Real Estate
Real Estate

New Joiner Training - PE Fundamentals
Intro Real Estate
Real Estate Investment Banking Overview

The Real Estate Investment Banking Group comprises all of IB Real Estate’s client service activities including initiating, developing and maintaining relationships with and executing transactions on behalf of real estate clients worldwide.

- IB Real Estate investment banking clients include public companies, institutions (pension funds, endowments, etc.) and private family/entrepreneur-run real estate entities.
  - These clients benefit from the group’s customized approach to investment banking, which focuses on the development and implementation of long-term financial strategies without product bias.

- IB Real Estate is an innovative and experienced advisor in all transaction types:
  - Mergers & acquisitions
  - Financings
  - Restructurings/recapitalizations
  - Portfolio/asset sales

- In addition, IB Real Estate is a market leader in all of the real estate capital markets:
  - Public and private equity
  - Property debt
  - Corporate debt

www.educorporatebridge.com
Securitisation - A General Description

What is Securitisation and ABS/CMBS?

- Securitisation involves the issuance of securities collateralised by assets that generate known or estimable cash flows (e.g. mortgage loans generate monthly payments from borrowers)
- The assets are sold by their owner (e.g. a bank) to a trust
- In order to fund the purchase of the assets from the owner, the trust creates and sells bonds to investors
- The periodic cash flows generated by the assets after the securitisation are directed to the trust, which uses the cash flows to make the required periodic payments to the bondholders
- Four primary types of securitisation product
  - **Asset Backed Securities ("ABS")**
    - Collateral assets include credit card receivables, residential mortgages, automobile loans, student loans, home equity loans, equipment lease receivables, etc.
  - **Commercial Mortgage Backed Securities ("CMBS")**
    - Collateral assets are mortgage loans to owners of commercial properties such as retail malls, hotels, apartment buildings, office buildings, self-storage facilities, etc.
  - **Collaterised Debt Obligations ("CDOs")**
    - Collateral assets include investment grade and high yield corporate bonds, government bonds, CMBS, ABS, whole loans\(^{1}\), mezzanine loans, etc.
  - **New Asset Securitisations/Operating Company/Whole Business Securitisations**
    - Collateral assets include operating company cash flow, royalty streams, etc.
Basic Structure

• In a securitisation, a company typically sells a portfolio of assets to a special purpose vehicle (SPV)
• The SPV finances the purchase of the assets through the issuance of asset backed securities (ABS) and pays the proceeds as an initial purchase price to the company
• The cash flow generated by the assets is used to make interest and principal payments to the ABS investors
• Any excess cash flow is paid to the company as a deferred purchase price
• Credit enhancement through overcollateralisation or third party guarantees generally leads to a rating of the ABS that is higher than the company’s unsecured debt rating
With respect to income-producing real estate assets, IB can provide its clients with either a classic mortgage loan or an agency securitisation or also a hybrid between the two alternatives.

The choice between a mortgage loan and an agency securitisation will be mainly determined by:
- Size of loan required
- Appetite for market risk
- Speed and certainty of funds required

Hybrid transactions where the client shares some upside potential on loans qualifying for stand-alone securitisations (large loans) are possible as well.

<table>
<thead>
<tr>
<th>Principal differences between Mortgage Loan and Agency Securitisation</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Mortgage Loan</strong></td>
</tr>
<tr>
<td>Any size from €1 MM to €1.5 Bn</td>
</tr>
<tr>
<td>Insulation from bond pricing – economics fixed at an early stage</td>
</tr>
<tr>
<td>Typically 6 week process</td>
</tr>
<tr>
<td>Normal closing costs associated with closing a commercial mortgage loan</td>
</tr>
<tr>
<td>Company’s involvement largely substituted by increased role of lender</td>
</tr>
<tr>
<td>One single loan</td>
</tr>
</tbody>
</table>
Real Estate as an Asset Class

- Alternative investment

- Similar to bonds

- Leverage

<table>
<thead>
<tr>
<th>Risks</th>
<th>Opportunities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Operating Cost: unexpected increases</td>
<td>Operating costs: exploit management expertise to lower operating costs</td>
</tr>
<tr>
<td>Vacancy</td>
<td>Rental Growth</td>
</tr>
<tr>
<td>Natural Disaster</td>
<td>Terminal Value</td>
</tr>
<tr>
<td>Leasing</td>
<td></td>
</tr>
<tr>
<td>Liquidity</td>
<td></td>
</tr>
</tbody>
</table>
The Real Estate System

Interaction of the Space Market, Asset Market and Development Industry

- Space Market:
  - Supply (Landlords)
  - Demand (Tenants)
  - Rents & Occupancy

- Development Industry:
  - If yes: Is development profitable?
  - Construction cost including land

- Asset Market:
  - Cash Flow
  - Property market value
  - Market required cap rate
  - Demand (Investors Buying)
  - Supply (Owners Selling)

- Local & National Economy:

- Forecast Future:

- Causal flows: ➔
- Information gathering & use: ➥

www.educorporatebridge.com
Real estate is cyclical in nature and historically has had four identifiable stages:
- Peak
- Correction
- Recovery
- Expansion

Geographic markets globally are at different stages and move around the cycle at different speeds. PE Fund benefits from an extensive network of local offices that identifies and takes advantage of attractive opportunities throughout the cycle.

Illustrative Diagram

---

**Real Estate Fundamentals**

**Real Estate Cycle**

**Illustrative Diagram**

- Peak
- Correction
- Recovery
- Expansion

**PEF Product Focus/Opportunities**

- NPLs
  - Distressed Sellers (Banks, Real Estate Operators/Construction Companies)
  - Hard Assets Corporate Restructurings

- Corporate Restructurings
  - Programmatic JVs
  - Value-added Investments (including development)
  - Operating Companies

- Capital Markets
  - Selective/Opportunistic Investments

**Countries**

- U.S.
- U.K.
- France
- Spain
- Germany
- Italy
- Norway
- Sweden
- Czech Rep.
- Korea
- China
- Poland
- Thailand
- Brazil
- Mexico
- Singapore
- Russia
- Belgium
- Canada
- Japan
- Indonesia

**Properties**

- Apartments
- CBD Office
- Industrial
- Retail
- Office
- Hotels

www.educorporatebridge.com
The Nature of Real Property

- Real Estate - the physical land and structures affixed thereto

- Real Property - the interest, benefits, and rights inherent in the ownership of the physical real estate

- Ownership of real estate
  - Right to use, sell, lease, and dispose of real property
  - Rights limited by powers of government and privately
    - Taxation, Eminent Domain, Police, and Escheat
    - Private legal agreements may impose restrictions: deed restrictions, easements, rights-of-way, and party-wall agreements limit the use of the property
What’s a “Market” … ?

- A mechanism for the voluntary exchange of goods and services among owners
Two Types of Markets Relevant to Commercial Property

1. The Space Market . . .
   - For the usage (or right to use) “real property”
   - AKA “usage market”, or “rental market”
     - e.g., tenants & landlords exchange money for leases

2. The Asset Market . . .
   - For the ownership of “real property”
   - AKA “property market”
     - e.g., Oh.STRS exchanges my pension $ for an office bldg
What’s “Real Property” ...?

