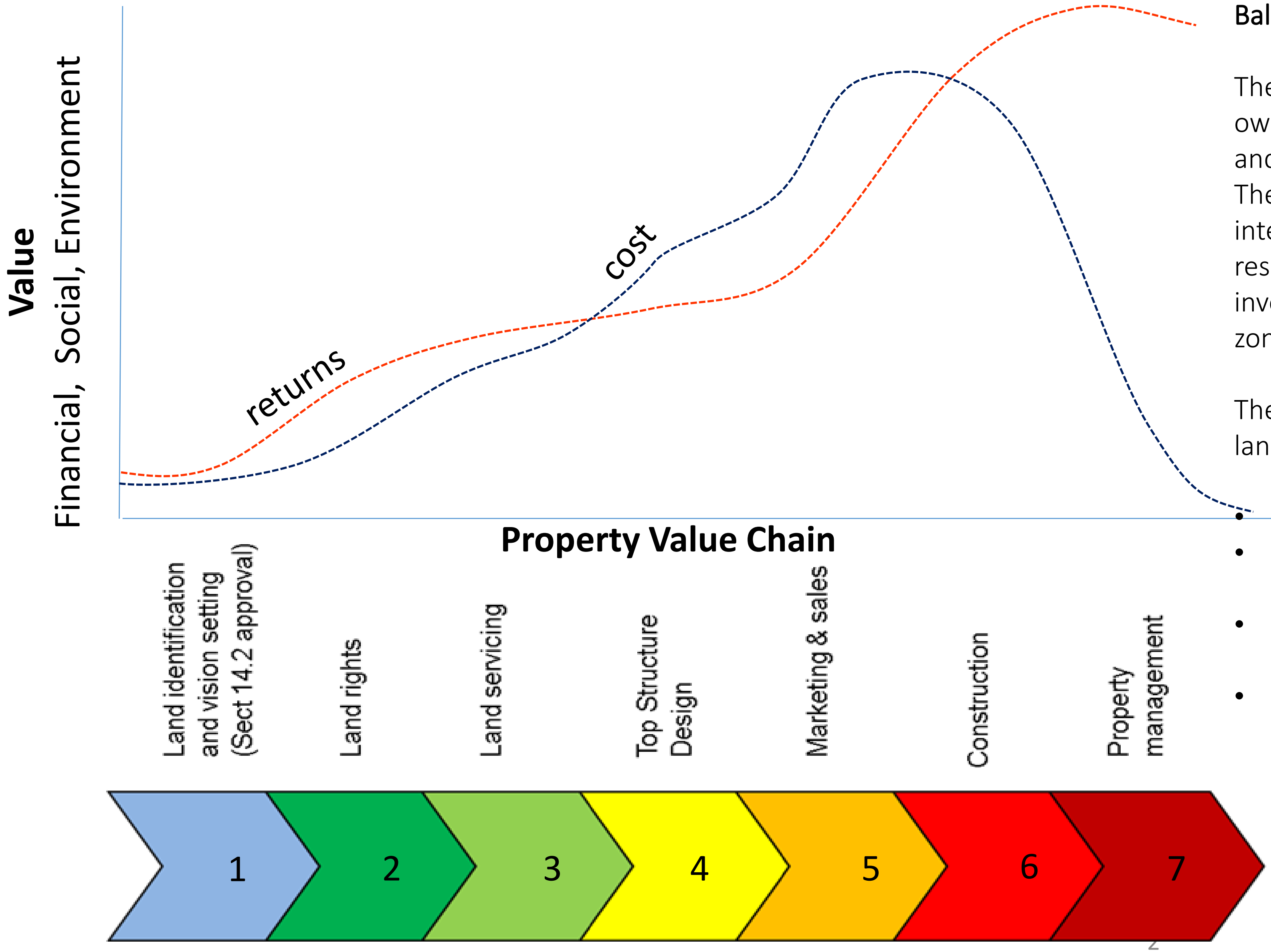
URBAN REAL ESTATE RESEARCH UNIT

PUBLIC SECTOR DEVELOPMENT FORUM

Transacting for Value Optimisation

September 2020

Value Realisation



Balancing Risk and Reward

The optimal risk/reward balance for land owners is achieved at the land packaging and preparation stages of the value chain. These stages are general less capital intensive and more time intensive, resulting in a significant return on investment. The output of these stages is zoned, serviced, development ready land.

The benefits of packing and preparing land are:

- Increased financial returns
- Increased attractiveness to reputable developers/ investors
- Increased certainty of the development coming to fruition
- Ability to define development outcomes and deliverables

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Increasing Returns per Development stage

Different methods for calculating value applicable per development stage

VACANT LAND

Calculated at a rate per m2 based on comparative sales.

