Management Rights

Market Update Covid-19

27 May 2020

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Where are we at?

April was out of the box, a full month of lockdowns and isolations.

Business was very slow which provided clear air, not only literally, but in our headspace to look at processes, report formats and speak as guests to various industry forums via Google Meet, Zoom and the like.

We joined a number of financiers, solicitors, accountants to devise a consistent approach to reviewing financial performance of management rights in these challenging times. There are some thoughts that this will roll into further changes, hopefully across the industry, but only time will tell.

As we reported last month, a number of financiers sought our thoughts on the impact to those locations with significant international tourism numbers, as the 'drive to' style markets would hopefully be less impacted.

However, as the following table notes, occupancy has decimated due to movement restrictions across South East Queensland:

2018/19	Brisbane	Gold Coast	Sunshine Coast	2019/20	Brisbane	Gold Coast	Sunshine Coast
July	76.70	76.90	70.81	July	79.00	75.40	70.60
August	76.80	76.50	68.71	August	77.60	71.90	71.40
September	71.10	73.20	70.26	September	74.10	68.80	72.90
October	74.10	77.40	75.56	October	76.30	76.80	76.00
November	73.90	74.40	68.33	November	78.80	71.70	71.00
December	64.80	73.80	72.69	December	68.80	73.30	73.10
January	60.90	80.20	77.65	January	65.30	82.10	79.30
February	71.80	68.20	59.35	February	71.00	66.60	60.50
March	71.20	66.60	60.85	March	41.70	39.90	43.10
April	66.60	68.60	68.60	April	18.80	7.70	7.30
May	73.20	59.10	54.65	May			
June	69.60	58.40	53.60	June			
Average	70.89	71.11	66.76	Average	65.14	63.42	62.52

Encouragingly though, the permanent letting market in south-east Queensland has been more resilient.

A survey completed by a syndication group found that within 18 buildings/complexes under their management, with approximately 2,500 rental units had only 3.7% of tenants seek rental relief.

Another client with 450 units in numerous buildings under management on the fringe of the Brisbane CBD has advised 4.1% of their tenants have been granted some form of relief.

A number of complexes across the Sunshine Coast indicated that they have limited Covid-19 impacts around rental relief with few tenants qualifying, however some rent roll operators around the Noosa region have indicated that the large impact on their tourism and hospitality market has seen rental assistance for up to 10% of tenants.

The Gold Coast's largest Ray White franchise group reported 7% of properties on their rent roll needed some rental assistance.

We anticipate that fringe and regional locations may be experiencing different conditions, and that as we near September 30, should business and travel restrictions still be in place, tenant circumstances may change.

Data collected since early April suggests:

- Residential markets have experienced a fall of approximately 40% in transactions but prices not been significantly affected. There have been instances where vendors, keen to sell, have accepted offers of up to 5% below their initial offers or earlier contracts pre-Covid-19. However, these are proportionately low compared to sale volume.
- Holiday unit complexes remain the most at risk, given their unit owner/investor returns are heavily impacted and will likely result in falling prices depending upon how quickly rooms can be filled post restrictions to travel being eased. In addition, serviced apartments where permanent letting is not permitting are subject to greater risk.
- The manager's lot/real estate component has not yet been widely impacted given the have been limited contract negotiated since late March.
- A number of potential buyers have looked to extend settlements past September. This has happened in a number of complexes, though has also led to contracts falling over for some.
- A number of agents have reported that listing complexes is becoming more difficult with the uncertainty around the multipliers. A number of vendors are still looking at record multipliers for locations, though agents are reporting that buyers in the market are typically not looking at pushing multipliers above previously noted ranges.

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Impacts on Valuation

Despite the overall general improvement in confidence experienced across most markets during 2019, the current Coronavirus, COVID-19, pandemic has had a significant impact on global economic growth and the Australian economy and as a result is likely to have detrimental impacts on the property market.

The market is experiencing a greater level of uncertainty, and some, or all, sectors are/will experience a period of weak buyer demand, extended selling periods and potentially diminution in asset values. Recent stimulus packages and policies introduced by the Federal and State governments, as well as record low interest rate levels, may limit the impact of the pandemic on property markets however it is difficult to predict at this stage.

Will Covid-19 change the valuation methodology?

There are conversations underway between many industry professionals about the use of 1 years' historic P&L being used in perpetuity for assessing the Net Maintainable Income. Management Rights is the only known going concern sold and valued using 1 years trading figures. There is conjecture some financiers may change to 3 years historic, plus projections for the next 12 months as part of due diligence.

'How are we approaching valuations of management rights businesses today?'