Answer: Land & Built Space

The Space Market ...

Supply:
Property Owners (Landlords)

Demand:
Property Users (Tenants)

Market

- Rents (e.g. $/SF)
- Occupancy
What’s “Real Property” ...? (cont’d)

Answer: Land & Built Space

“Segmentation” in the Space Market …

• A market is “segmented” if it breaks up into sub-markets, or market segments

• Within each sub-market or segment, the same good may have a different equilibrium price

• The real estate space market is highly segmented
  – Why …?
Demand Side

• Users require *specific types* of space … A lawyer can’t use a warehouse. A trucking firm can’t use a high-rise office building

• Users require *specific locations* (or types of locations) … A lawyer won’t get much business at the intersection of I-70 and I-77. A trucking firm’s trucks would spend all their time stuck in traffic if their warehouse were located in downtown Cincinnati
Supply Side

• Buildings are of *specific physical types* (warehouses ≠ high-rise offices)

• Buildings are in *specific locations* (and they can’t move!)
Two Major Dimensions of Space Market Segmentation

• Geographic location

• Property type
  – Residential (apartment)
  – Office
  – Industrial (warehouse)
  – Retail
  – Other (hotels, health-care, etc. …)
What’s “Real Property” ...?

The Asset (PROPERTY) Market ...

Supply:
Investors Wanting to Sell

Market

Demand:
Investors Wanting to Buy

Property Prices:
• Cap Rates
For Investors

Real Estate Assets = Future Cash Flows

• “Cash is fungible”

• Cash is cash is cash, whether it comes from real estate, stocks, or bonds

• Real estate assets compete against stocks & bonds. The real estate asset market is part of the broader capital market
The Real Estate System
Interaction of the Space Market, Asset Market and Development Industry

Space Market
- Supply (Landlords)
- Demand (Tenants)
- Rents & Occupancy

Development Industry
- If yes
- Construction cost including land
- Is development profitable?

Asset Market
- Cash Flow
- Property market value
- Market required cap rate
- Supply (Owners Selling)
- Demand (Investors Buying)

Local & National Economy
- Forecast Future

www.educorporatebridge.com
Introduction
Office

**Dictionary**
Office premises: *A building, the sole or principal use of which is as an office or for office purposes*

**Layman**
Office building: *A place where people work*

**What is an office building?**
- Space
  - Useable space
  - Non-useable space
- Services
  - HVAC (Heat, Ventilation and Air-Conditioning)
  - Lifts
  - Security
  - Telecoms
Key Drivers
Office

What drives rents and rental growth?

Types of Tenants
- Corporations, small companies, partnerships and start-ups
- These tenants differ in terms of:
  - Credit quality
  - Amount of space required
  - Single-tenant vs. multi-tenant buildings

Key Demand Drivers
- Macroeconomic growth
  - The better the economy is....The more businesses there are/existing businesses grow....Demand for new space increases
  - As more businesses want quality office space, landlords will charge higher and higher rents for that space; especially if that tenant cannot go anywhere else for comparable space

Key Tenant Drivers
- Location, location, location
- Architectural quality
  - Is it pleasing to the eye?
- Floor plates
  - Size, depth
  - Column free
  - Raised floors/suspended ceilings
  - Distance to natural light
- Amenities

Key Supply Drivers
- Government planning
  - You cannot build or redevelop or extend or change the use of a building without government approval
- Obsolescence
  - Structural vs. functional obsolescence
Lease Terms
Office

- Leases vary country to country
  - specially in emerging countries terms might change year to year as markets mature so always make sure you use the latest info
  - in some European countries rental levels may be denominated in a foreign currency. For example, in CEE some rents might not be quoted in euros

Sample Office Lease

Tenure: 3-10 years for Continental Europe; 10-25 years for UK

Rent Increases: 50-100% of inflation index, or rent reviews to market (every 3, 5 or 10 years)

Security Deposit: 1-3 months

Rent Paid: Monthly or quarterly; in advance or in arrears

Free Rent Period: Varies according to country, point in cycle and tenure of lease contract

Tenant Responsibilities: Maintenance costs (cleaning, utilities, real estate tax, security, etc.)

Landlord Responsibilities: Structural and internal repairs (in UK landlord typically only responsible for exterior walls and roof)
Introduction

Industrial

- Not the most glamorous asset class but PE Fund and GSIII have substantial sector experience
  - successfully priced the IPO of ProLogis European Properties (PEPR), owner of a €4.2 Bn pan-European portfolio of distribution facilities. It is the largest multi-country European real estate IPO ever
  - bought and sold a distribution warehouse portfolio, comprising of 9 assets (1 in France, 8 in Germany) totaling c.270,000 m² for GSIII and PE Fund Total portfolio AiC of €146 MM
  - PE Fund used to own 96% of Industrious, the 2nd largest UK industrial Co owning 14 MM sq ft across 181 estates throughout England and Wales with total assets of £559 MM

- Industrial assets are:
  - Manufacturing
  - Assembly
  - Warehouses
  - Distribution centers
  - Self storage facilities

- Rather simple asset class
- Tend to be high yielding
  - Prime industrial property in Europe provides an investment yield of 4.75%-7.5% in core markets

- High cash flow
- Increases in popularity as demand for other assets becomes saturated, though, many of the mainstream real estate investors dont like the highly specialized ‘heavy industry’ assets given no alternative use
# Key Drivers

## Industrial

- The key supply driver for industrial is building permits and available land
  - Europe vs. the US
- Industrial sector is often characterized by owner occupation
  - i.e. big box retailers, manufacturers, post office companies, internet retailers (Amazon)
- Increased transport costs drive the growth of alternative modes – main focus is still on road transport, although other modes like railways or access to ports are likely to become increasingly important in next 5-10 years

## Type of Tenants

- Logistics companies
- Retailers (Tesco, Carrefour, Asda, IKEA)
- Manufacturers
- Internet / E-commerce

## Key Demand Drivers

- Trade
- Consumer consumption

## Key Asset Characteristics

- Free height
- Floor load
- Free support
- Access doors / loading areas
- Movement areas
- Other specifications: HVAC, UPS, fire suppression system, security, etc.

