Value net	Against holding
Hold and re-let, category A each cycle		
Hold and let as it stands		
Comprehensive repositioning		
Residential conversion		

Repositioning threshold	Assumed	Required	Evidence 1	Evidence 2	Evidence 3
Post-works rent (three refurbished comparables, achieved)					
Works cost (two contractor specifications)					
Surrender premium each tenant accepts					
Programme to practical completion					

Calderon House: 32.6, 25.4, 24.9 and 4.9 million. Repositioning needs a post-works rent of 401 rather than 345, or works at 525 rather than 1 250. Conversion needs 8 271 per m2 of residential value against 4 800.

What a lender will lend

Chapter 19. Three tests, run together; the loan is the smallest. Then the provisions worth more than the margin.

Building		Prepared by	
Date		Price and basis	

Test	Limit	At the asking price	At the underwritten value
Loan to value			
Interest cover (net income / interest)			
Debt yield (net income / loan)			
Loan: the smallest			
Equity			
Unlevered IRR			
Equity IRR			

Covenant in the year of	Expiry 1	Expiry 2	Expiry 3	Energy works
Net income (look-forward, committed lettings)				
Interest				
Cover				
Headroom to the minimum				

Item	Answer	Source document
Negotiate harder than the margin		
Cover tested look-forward, with committed lettings		
Capital expenditure carve-out from the cash trap (fit-out and energy works)		
Equity cure: mechanic defined, number of uses stated		

Calderon House: at a 5.35 per cent all-in rate, loan to value binds at both prices: 23.7 million at the asking price, 17.9 at the value. Equity earns 3.27 per cent at the asking price and 9.54 at the value: 343 basis points apart unlevered, 628 levered.

The bid and what would have to be true

Chapters 20 and 21. Bid a number and publish the schedule underneath it, so that every concession has a price the vendor can see.

Building		Prepared by	
Date		Price and basis	

The paragraph: we are paying ..., a ... per cent net initial yield, for ... m2 with ... years of income and ... per cent over-rented. We underwrite ... of fit-out, a ... void, ... rent-free and ... of dated works. On those assumptions we earn ... unlevered; at the asking price If the vendor can evidence ..., we will pay more.

Assumption, one at a time	Underwritten	Required for the asking price	Move	Evidence that would settle it
Market rent				
Exit yield				
Category A fit-out				
Rental growth				
Term certain				
Space taken at renewal				

Joint case (all at the edge of arguable)	Value	Do we underwrite it?
The vendor's six assumptions together		
Which of the six we accept, and the value that follows		

Funding plan and the decision if leasing is worse	Amount / decision
Capital over the hold (price is the first half of the bid)	
If the vacant floor is still vacant in year three: cut the rent, extend the incentive, split, or hold empty?	

Calderon House: bid 32.6 million, 76 per cent of the asking price, 7.92 per cent net initial. The asking price needs a rent of 392, an exit of 4.76 per cent, a fit-out of minus 167 or growth of 5.30 per cent; the six vendor assumptions together give 43.3 million.

The asset management plan and the committee paper

Chapters 22 and 24. Eight columns and a row per unit; one page. Then six items for the committee, and three numbers every quarter.

Building		Prepared by	
Date		Price and basis	

Unit	Expiry	Break	Current rent	Market rent	Fit-out estimate	Void as summed	Marketing starts	The one thing that would most improve it

Item	In the paper?	Page
The paper: six items		
1. The three yields on the first page		
2. The share of value in the exit		
3. The capital schedule by year, next to the income		
4. The bridge to the valuation, two rungs		
5. What would have to be true, unedited		
6. The decision if the plan fails, written before approval		

Every quarter	Q1	Q2	Q3	Q4
Capital-adjusted yield				
Distance to the income cliff				
Distance to the value cliff				
Achieved net effective rents (never headlines)				

Levers, largest first: extend the term certain (3.7 million on this building), shorten the void (2.1 million for six months), choose between aligned and staggered expiries, settle dilapidations early, control the service charge.