Mixed-use assets require a tailored valuation approach

Given the uncertainty of the market these days, mixed-use real estate plays seem like a great solution. A property that can be rented for various residential, commercial and institutional needs allows for the owner to stay nimble when local market demands shift. But with that flexibility comes complexity, and getting that mix right is not simple.

Proper valuations therefore matter more than ever in understanding how best to use all those units under a single roof. And as mixed-use grows as a share of the real estate industry, proper valuations are needed to accurately assess the market as a whole.

In 2017, the National Community and Transportation Preference Survey reported that over 60 percent of millennials, 45 percent of gen-Xers and baby boomers and over half of the silent generation would prefer walkable communities and shorter commutes. Given that mixed-use properties often provide both, and neither preference appears to be on the wane, it is safe to assume that mixed-use strategies are here to stay.

PERE spoke with Damien Georges of RealPage, a global provider of software and data analytics to the real estate industry, to discuss how best to execute valuations of mixed-use single properties, and the role that service providers can play in conducting them.

Q: There has been a lot of buzz about the growth of mixed-use properties and portfolios. In your experience, how real is that trend?
We are looking at mixed-use properties in an investment portfolio as the new normal. Back before the financial crisis, it was common to see a fund’s investment thesis focus on purchasing a number of core assets in specific markets with a specific use. Usually office, industrial, retail, office and multifamily. Now it is not uncommon for a fund to invest in everything from airport hangars to theme parks and then allow the usage of

Damien Georges, senior vice-president at RealPage, tells PERE how service providers can play a critical role in helping managers accurately value mixed-use property.
their investments to vary wildly through the investment period. This model offers a flexibility that will allow an investment manager to be more resilient in the face of whatever comes next. Investors and top-quartile investment firms understand this, and have seen a lot of success with this strategy, resulting in higher investor returns all while actually mitigating risk.

But as much as both managers and investors are aware of the strategy’s value, the valuation practices of many industry participants has not evolved with them. There is still a focus on single real estate assets, where there is a property devoted to office space, another to retail and another to say, multifamily living. But we all know that has changed. Often, there will be a retail space on the ground floor, with some mix of office or living spaces above. And then there are other property types, such as senior housing, student living and storage facilities that are all increasingly common as well.

Against that backdrop, a single valuation simply will not capture the value of all the spaces under one roof. Instead, each space requires its own valuation, which can be a challenge to auditors and, of course, to service providers.

**Q** Can you explain what makes mixed-use real estate single assets and/or portfolios so hard to value?

Given a single asset can have the complexity of multi property types in a single model, the data required to perform the valuation and even the valuation methodology itself can vary considerably. Traditionally, real estate valuation models and software have focused on the ability to value a single property type for each asset. In this new world of mixed uses and co-working, institutional owners must grapple with the problem of valuing different cashflow streams in different ways, based on how a property is being used.

Unfortunately, one size does not fit all when it comes to valuing a mixed-use asset. This is why the majority of valuation analysis for mixed use portfolios currently occurs in Microsoft Excel.

**Q** Are there some common mistakes to these valuations?

By not taking into consideration the actual usage of each space and trying to assign a single valuation methodology based on the property type, mistakes can be made in both the market leasing assumption of the building and in the modeling of the general leasing profile.

By applying incorrect assumptions, the overall calculated value of the building will be flawed and lead to incorrect cashflows and values. Also cap rates should be applied to a specific property type, not globally across property types. Applying the incorrect cap rate to the usage of the asset can have a material impact on value.

Furthermore, when reporting asset valuations to benchmarking organizations, the reporting of inaccurate values can have a cascading impact. Not only will the benchmark itself be impacted, but downstream, some asset managers’ compensation is driven by the benchmarks. This could lead to incorrect assessments of asset manager performance by owners and investors.

**Q** What role can a service provider play in improving the quality of these valuations?

Software needs to be built to accommodate space-specific usage requirements. Having software that values one type of real estate or even one type of real estate per asset does not go far enough to support mixed use or co-working portfolios.

That means that right down to the collection of data from third parties, or the entry of data into a property management system, a user must be able to identify the type of space associated with a lease. This requires robust data models for the storage and ultimately the dissemination of this information into valuation and portfolio modeling tools.

**Q** So what should managers look for in a service provider to help with their mixed-use real estate valuations?

Managers should look for service providers with a history of developing data management and portfolio management solutions for complicated investment managers. It is not uncommon for an investor to hold portfolios comprised of traditional asset types like retail, office, industrial and multifamily but also student, senior living, data center, storage and co-working portfolios. It is also common for two or more of these property types to exist in a single asset. Without a history of developing and implementing solutions that meet these complex requirements, the chance of implementing a successful strategy is practically zero.
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