Rates will vary depending in size and location

Typical Gauteng bulk farmland rate R30-R100 per m2

ZONED AND SERVICED LAND (SHOVEL READY)

4X returns

Calculated at bulk rates for commercial land or price per opportunity for residential land.

Rates will vary depending in size and location

Typical Bulk rates for commercial land range from R1000-4000 per bulk m2
Typical opportunity prices for high density residential units range from R80 000- R120 000

COMPLETED DEVELOPMENT

10X returns

A capitalised value is used determine the value of completed developments.

This capitalised value is based on the net income received by the development.

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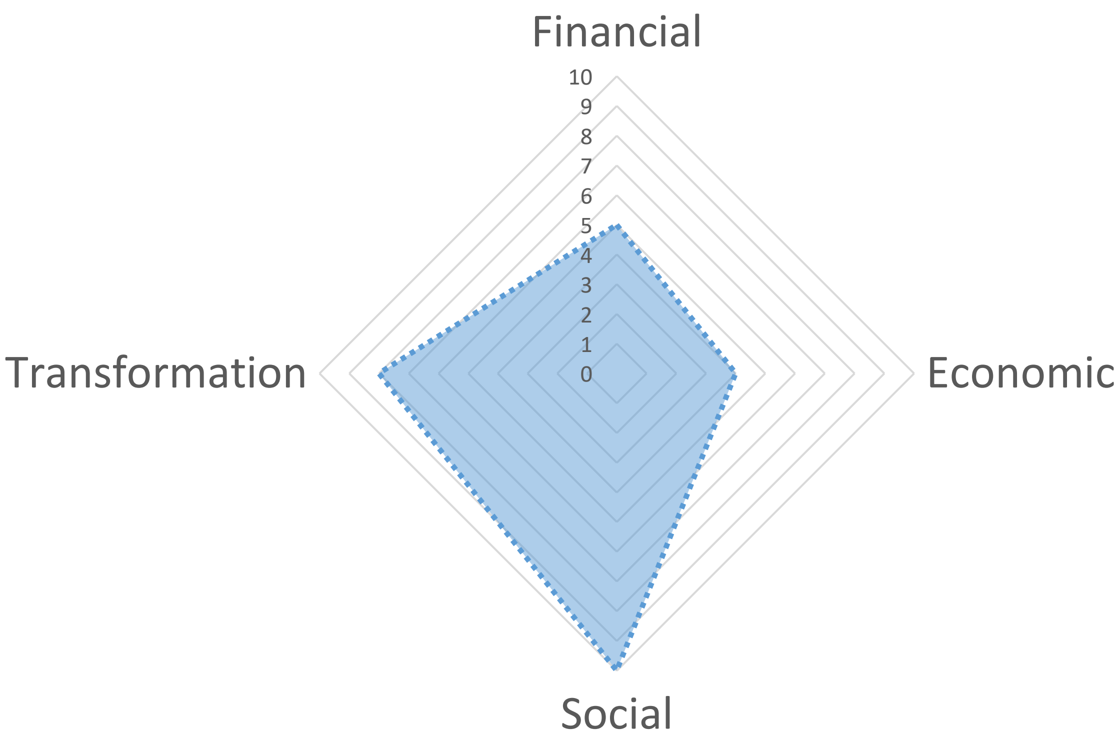
Public Land Value Strategy



The Value of public land is more complex than just its financial value. In assessing returns the following values need to be balanced):

- **Financial** (The value of revenue from land is an important Alternative Revenue Source)
- **Economic (**Direct and indirect economic benefit of investment)
- **Social (**City Building, Green building, TOD, Inclusionary housing, New Urbanism, areas of deprivation, leveraging of public assets.)
- **Transformation** (Jobs, Skills Development, Localisation and Enterprise Development)

Value Strategy Example: Targeting of Social and Transformation returns over financial and economic returns

Land Value in Deal Structuring

LAND
10%

Land Value(Zoned and Serviced) is generally 10% of Total development cost

INVESTOR
20%

Balance of equity raised by developer

EQUITY FINANCE
30%

Finance expected to be contributed by developer or investor. Typically 20-40% of the required finance

DEBT FINANCE
70%

Loan finance raised from conventional financial institutions.