Given permanent businesses appear to be faring reasonably well, there is unlikely to be much change. If we consider a basic rent relief scenario where only 4% of tenants are seeking assistance:

eg letting pool 100 units, average rental $400/week, 4% were granted a $50 per week reduction for 6 months, the loss of commission to the manager is:

- 4 x $50 x 8% commission x 26 weeks
- $416

So, in this example, the reduction in net profit for a 12 month period could be negligible. It is business as usual.

However, with profits likely to be significantly impacted in the short term or holiday let market, how do we approach that valuation if instructed to assess a value right now?

As a result, our approach to valuation is similar to other asset classes as follows:

- assess a maintainable net profit and adopt a market derived multiplier (years purchase) factor.
- deduct loss of net profit (which we will assess for the affected period) to arrive at our adopted value of the management rights business component. In a numerical example:

NOP	$500,000
Multiplier	5
Value	$2,500,000
Less Loss of Income	$300,000
Adopted Value	$2,200,000

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What new information is required to undertake due diligence?

Together with a number of industry professionals, a list of questions is now required to be answered:

1. Do you have an overall strategy to manage tenants / landlords? If so provide details.
2. How many tenants have advised you or applied for break lease as a result of a loss of employment from the restrictions and shut down of businesses?
3. How many tenants have requested or have been granted reduced rent?
4. How many tenants have requested or have been granted rent free period?
5. Can you provide details of lot/unit numbers of those that have applied and those that have been granted and those that have been refused;
6. Can you provide details for those that have been approved, the previous rent, the new rent, the period of the reduction, and end of lease dates;
7. Can you provide details for those that have been refused, whether that has been accepted by the tenant and if not the status of that tenancy.
8. Have the number of rental arrears changed?
9. Current vacancies and numbers of units to become vacant in the next 1 to 3 months because of tenancies ending or tenant having given notice to terminate.
10. Current recent vacancy time before a unit is rented (give examples).
11. Level of enquiry for any current vacancies (What if any incentives are being offered to attract tenants? Any indication or expectation that it will take longer to let units over the next 3 months?)
12. Recent history of rents achieved from new rentals and if higher or lower than in the past (give examples).
13. Tenants' general occupation if possible (eg: 50% employee, 30% tradie or self-employed, 20% Centrelink or welfare).
14. Have unit owners been advised or pre-warned for any potential requests for rent reduction, rent payment on hold etc.?
15. Have any owners expressed they would experience financial hardship if rent/s are reduced or the unit is vacated?
16. Are any owners body corporate levies in arrears? If so, are there any signs at present that this is increasing at all?

Are you still working and do you conduct inspections given restrictions?

The short answer – yes.

We are open and continuing to do business to help support the local economy by allowing people to access equity within their homes, commercial properties and businesses to help see them through this health and economic crisis.

How Can We Help?

NATIONAL STRENGTH

For more than 50 years, Herron Todd White has been helping our clients make the most of their property assets. As specialists in valuation and advisory services, with our extensive experience, our main objective is to look after our clients' best interests; upholding high standards of independence and professionalism that we believe are second to none. Valuing is our core business. We do not sell, lease or manage property, so you can be certain that our advice is always impartial and unbiased.

LOCAL EXPERTISE

Whilst Herron Todd White has the largest valuation team across Australia, one of our strengths is the range of local specialists across multiple going concern asset classes. We also have a database of information extending across a range of market impacts from the 1989 pilot strike, the 1990-91 recession, GST impacts in 1999/2000, the significant value growth during the 2000's, the GFC impacts through 2008-2010 and the steady growth from 2013 noted.

As a result, we are uniquely positioned to be able to assist clients through this period of significant uncertainty. We can undertake a range of services including, though not limited to:

- General Residential & Rural Residential
- Prestige Residential & Rural Residential
- Residential Development
- Office
- Industrial
- Retail
- Rural
- Hospitality & Leisure
- Education & Child Care
- Service Stations
- Other specialised property

WHAT CAN WE DO FOR YOU?

Valuations

- SMSF
- Stamp duty and accounting purposes
- Family Law and Expert Witness
- Pre-purchase and pre-sale
- Retrospective assessments
- Portfolios
- Rental assessments and determinations
- Statutory land value advice and assessments
- Easements
- Mortgage security

Legal

- Family law
- Compulsory acquisition and compensation
- Single Expert Witness
- Shadow Expert Witness
- Deceased Estates

Due Diligence

- Asset risk analysis
- Highest & best use assessment
- Feasibility analysis

Research

- Supply & demand analysis
- Product & pricing mix analysis
- Competition analysis

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