## Key Valuation Considerations

- Distance to transport nodes
  - Harbour
  - Road
  - Airport
  - Rail
- Access to major arteries
- Age
- Supply / competition
Leases
Industrial

- Leases vary from country to country
  - make sure you model lease terms prevalent in the market you are analyzing
  - especially in CEE countries terms may evolve year to year

Sample Industrial Lease

**Term:** 1 - 25 years

**Rent Increases:** Inflation indexed or rent reviews to market (every 3, 5 or 10 years)

**Security Deposit:** 1-3 months

**Rent Paid:** Monthly or quarterly; in advance or in arrears

**Tenant Responsibilities:** Maintenance costs (cleaning, real estate tax, security, etc.)

**Landlord Responsibilities:** Structural and internal repairs (in UK landlord typically only responsible for exterior walls and roof)
Distribution Centers

Industrial

- Industrial and distribution warehouses represent a growth sector in the robust industrial property market
- In particular, large / flexible assets located near airport centres provide a strong growth element to a traditionally stable asset class
- Emerging region of Central and Eastern Europe (“CEE”) driven by the above average economic growth rate is currently driving European supply chains and thus a larger distribution area needs to be covered. To meet the new demand, regional distribution centres are set up throughout the CEE region (i.e. Poland, Czech Republic, Romania). Nevertheless, good quality space is scarce in some locations as demand exceeds supply

Overview

- Strong demand for modern, high quality space in good locations
  - Growing demand for larger warehouses (10,000 - 30,000 m²) as occupiers are increasingly trying to manage their accommodation in a more dynamic and efficient manner by centralizing their requirements
- Owner-occupiers increasingly moving towards leasing their facilities (increased interest of retailers, industrial companies, as well as logistic / distribution companies to outsource parts of their logistic chain)
- Potential upcoming locations as trade patterns develop due to the EU integration
- Fragmented market / acquisition opportunity for programmatic JVs and partnerships as smaller and medium-sized players are put under increasing pressure
- Upside potential in redeveloping existing, often obsolete, logistic property supply

Heathrow Corporate Park

Heathrow Airport

www.educorporatebridge.com
Self Storage

Industrial

- The European self storage industry is in an early growth phase relative to the mature US market
- Storage market in Europe still small and fragmented
- Hotel-like business with average stay time of 13 months for private and 15 months for business
- Returns become more stable as centres mature
  – stay time average for centres which have been open for 5 years is 6 months
- Supplier power is still medium since customer awareness is low in Europe
  – however customers tend to accept price rises once goods are in storage
- Self storage space currently concentrated in few areas
- UK is the largest and most well-established market in Europe

### Overview of Self Storage Industry

#### Key Features

- Strong growth dynamic
  – 45,000 facilities in US for population of 295m
  – 600 facilities in UK for population of 61m
  – The biggest UK player, Big Yellow, only has 42 centres
- Favourable demand drivers
  – Population density
  – High per capita GDP
  – Cost of residential and commercial real estate
  – Increased mobility of the workforce
- Hybrid customer profile
  – Industry primarily driven by retail demand, but includes significant commercial component
  – Improved diversification and economic resilience
- Customers are cyclical and seasonal
  – Easier to grow new store occupancy in the summer than in the winter
- Limited competitive environment in Europe
  – Most competitors focused on UK market

### Key Self Storage Asset Dynamics

- Safe individual storage for private and commercial use
- Typical facility 4,000-6,000 m²
- Variable-size and multi-purpose units
  – 1-50 m²
  – External direct access / internal heated units
- Convenient, security-monitored access
  – 24/7 access
  – Tenant uses own lock & key
- Flexible lease tenure
  – Rent tenures from as little as one week to over a year

www.educorporatebridge.com
Introduction

Retail

- What are the different types of retail assets?

<table>
<thead>
<tr>
<th>Super Regional Centres</th>
<th>Shopping Centres</th>
</tr>
</thead>
<tbody>
<tr>
<td>• &gt;30,000 m²</td>
<td>• 5,000 - 30,000 m²</td>
</tr>
<tr>
<td>• Typically 2-4 anchor tenants</td>
<td>• Typically 1-2 anchor tenants</td>
</tr>
<tr>
<td>• Large, international retailers</td>
<td>• Mainly local or domestic retailers with some international retailers</td>
</tr>
<tr>
<td>• Critical mass; &gt; 200 units</td>
<td>• Smaller catchment area than super regional centres</td>
</tr>
<tr>
<td>• Large catchment area</td>
<td></td>
</tr>
<tr>
<td>- High levels of foot traffic (a.k.a. footfall)</td>
<td></td>
</tr>
<tr>
<td>• Leisure components (e.g. cinema, fun park, arcade)</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>High Street</th>
<th>Retail Warehouses</th>
</tr>
</thead>
<tbody>
<tr>
<td>• 50 - 2,000 m²</td>
<td>• 1,000 - 4,000 m²</td>
</tr>
<tr>
<td>• One tenant</td>
<td>• Located in retail parks, not usually stand-alone</td>
</tr>
<tr>
<td>• Can be any type of retailer</td>
<td>• Typically heavy goods (i.e. appliances, furniture)</td>
</tr>
<tr>
<td>• Major city CBD or town centre</td>
<td>• Some retail warehouses can be much larger, sometimes up to or in excess of 10,000 m²</td>
</tr>
</tbody>
</table>
### Key Drivers

**Retail**

#### Key Asset Drivers

- Catchment area
- Area demographics
  - Age structure
  - Population growth
- Competition
- Population affluence
  - Consumer confidence
  - Income growth

#### Key Demand Drivers

- Defensive asset class which is particularly attractive during economic downturns
- Purchase power
- Inflation (consumer price vs. producer price relationship/hedge)
- Granularity

#### Key Asset Characteristics

- Anchors
- Transportation access
- Tenant mix
- Pedestrian flow
- Parking
- Sales psm
- Effort rate

#### Key Supply Drivers

- Planning controls
  - Retail development permits are near impossible to get in Europe, but vary by country
- Lack of asset trades
  - Prime retail properties do not trade very often
  - Large lot size

---

*What makes a shopping centre a success or failure?*
Leases

Retail

- Leases vary from country to country
- Anchor tenants either receive extremely favourable lease terms (low rent levels with very long tenure) or own their space

Sample Retail Lease

**Tenure:** 3-10 years for Continental Europe; 10-25 years for UK. Longer term for anchors and large units

**Rent Increases:** Rent increase based on inflation and rent reviews to market at end of lease

**Percentage Rent:** Rent calculated as a percentage of gross sales if this amount is above the contracted indexed rent

**Security Deposit:** 1-3 months of lease deposit on bank guarantee

**Rent Paid:** Monthly or quarterly; in advance or in arrears

**Tenant Responsibilities:** Maintenance and operational costs for own unit and common areas (cleaning, real estate tax, security)

**Landlord Responsibilities:** Structural and internal repairs (in UK landlord typically only responsible for exterior walls and roof)
Residential Property in the Real Estate Spectrum

- General Definition: “Residential property includes all property currently in use for residential purposes or all property under construction or conversion that is intended for residential use, which does not imply operating risks”
- Types of residential real estate:
  - Single-family homes
  - Multi-family homes
  - Large apartment complexes
  - Condominiums
## Fundamental Drivers of Residential Property