Development Entity

Public Secor "Equity options"

Land Owner
Provides 10% of the 30% equity required
Shareholding 10%/30% = 33.3%

Investor
Provides 20% of the 30% equity required
Shareholding 20%/30% = 66.6%

Note: need to consider shareholder exposure to surety of debt finance raised by Development Entity

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Transaction Types

Lease

- *Short term lease (less than 10yrs)/Notarial Lease (longer than 10 years – notarized in title deed)*
- *straight* - requirements depend on land use and basic terms
- *development* lease- can be phased, can contain various requirements as outputs.
- *management agreement* (where manager does not have right of use or control of land – exempt from MFMA
- *Turnover Lease- Rental is paid as a % of net or gross income.*
- *Lumpsum Lease – Rental due is paid upfront in one bullet payment equal to the NPV of the rent over the rental term*
- *Reset Lease – Lease is reset to original lease period on "transfer" of lease (or at end of lease period) against payment of a reset fee (3% of value)*
- Lease & *Leaseback (PPP) – Land over leases back competed development in exchange for unitary payment.*

Sale

- *Straight sale* - basic terms
- *Development sale* - can contain various requirements as outputs (can be captured as title deed conditions).
- *Option Agreement – Purchase given option to purchase land within option period. Non-refundable Option fee usually charged*
- *Deferred transfer Sale – Sale agreement with agreement to transfer at a later date. Deposit usually required*
- *Instalment sale – Sale agreement paid off in installments*
- *Land Availability Agreement – Land "allocated to developer" transfer of completed development directly to third party/ies against agreed payment.*
- *Offset Sale – Payment for land "offset" against delivery of public asset of equal or greater value*

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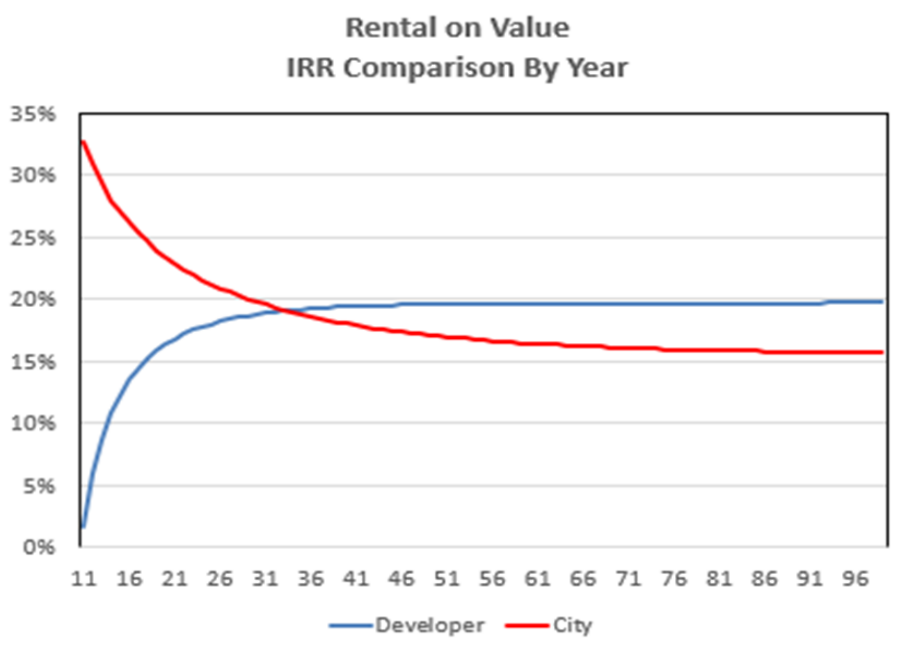
Research Findings: Optimal Lease Length Model

- Municipalities and other public entities in South Africa often dispose of land they own to generate income for municipal purposes and or to achieve broader economic and social objectives. To date, the most common method to do this has been to dispose of the land on a freehold basis. However, this approach has been questioned in that it is argued that the municipality may forego higher annuity income in the future and the long-term assets are lost in perpetuity. Furthermore, a large upfront payment requirement from a developer may undermine the viability of a project as such a payment will require the developer to invest significant equity into the project and or additional finance costs will have to be borne by the project.

- As a result, there is an increasing interest in releasing public land on a leasehold basis. Despite these concerns, there has not been a systematic assessment of terms on which public land can be disposed on through a leasehold structure. In response to this, the Public Land Development Research Project (PLDRP) has developed a financial model to assist in determining the optimal lease term length from both a developer and state perspective.

- The optimal lease length has been a source of dispute between public sector land owners and developers with the landowners pushing for shorter term leases and developers insisting on longer term leases, both without any detailed empirical basis for their specific preferred lease term. The model runs on a conventional viability study engine and models the Internal Rates of Return for both developer and land owner. The model maps the “Parity point” of both IRRs in term of lease length. This “parity point” can be used as a starting point for settling on a lease length that is suited to both parties.

- The preliminary results of running various case studies through the model indicate that the optimal lease length seems to be around 30 years when the IRRS for both parties seem to plateau after escalating steeply in the initial years of the lease. In the research the need to explore “reset clauses” for shorter term leases was identified to accommodate the on-sale and refinancing of developments.



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