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Returns from Property Development

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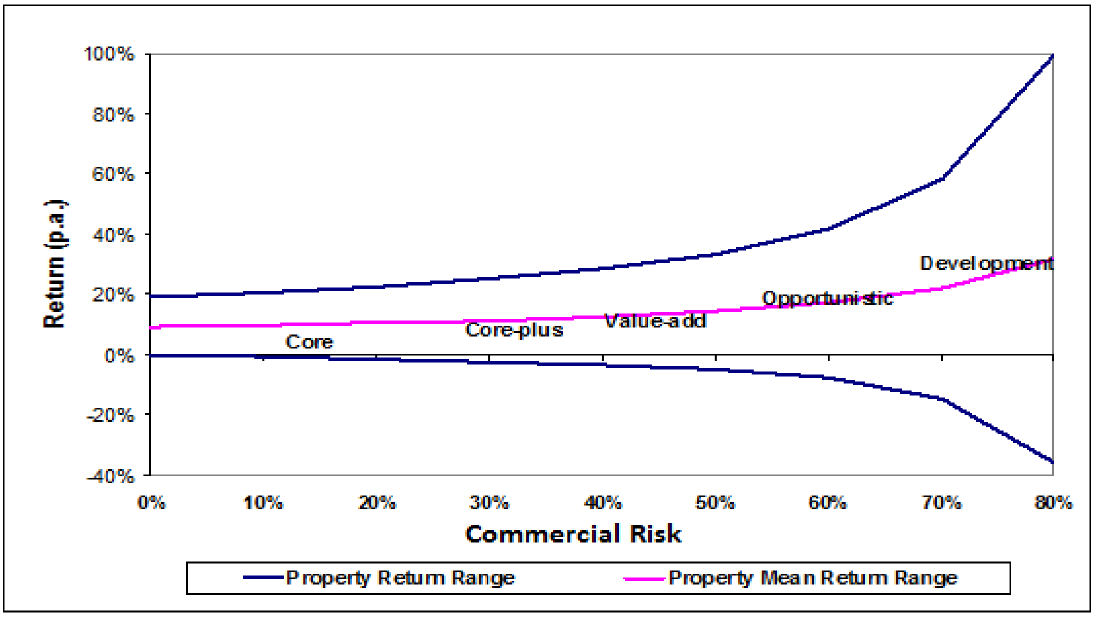
As property development involves significantly more components of risk factors, higher returns are required above rental income generating property returns. Property investment strategies include: core; core-plus; value-add; opportunistic; and development. Each strategy exhibits different characteristics which have been evaluated and quantified. The differences in required returns and prospective volatility of returns are demonstrated in Figure 1.

Figure 1: Effect of Increasing Risk in Property Strategies



Source: Atchison Consultants

Investors in property across the risk spectrum encounter multiple risk factor exposures. Key risk factors include:

Property

There are risks inherent in direct property investment. They reflect the potential variability of property return due to macroeconomic events, such as rental market changes, economic activity involving demand and supply and change in transaction costs.

Planning and zoning

In the preliminary stages applying for and obtaining the planning and zoning approvals can be a protracted process. Time taken in the process results in consequential increase in holding costs for outlays during the process.

Construction

Construction risks are viewed from a cumulative perspective as each stage cannot commence until the preceding stage has been completed. Activities are grouped by the three key stages of construction comprising in-ground, structure and fit-out and completion with resulting holding costs.

Settlement

Settlement risk considers the potential for a downturn in financial markets, in particular property markets and the prospective failure of pre-committed contracts for sale or lease to settle.

Leasing

This represents the prospect that on completion of a property development or expiry of a lease, it cannot be leased or released for an extended time.

Capital works

Capital works risk represents the potential extensive time during which rental income is not being generated when capital works are being undertaken.

Capital management including gearing

Capital management includes structuring equity and debt financing terms which are suitable for specific property acquisition and development.

Asset management risks

Inefficient asset management would result in delay in successful leasing, which consequentially results in lower rental income.

Risk factors result in the opportunity cost of time when these factors are incurred. Premiums for these risk factors would be measured on the basis of the opportunity cost being core property expected return over the time period when return income is not being received.

Table 1 illustrates the property investment strategies and their prospective required rate of return range.

Figure 1: Australian property strategies and expected returns

	Property Return Range
Core	8 – 10% p.a.
Core Plus	9 – 12% p.a.
Value Add	12 – 15% p.a.
Opportunistic	14 – 25% p.a.
Development	25 - 45% p.a.

Source: Atchison Consultants