<table>
<thead>
<tr>
<th>Supply</th>
<th>Demand</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>New Constructions/ Developments</strong></td>
<td><strong>Population Development</strong></td>
</tr>
<tr>
<td>• Increase total available space, therewith direct competition for existing properties</td>
<td>• Drives absolute demand for space</td>
</tr>
<tr>
<td>• New construction influenced by various factors:</td>
<td>• Demand for different types of residential property</td>
</tr>
<tr>
<td>– Availability of land</td>
<td></td>
</tr>
<tr>
<td>– Regulatory limitations</td>
<td></td>
</tr>
<tr>
<td>– Construction costs (vs. acquisition costs)</td>
<td></td>
</tr>
<tr>
<td><strong>Refurbishments/ Redevelopments</strong></td>
<td><strong>Age Structure</strong></td>
</tr>
<tr>
<td>• No impact on total available space, but can create additional supply in specific sub-asset classes (e.g. shift from low to high quality space)</td>
<td>• Different space quality requirements (e.g. elderly people vs. young families)</td>
</tr>
<tr>
<td></td>
<td>• Important driver of household size</td>
</tr>
<tr>
<td></td>
<td><strong>Space Consumption per Person</strong></td>
</tr>
<tr>
<td></td>
<td>• Age structure (older people usually take-up more space)</td>
</tr>
<tr>
<td></td>
<td>• Wealth is positively correlated with space/person</td>
</tr>
<tr>
<td></td>
<td>• Number of marriages vs. divorces influences average household size</td>
</tr>
<tr>
<td></td>
<td><strong>Migration</strong></td>
</tr>
<tr>
<td></td>
<td>• Economic growth areas likely to see positive migration and population growth</td>
</tr>
</tbody>
</table>

www.educorporatebridge.com
Fundamental Drivers of Residential Property (cont’d)

Example: Germany

- Residential property is the major part of the German real estate universe
- Relatively stable population development combined with limited construction activity and a trend to smaller household-sizes result in positive supply/demand characteristics

<table>
<thead>
<tr>
<th>Non-Residential Real Estate</th>
<th>Multi Family Homes</th>
<th>Single or Double Family Homes</th>
</tr>
</thead>
<tbody>
<tr>
<td>42%</td>
<td>27%</td>
<td>31%</td>
</tr>
</tbody>
</table>

Total Value Excluding Land: €5,533 Bn

Source: Federal Statistical Office, Eurostruct, IFO Institute Estimates

Household and Population Development until 2020

<table>
<thead>
<tr>
<th># of Households in ‘000</th>
<th>Population in ‘000</th>
</tr>
</thead>
<tbody>
<tr>
<td>40,000</td>
<td>86,000</td>
</tr>
<tr>
<td>38,750</td>
<td>83,750</td>
</tr>
<tr>
<td>37,500</td>
<td>82,500</td>
</tr>
<tr>
<td>36,250</td>
<td>81,250</td>
</tr>
<tr>
<td>35,000</td>
<td>80,000</td>
</tr>
</tbody>
</table>


Households (LHS) Population (RHS)

Development of Households by Size 2000-2020

<table>
<thead>
<tr>
<th>Change in %</th>
</tr>
</thead>
<tbody>
<tr>
<td>15%</td>
</tr>
<tr>
<td>10%</td>
</tr>
<tr>
<td>5%</td>
</tr>
<tr>
<td>0%</td>
</tr>
<tr>
<td>(5%)</td>
</tr>
<tr>
<td>(10%)</td>
</tr>
<tr>
<td>(15%)</td>
</tr>
</tbody>
</table>

Source: Federal Office for Construction and Regional Development (Bundesamt für Bauwesen und Raumordnung), Raumordnungsprognose 2020, edition 2004

www.educorporatebridge.com
# Residential Real Estate Strategies

<table>
<thead>
<tr>
<th><strong>Acquisition</strong></th>
<th><strong>Management</strong></th>
<th><strong>Exit</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Portfolio/ Operating Company Acquisition</strong></td>
<td><strong>Rental Growth</strong></td>
<td><strong>Privatisation</strong></td>
</tr>
<tr>
<td>• Offers efficient market entry for new investors</td>
<td>• Potential growth of existing rents limited in most countries</td>
<td>• Disposal of individual units to tenants, new owner-occupiers or private investors</td>
</tr>
<tr>
<td>• Portfolio diversification and potential to create value with efficient management</td>
<td>• Fluctuation enables rent step-up to market level</td>
<td>• Higher pricing due to different valuation approach – tends to be based on affordability, i.e. comparability of mortgage payments to future rental payments</td>
</tr>
<tr>
<td>• Usually competitive processes resulting in higher prices</td>
<td><strong>Margin Improvement</strong></td>
<td>• High management intensity and long business plans</td>
</tr>
<tr>
<td><strong>Accumulation Strategy</strong></td>
<td><strong>Lease-up</strong></td>
<td><strong>Trade Sale/ IPO</strong></td>
</tr>
<tr>
<td>• Primarily smaller investors with a local expertise</td>
<td>• Reduction of existing vacancy through capex investments and better management of leasing-activity</td>
<td>• Disposal of large (sub-) portfolio/ company</td>
</tr>
<tr>
<td>• Higher acquisition costs</td>
<td></td>
<td>• Allows for 100% exit</td>
</tr>
<tr>
<td>• Potentially favourable pricing through off-market opportunities</td>
<td></td>
<td>• Attractive valuation through yield pick-up and higher rental income</td>
</tr>
<tr>
<td></td>
<td><strong>Exit</strong></td>
<td>• New investors to the market willing to pay strategic premiums</td>
</tr>
</tbody>
</table>
What is Property Development?

• A **COMPLEX ACTIVITY** using scarce resources
• A **HIGH RISK ACTIVITY** often involving large sums of money tied up in a production process, providing a product which is relatively indivisible
• The performance **INFLUENCED BY NATIONAL AND LOCAL ECONOMIES**
• A **LENGTHY PROCESS** where assumptions made at the outset may change dramatically by completion
• **ATTENTION TO DETAIL AND STRONG JUDGEMENT** required for success
• **UNIQUE END PRODUCT**, either in terms of its physical characteristics and/or its location
• Process is under **CONSTANT PUBLIC ATTENTION**
When do you develop?

“Release of latent value”
- Development occurs when the developer can release value from a site or building by injecting new money into the project

<table>
<thead>
<tr>
<th>New / Alternative Land Use Value</th>
<th>Existing Use Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>GREAHER</td>
<td>THAN</td>
</tr>
<tr>
<td>Land Value for New Development</td>
<td>Value of Existing Property</td>
</tr>
</tbody>
</table>

Examples
- Conversion of an commercial office building into residential
- Conversion of land currently occupied by industrial properties to a regional shopping mall
- Redevelopment of a 5,000 sqm office building into a 50,000 sqm office building

Development Drivers
- Alterations to traditional demographics
- Changing requirements by users of buildings
- Rising standard of living
- Evolving growth of new technology

Potential Constraints to development – even when economically viable
- Planning laws
- Legislative controls
- Vacant possession of the property is not available

www.educorporatebridge.com
Who are Property Developers

**Investor Developer:** Those who develop as a way of gaining access to good quality property stock:

– Construct buildings to their specifications
– Access to good quality stock
– Higher return (overheated market?)
– Undertaking property investment through development

**Merchant Developer:** Those who develop for purpose of trading (selling) at the completion of construction.

– Seeking to make trading profits from the development process

They have different timescales, different motivations, potentially different performance requirements.
Development Process – Example

- Determine planning status
- Develop project brief
- Determine financial viability inc. cost of construction, net rental, development period, investment yield
- Appoint design team
- Prepare full financial appraisal
- Apply for planning and all other necessary consents
- Tender building work and appoint contractor
- Obtain funding
- Commence development
- Secure lease up
- Complete development
- HOLD/SELL
Typical Development Risks

• Planning
• Interested / Consultative parties
• Groundworks / Archaeology
• Cost over-runs
• Cost Inflation
• Contractor / Sub-contractor risk
• Materials defects
• Design Shortcomings
• Rights of Light
• Interest Rate Variations
• Weather
• Letting Delay
• Market Cycle – Capital Markets / Leasing Market
• Competition
Land value & profit

- Profit is what is left after all costs are incurred and development is sold.

