ERRATA

CHAPTER 6

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By September 2008, in the eye of the GFC storm, the Pinnacle/Helter Skelter development was underway. The first and only pre-let – the penthouse restaurant – was announced in October 2008, but by the time that piling works began in March 2009 no office tenants were showing any interest. By 2009, construction costs (including fees) had risen to £575m, due to developer variations, despite the fixed price Multiplex contract. The scheme was now severely loss-making, due partly to these cost increases but mainly because of a fall in rental values and a rise in cap rates (see table 6.3). What could the developer do now?

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The planning consultation process started in 2012 and bi-weekly meetings were held throughout 2014, with both sides motivated and keen to secure a quick agreement, which was possible because LRD had been working closely with planners for at least 12 months before AXA REIM acquired the site. Planning approval was granted in November 2015. The new Pinnacle, now to be known as 22 Bishopsgate, was 278 metres high – the tallest office development in the City of London[1] – with 140,000 sqm of offices (later reduced to 125,000 sqm) , including 10,000 sqm of amenity space, capacity for 12,500 people, and over 200,000 sqm of gross external area. The result was a highly profitable project, about to be restarted at a time of considerable optimism.

CHAPTER 7

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The present value of the effective rent is £518,730; the annual equivalent of this is given by £518,730÷ PV£1 p.a. 5 years @8% = £518,730/3.9927 = £129,919.

CHAPTER 8

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The borrower could also apply for an even higher LTV of 75 per cent, a loan of €3m. The bank will charge a higher interest rate of 4.5 per cent and require amortisation 2 per cent per year. The DSCR will now be €200k/(€135k interest + €60k amortisation) = 1.03. The bank will very likely decline this loan, as a very small decrease in NOI will probably cause a default.

CHAPTER 10

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The discount rate is lower, because the interest rate demanded by pension funds is lower for a diversified pool, so the value of the loans is higher. Each individual £320m loan justifies an interest rate of 7 per cent and therefore soaks up £22.4m of income. Once pooled into a bond earning (4*£22.4m =) £89.6m, the required interest rate falls from 7 to 6.5 per cent, and this income is now worth say £1.38bn (£89.6m/.065 = £1.379bn). The bank now makes £100m, or £25m on each £320m loan, plus one-off structuring fees of say £10m.

[1] The Shard is the tallest office building in London, but is not in the City.

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To develop this, let us use an example, based in the depressed UK market of 2008. Assume that at the beginning of 2008 a property is valued at a cap rate of 5 per cent. The required return is 7 per cent, incorporating a 3 per cent risk premium over conventional bonds yielding 4 per cent. It is priced at £20 with an expected initial dividend of £l. The expected growth in income is given as follows:

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Table 13.20 shows that core funds delivered statistically significant betas of between 1.4 and 1.6 in all markets, all higher than should be expected. Core funds delivered tracking errors of around 5-6 per cent in all markets, again higher than should be expected (strong doubts exist about the quality and replicability of the underlying benchmark in many markets around the world, but this is part of the problem for investors). This means that for two years in three, returns will typically be the index return plus or minus 5-6 per cent; one year in three, returns will be more than 5-6 per cent above or below the index return. Using the Europe core fund beta in a capital asset pricing model framework would imply a risk premium of 1.6 times the property risk premium of say 3 per cent, which is 4.8 per cent. This suggests that funds need to deliver returns 2 per cent above the market. However, in the UK funds have under-performed the market: see Table 13.15.

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Europe opportunity funds delivered a very significant beta of over three. The (barely significant) alpha is negative, and more than 6 per cent prior to performance fees. North American funds were better performers. The highly significant negative alpha is about the same as in Europe, but core beta is lower, and opportunity alpha is less negative. Opportunity fund betas ranged from 2.3 in North America to 3.6 for the global fund sample, all statistically significant, around twice the core fund betas. Leverage explains the majority of the higher beta. There were some very big winners and losers (fat tails), and a negative skew, meaning that investors were more likely to do very badly than very well.

GLOSSARY
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Yield

With many thanks to readers, especially Enrique Marti