- At the outset, a Developer will determine how much profit the development is likely to make and the whether this profit is reasonable or sufficient:
  - Typically greater than 13%
  - Acceptable profit will be based upon the type and risk profile of the development:
    - 13-20% for residential development in central London
    - 50+% for office development in Emerging Europe
- If the developer is acquiring the site, then it will undertaking a residual calculation to work out site value and how much

The Residual Method

- All inputs are estimates & success of project depends upon the realism and final outcome of these assumptions.

| Expected Sale Price of Completed Development | A          |
| Total Cost of Development                | B          |
| Required Developer’s Profit               | C          |
| Residual for Purchasing Land              | D = A-B-C  |

www.educorporatebridge.com
# Profit Calculation

## REVENUE

<table>
<thead>
<tr>
<th>Description</th>
<th>Formula</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross Rent Per Annum</td>
<td>Number of SqFt x Rent Per Square Foot</td>
</tr>
<tr>
<td>Gross Price Capitalized Value</td>
<td>Gross Rent Per Annum ÷ 'Market Yield'</td>
</tr>
</tbody>
</table>

Less:

<table>
<thead>
<tr>
<th>Description</th>
<th>Formula</th>
</tr>
</thead>
<tbody>
<tr>
<td>Free Rent Adjustments</td>
<td>Any Free Rent</td>
</tr>
<tr>
<td>Purchasers costs</td>
<td>Legal, Due Diligence, Transfer taxes</td>
</tr>
</tbody>
</table>

**NET SALES PROCEEDS**: A

**Net Development Value**

## COSTS

<table>
<thead>
<tr>
<th>Description</th>
<th>Details</th>
</tr>
</thead>
<tbody>
<tr>
<td>Land Costs</td>
<td>Land acquisition</td>
</tr>
<tr>
<td>Soft Costs</td>
<td>Planning permission</td>
</tr>
<tr>
<td></td>
<td>Professional fees</td>
</tr>
<tr>
<td></td>
<td>Marketing</td>
</tr>
<tr>
<td></td>
<td>Disposal</td>
</tr>
<tr>
<td>Hard Costs</td>
<td>Financing</td>
</tr>
<tr>
<td></td>
<td>Construction and Demolition</td>
</tr>
</tbody>
</table>

**TOTAL**: B

**Total Costs to Develop the Property**

**DEVELOPER’S PROFIT**: C (A-D-B)

- **Profit (Yield) on Cost**
  - Usually > 13%
  - Developer’s Profit ÷ Total Development Cost

www.educorporatebridge.com
Allocation of Development Costs

Example

- Site
- Building
- Fees
- Interest
- Profit
# Hard Costs

<table>
<thead>
<tr>
<th>Largest portion of development costs</th>
<th>Timing</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Labour</strong></td>
<td><strong>See chart below for Graph</strong></td>
</tr>
<tr>
<td>• contractors</td>
<td>• Early on, costs are low are relate primarily to:</td>
</tr>
<tr>
<td>• construction workers</td>
<td>– Demolition</td>
</tr>
<tr>
<td><strong>Materials</strong></td>
<td>– Design and Engineering fees</td>
</tr>
<tr>
<td>• steel</td>
<td>• As time progresses</td>
</tr>
<tr>
<td>• concrete / aggregate</td>
<td>– more labour and capital intensive work</td>
</tr>
<tr>
<td>• cladding</td>
<td>takes place, costs begin to increase</td>
</tr>
<tr>
<td></td>
<td>– and reach maximum level at completion</td>
</tr>
</tbody>
</table>

## Total Costs over time

![Graph showing total costs over time with stages: Completion of demolition and site preparation, Building Construction, Final Works.](www.educorporatebridge.com)
Soft Costs

• Soft costs include:
  – Planning fees
  – Consultant Fees
  – Marketing Costs
  – Rights of Light
  – Legal fees
  – Financing Costs

• The largest soft cost associated with development is Finance Costs
  – a large share of development costs will be paid with borrowed funds
  – Interest in a construction loan accrues as there is no income to pay interest
    – Effectively the lender loans the money to the developer to pay the interest due
  – This is added to the principal balance with interest charged on the accrued interest
  – This is called Capitalization of Interest
  – Capitalized Interest usually represents approximately 10% of total development costs

www.educorporatebridge.com
# Development Financing

## Loan Structures

<table>
<thead>
<tr>
<th>Three General Structures</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Property to be sold on completion</td>
<td>Short term financing structures</td>
</tr>
<tr>
<td></td>
<td>• bank loans</td>
</tr>
<tr>
<td>Property to be held on completion</td>
<td>Longer Term financing structure</td>
</tr>
<tr>
<td></td>
<td>• longer term commitment including mini-permanent features</td>
</tr>
<tr>
<td></td>
<td>• generally more expensive due to longer term however provides certainty of funds for longer duration</td>
</tr>
<tr>
<td>Undecided - flexible structure required</td>
<td>Hybrid - short term financing with option to extend beyond construction period</td>
</tr>
<tr>
<td></td>
<td>• provides flexibility to prepare for sale or refinance</td>
</tr>
</tbody>
</table>

## Principal suppliers

- Insurance companies – Life funds
- Pension funds
- Unit Trusts
- Building Societies
- Banks
- Trusts and Charities – Crown, Church, Great Estates
- Public Property Companies
- Government
- Other Companies (e.g. Building contractors)
- Private Investors+

## Different Funding Methods

- Bank loans – Bridge, term, revolving credit
- Forward Sale – unconditional contract to sell on completion
- Mortgage or other fixed interest finance
- Sale (or lease) and leaseback – between developer & investor
- Government grants, loans, subsidies
- Project Management – developer as PM

[www.educorporatebridge.com](http://www.educorporatebridge.com)
Typical Construction Loan Terms

- Construction lenders follow the cardinal rule of never advancing loan funds in excess of the economic value of the property that serves as security.
- Loan terms will vary based upon:
  - Quality of project
  - Quality of sponsor (owner / developer)
  - Amount of bank debt / leverage

### Basic Terms

<table>
<thead>
<tr>
<th>Term</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Commitment Amount</td>
<td>Calculated as a % of total development costs</td>
</tr>
<tr>
<td></td>
<td>- Lender typically requires developer to contribute equity ranging between 20-50%</td>
</tr>
<tr>
<td></td>
<td>- Equity can be in the form of cash - new as well as cash already spent - or land that is already owned</td>
</tr>
<tr>
<td>Term</td>
<td>Typically 6 months beyond expected project completion date</td>
</tr>
<tr>
<td></td>
<td>- Can be up to one year</td>
</tr>
<tr>
<td>Interest Rate</td>
<td>Typically Floating Rate</td>
</tr>
<tr>
<td></td>
<td>- LIBOR / EURIBOR plus a Credit spread</td>
</tr>
<tr>
<td></td>
<td>- Credit Spread will be based upon amount of equity contributed by owner as well as overall quality of Sponsorship</td>
</tr>
<tr>
<td></td>
<td>- eg PE Fund would pay a much lower credit spread than an individual</td>
</tr>
<tr>
<td>Project Monitoring / Approval</td>
<td>Lender’s will hire a third party engineer to monitor the process and approve monthly construction draws</td>
</tr>
<tr>
<td>Recourse</td>
<td>This is when something or someone other than the value of the project itself is available to repay the loan</td>
</tr>
<tr>
<td></td>
<td>- Lenders preference is for the owner to provide a bank guarantee for the full amount of the loan</td>
</tr>
<tr>
<td></td>
<td>- Owners prefer the loan to be recourse only to the property</td>
</tr>
<tr>
<td></td>
<td>- Typically result is somewhere in the middle where an owner guarantees completion of the project and possibly interest amounts.</td>
</tr>
</tbody>
</table>

www.educorporatebridge.com
Planning

Legislation
UK has a plan led system – sets out what can be built and where
- **Regional Spatial Strategies**: Each Regional Planning Body sets out for example, how many homes need to meet future needs in region or whether region needs a new shopping centre
- **Local Development Framework**: each Local Authority prepares to set out how planning will be managed in the area. Includes sub-documents – Core Strategy, Site specified allocations of land, action area plans

Consents
- Full Planning permission – usually granted for 3 years and typically includes a number of conditions to be complied with (e.g. landscaping, materials to be used, means of access)
- Outline planning permission – establishes that a development is acceptable in principle. Valid for 3 years but extends up to 5 years if reserved matters are applied for
- Reserved Matters (these aspects not dealt with in the outline permission)
- Renewal of planning permission
- Removal or Alteration of a planning condition

• Upon Full application, local authority will consult with Statutory Consultees and Public. Authority must issue a decision in 8 weeks or 13 weeks to major applications. Extensions of time can be agreed.
• Secretary of State can ‘call in’ applications which have wider effects beyond locality or are of significance. Then subject to a Public Inquiry
• Will be more stringent planning requirements if property is Listed or in a Conservative Area.

www.educorporatebridge.com
Introduction

Lodging

- Hotels and motels have different revenue and expense structures than traditional commercial real estate
- Revenues in the lodging industry are calculated in terms of the *Average Daily Rate (ADR)*
  - The ADR is calculated by taking the gross room revenues and dividing by the number of rooms sold
- Occupancy is very important in the lodging industry. Companies are able to increase revenues substantially by filling their rooms
- RevPAR (ADR multiplied by occupancy) is an important statistic in the lodging industry, as it is a measure of yield or how much revenue a hotel is generating
- Expenses are tracked on a per room basis
- Items such as food and beverage, telephone and incidental services are key components of lodging industry cash flow
- Hotel real estate investments offer an effective GDP tracker and an attractive inflation hedge since room rates are extremely short term
- Certainty of future occupancy and the implicit volatility in cashflows due to the nature of the hotel industry (i.e., short-term rentals) makes hotel real estate more difficult to finance than other types of assets
# Key Drivers

## Lodging

<table>
<thead>
<tr>
<th>Type of Guest</th>
<th>Demand Drivers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Business</td>
<td>Macro level</td>
</tr>
<tr>
<td>Leisure</td>
<td>–GDP growth</td>
</tr>
<tr>
<td>Conference</td>
<td>–Events (e.g., Olympics, World Cup)</td>
</tr>
<tr>
<td>Airline</td>
<td>Asset level</td>
</tr>
<tr>
<td>Tour</td>
<td>–Location</td>
</tr>
<tr>
<td>“Last Minute”</td>
<td>–Reputation</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Building Characteristics</th>
<th>Supply Drivers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Location</td>
<td>Availability of top locations</td>
</tr>
<tr>
<td>Architectural</td>
<td>Office conversions</td>
</tr>
<tr>
<td>–Attractive</td>
<td>Budget opportunities</td>
</tr>
<tr>
<td>–Functionality of service</td>
<td></td>
</tr>
<tr>
<td>Amenities</td>
<td></td>
</tr>
</tbody>
</table>
## Difference Between “Real Estate” & Hotels

**What is a Hotel?**
- Short term residential
  - Varying quality
  - Varying specification
  - Varying price
- Significance of operator
  - Client facing
  - Yield management
  - Reputation
- Branded vs. unbranded
  - Owned/leased
  - Management contract
  - Franchise

<table>
<thead>
<tr>
<th>Real Estate</th>
<th>Hotels</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rent</td>
<td>ADR</td>
</tr>
<tr>
<td>Sq m</td>
<td># Rooms</td>
</tr>
<tr>
<td>Vacancy</td>
<td>Occupancy</td>
</tr>
<tr>
<td>Total Rental Income</td>
<td>Room Revenues</td>
</tr>
<tr>
<td>Ancillary Income</td>
<td>F&amp;B Revenues</td>
</tr>
<tr>
<td>Total Income</td>
<td>Total Revenues</td>
</tr>
<tr>
<td>Operating Expenses</td>
<td>Departmental Expenses</td>
</tr>
<tr>
<td>EBITDA</td>
<td>EBITDA</td>
</tr>
<tr>
<td>Less: capex (net of TIs)</td>
<td>Less: FF&amp;E Reserve</td>
</tr>
<tr>
<td>NOI</td>
<td>NOI</td>
</tr>
</tbody>
</table>

www.educorporatebridge.com
## Income Drivers

### Lodging

<table>
<thead>
<tr>
<th>Revenue Sources</th>
<th>Key Factors</th>
</tr>
</thead>
<tbody>
<tr>
<td>Room revenue</td>
<td>Occupancy, average room rate (ADR, RevPAR)</td>
</tr>
<tr>
<td>Food &amp; beverage (F &amp; B)</td>
<td>Type of hotel, occupancy</td>
</tr>
<tr>
<td>Banqueting/conferences</td>
<td>Type of hotel</td>
</tr>
<tr>
<td>Telephones</td>
<td>Type of hotel, occupancy</td>
</tr>
<tr>
<td>Other (e.g., pay-per-view movies)</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Costs and Overheads</th>
<th>Key Measures</th>
</tr>
</thead>
<tbody>
<tr>
<td>Variable</td>
<td></td>
</tr>
<tr>
<td>Salaries &amp; wages</td>
<td>Staff per room ratio</td>
</tr>
<tr>
<td>Cost of goods sold</td>
<td>Revenues</td>
</tr>
<tr>
<td>Maintenance</td>
<td>Turnover</td>
</tr>
<tr>
<td>Fixed</td>
<td></td>
</tr>
<tr>
<td>Administration</td>
<td>Size of group</td>
</tr>
<tr>
<td>Sales &amp; marketing</td>
<td>Size of group, quality of hotel</td>
</tr>
<tr>
<td>Energy &amp; utilities</td>
<td>Number of rooms</td>
</tr>
<tr>
<td>Rent, taxes &amp; insurance</td>
<td>Number of rooms, location</td>
</tr>
</tbody>
</table>
Introduction

- The total Care market in the UK is estimated to be worth c.£12 Bn
- Within the market there are a number of distinct submarkets, each providing differing services depending on the type of customers/patient and dependency level
Overview of the UK Care Market

- There are 475,000 beds in the UK Care market, split between
  - Private Sector (72%)
  - Voluntary Organisations (14%)
  - Public Sector (14%)
- The Public Sector has been gradually withdrawing from the sector over the last c.20 years
- Market remains highly fragmented despite significant corporate activity over last 5 years. Top 10 providers account for c.20% of the market
  - Largest providers are “for-profit” operators
  - With the exception of Southern Cross and Care UK, all the leading operators are privately owned

### Leading UK Care Home Providers

<table>
<thead>
<tr>
<th>Provider</th>
<th>No. Homes</th>
<th>Market Share</th>
</tr>
</thead>
<tbody>
<tr>
<td>Southern Cross</td>
<td>578</td>
<td>5.8%</td>
</tr>
<tr>
<td>BUPA</td>
<td>299</td>
<td>4.5%</td>
</tr>
<tr>
<td>Four Seasons</td>
<td>336</td>
<td>3.5%</td>
</tr>
<tr>
<td>Barchester</td>
<td>164</td>
<td>2.2%</td>
</tr>
<tr>
<td>Craegmoor Care UK</td>
<td>53</td>
<td>1.0%</td>
</tr>
<tr>
<td>Care UK</td>
<td>43</td>
<td>0.6%</td>
</tr>
<tr>
<td>Bondcare</td>
<td>48</td>
<td>0.5%</td>
</tr>
<tr>
<td>Exelcare</td>
<td>37</td>
<td>0.4%</td>
</tr>
<tr>
<td>Life Style Care</td>
<td>22</td>
<td>0.4%</td>
</tr>
<tr>
<td>Paragon</td>
<td>19</td>
<td>0.3%</td>
</tr>
<tr>
<td>Sunrise</td>
<td>20</td>
<td></td>
</tr>
</tbody>
</table>

**Source**: Company Data, LCS (2004)

**Notes**
2. Based on 5 existing assets and Initial and Future Portfolio acquired by PE Fund
Favourable Market Characteristics

- The elderly care market in the UK is expected to experience significant growth over the coming years, driven primarily by
  - Positive demographic trends
  - Limited supply of new beds
  - Increasing demands for higher quality facilities
- Self-pay facilities likely to be increasingly attractive due to
  - Demand for high quality facilities
  - Low government assistance threshold of just £21,000
  - Increased wealth in the 65+ age group due to growth in property values
- Lack of supply of premium priced luxury care homes appealing to today’s increasingly affluent elderly population

- Diminishing supply with the exit of smaller operators leading to stronger bargaining power with local authorities translating into healthy fee increases
  - c.100,000 beds have left the market since 1996
  - Current fee rates are not prompting widespread new build
  - Non-purpose built homes continue to exit the market
- NHS no longer operates its own geriatric care units and is increasingly looking to externalise long term care provision to private providers
- The introduction of National Minimum Standards maintains significant barriers to entry
- Fee rates expected to continue to rise above cost inflation as a result of a supply shortfall
  - Average fees have been increasing at 4-8% since 1999
- Introduction of National Minimum Standards in 2000 affecting primarily physical environment and staffing requirements, has forced many small independent operators out of business whilst increasing consumer expectation as to the quality of accommodation required
- Elderly people are increasingly demanding a higher quality of residential care and are now more likely to have accumulated sufficient wealth to pay for it
- Self-pay client referrals expected to continue to grow as a result of increased affluence
  - Means testing regime likely to become more robust and alternative payment products expected to become available
  - Current threshold of net wealth in excess of £21,000 including property value
- Premium-end of market is under supplied and there remains an unfulfilled demand for more high quality care homes
  - Only 11% of rooms in the UK have weekly rates of £700+ per week
  - Large properties typical of the large scale operators do not lend themselves to exclusive luxury care homes where premium pricing can be achieved
  - Top-end care homes usually only have 30-40 rooms

Positive Demographics Driving Demand

Limited Supply

Rising Fee Rates

Higher Standards

Increased Portion of Self-pay

Limited Competition
Real Estate Fundamentals …is forecast to continue to drive the demand for beds…

**Key Points**

- People with chronic illness may live longer in a high state of dependency (extension of morbidity)
- Projections suggest that an ageing population will drive the number of people living in a residential setting
- As the population ages the demand for care home per capita will increase
- It is possible that people will spend a longer period of time at the end of life requiring nursing care
- Occupancy rates have remained firmly above the 90% level over the last five years as supply has contracted
- Industry commentator Laing & Buisson expects occupancy rates across the industry to remain stable at the current average of 91%
- Some market commentators are expecting demand for residential care (both elderly and physically disabled people) to reach 590,000 beds per year in 2020 from the current level of 433,000, an increase of 2.1% per annum

**Occupancy Levels in Private Nursing Homes**

![Occupancy Levels in Private Nursing Homes](chart)

**Projected No. of Elderly and Physically Disabled People Living in Residential Settings**

![Projected No. of Elderly and Physically Disabled People Living in Residential Settings](chart)

- There was demand for 433,000 beds in residential care facilities in 2005
  - Demand declined over last 4 years due to WW1 effect
- Demand is forecast to increase significantly over the coming years due to an aging population
  - c.10,000 extra beds needed annually over next 15 years
  - Requirement for:
    - 505,000 beds by 2010
    - 555,000 beds by 2015
    - 590,000 beds by 2020

Source: Laing & Buisson, “Care of Elderly People – UK Market Survey 2005”, Colliers CRE
…despite reduced bed capacity…

- Since 1996 c.100,000 beds have left the market, or c.20% of market capacity
  - Currently c.475,000 beds in the market
- A change in the commissioning environment, which gave local authorities responsibility for funding, led to a move away from residential care into personal home care
- Smaller homes became uncompetitive or uneconomical to operate and closed due to rising costs and increased regulations
- Conversion of double bedrooms into single rooms has also taken out available beds

**Supply of Beds (1)**

<table>
<thead>
<tr>
<th>Year</th>
<th>Supply (000's)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1990</td>
<td>590</td>
</tr>
<tr>
<td>1992</td>
<td>570</td>
</tr>
<tr>
<td>1994</td>
<td>550</td>
</tr>
<tr>
<td>1996</td>
<td>530</td>
</tr>
<tr>
<td>1998</td>
<td>510</td>
</tr>
<tr>
<td>2000</td>
<td>490</td>
</tr>
<tr>
<td>2002</td>
<td>470</td>
</tr>
<tr>
<td>2004</td>
<td>450</td>
</tr>
</tbody>
</table>

**YOY Net Beds Entering the Market**

<table>
<thead>
<tr>
<th>Year</th>
<th>Change in # of available beds</th>
</tr>
</thead>
<tbody>
<tr>
<td>1991</td>
<td>20 (4%)</td>
</tr>
<tr>
<td>1993</td>
<td>15 (3%)</td>
</tr>
<tr>
<td>1995</td>
<td>10 (2%)</td>
</tr>
<tr>
<td>1997</td>
<td>5 (1%)</td>
</tr>
<tr>
<td>1999</td>
<td>0 (0%)</td>
</tr>
<tr>
<td>2001</td>
<td>5 (1%)</td>
</tr>
<tr>
<td>2003</td>
<td>10 (2%)</td>
</tr>
<tr>
<td>2005</td>
<td>15 (3%)</td>
</tr>
<tr>
<td>2007</td>
<td>20 (4%)</td>
</tr>
</tbody>
</table>

Source: Laing & Buisson data, Cendisic Analysis
…leading to higher fees

- Substantial above inflation increases in fees have occurred for the last 4 years
  - To meet the escalating cost of providing services as a result of new legislation impacting the sector
  - To stem the flow of closures and encourage redevelopment of new modern care home facilities
- The average weekly fee across the UK in 2006 was £575
  - However, fees are significantly higher in London and the South East due to greater demand/supply imbalances as well as higher land values and labour costs

### Year on Year Change in Average Weekly Fees

<table>
<thead>
<tr>
<th>Year</th>
<th>Nursing care weighted average</th>
<th>Residential care weighted average</th>
<th>RPI</th>
</tr>
</thead>
<tbody>
<tr>
<td>1995/96</td>
<td>1%</td>
<td>2%</td>
<td>0%</td>
</tr>
<tr>
<td>1996/97</td>
<td>3%</td>
<td>4%</td>
<td>1%</td>
</tr>
<tr>
<td>1997/98</td>
<td>5%</td>
<td>6%</td>
<td>2%</td>
</tr>
<tr>
<td>1998/99</td>
<td>7%</td>
<td>8%</td>
<td>3%</td>
</tr>
<tr>
<td>1999/00</td>
<td>9%</td>
<td>10%</td>
<td>4%</td>
</tr>
<tr>
<td>2000/01</td>
<td>12%</td>
<td>13%</td>
<td>5%</td>
</tr>
<tr>
<td>2001/02</td>
<td>16%</td>
<td>17%</td>
<td>6%</td>
</tr>
<tr>
<td>2002/03</td>
<td>20%</td>
<td>21%</td>
<td>7%</td>
</tr>
<tr>
<td>2003/04</td>
<td>24%</td>
<td>25%</td>
<td>8%</td>
</tr>
<tr>
<td>2004/05</td>
<td>28%</td>
<td>29%</td>
<td>9%</td>
</tr>
</tbody>
</table>

As local authorities became better educated about the sector and the supply/demand imbalance shifted back in favour of the suppliers, fee rate increases began to rise

During the mid 1990s, fee rate increases were below cost of care – exacerbated by shift of payment structure from central to local government

### Average Weekly Fee by Region (£) 2006

<table>
<thead>
<tr>
<th>Region</th>
<th>Fee (£)</th>
</tr>
</thead>
<tbody>
<tr>
<td>UK</td>
<td>515</td>
</tr>
<tr>
<td>South East</td>
<td>615</td>
</tr>
<tr>
<td>London</td>
<td>675</td>
</tr>
</tbody>
</table>

Project Dawn Case Study
PE Fund acquisition of 17 assisted living facilities in the UK from Sunrise Senior Living

- PE Fund has formed a 90/10 JV with Sunrise to acquire 15 (with an option over an additional 2) assisted living facilities in the UK for an initial consideration of £544 MM
- Sunrise will operate the communities under a 30 year management agreement
- Sunrise is a “best-in-class” operator and is focussed at the premium-end of the care home market that is modelled on the luxury residential hotel industry

Transaction Summary
PE Fund formed a 90/10 JV with Sunrise Senior Living Inc. (“Sunrise”) to acquire 15 (with an option over an additional 2) assisted living facilities in the UK from Sunrise for an initial consideration £544 MM (1)

- The communities will provide assisted living and dementia care to c.1,600 residents. Average age of residents are c.85 years old with annual fees of c.£7.2 MM per annum
- Initial Portfolio: Immediate acquisition of 6 properties, which are currently operational but not yet stabilised for £221 MM, implying a 6.35% stabilised NOI yield. Sunrise will provide income support until stabilisation on these assets
- Pipeline: The remaining properties are currently under construction or newly opened. The JV will acquire these assets between Dec 07 and Mar 12, 12 months after they open
  - The Pipeline properties are acquired at a floor price of £323 MM (2)
  - There will be a further top-up payment for each property payable at the earlier of stabilisation or 36 months after opening. The top-up payment will be based on the performance of each community at that time
- Sunrise will continue to operate the properties under a 30 year management agreement for fees and promote
- As part of this transaction, PE Fund and Sunrise have agreed to work together to explore ways of expanding Sunrise’s presence into new markets for premium assisted living facilities
- Sunrise is a US based best-in-class premium assisted living operator offering high quality accommodation and superior services in more than 440 communities across the US, Canada, UK and Germany

Notes
1. Based on acquisition of 17 assets (includes option of 2 additional assets)
2. Based on acquisition of 11 pipeline assets (includes option of 2 additional assets)

www.educorporatebridge.com
Four Seasons Healthcare Financing
December 2006

- Four Seasons Healthcare Limited (FSH) is the 3rd largest provider of care homes and specialist services in the UK
  - 19,600 beds in 415 facilities
  - Over 20,000 employees
  - 2006E sales of £431 MM and 2006E EBITDA of £101 MM
- FSH was acquired by Qatar Investment Authority for £1,532 MM in August 2006
  - Funded with a £1,240 MM Credit Suisse (CS) Bridge Facility
- GSS III acquired two tranches of the CS loan for £96.67 MM
  - B2 Tranche (£58.67 MM)
  - Facility C (£38.00 MM)
- This transaction has been the first mezzanine investment for Morgan Stanley Real Estate Special Situations Fund in Europe

Transaction Overview

- Global Special Situations Fund III (GSS III) has acquired the B2 Tranche and Facility C (Capex Facility) of the Bridge Facility
  - B2 Tranche: Amount: £58.67 MM; Maturity: 2 years; Coupon: L+900 bps cash pay; Fees: 3.15% up-front, 0.5% on undrawn amount; Control rights within the capital structure
  - Facility C: Amount: £38 MM; Maturity: 2 years; Coupon: L+1,100 bps cash pay; Fees: 1.0% on drawdown, 0.5% on undrawn amount; Control rights within the capital structure
- Investment rationale:
  - FSH is heavily asset-based with 415 freehold and leased properties (property value of £1,314 MM)
  - No return to equity during the term of the loan
  - Our position is senior to £283 MM of mezzanine debt and equity
- MS value FSH at £1,688 MM
  - OpCo EBITDA of £38 MM
  - Conservative EV/EBITDA multiple of 8.5x
  - PropCo valuation (£1,314 MM) based on DTZ valuation

Overview of Transaction Structure

<table>
<thead>
<tr>
<th>Facility</th>
<th>Term Loan A</th>
<th>Inv Grade 1</th>
<th>Inv Grade 2</th>
<th>Inv Grade 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>B 1 Tranche</td>
<td>£600 MM</td>
<td>£140 MM</td>
<td>£200 MM</td>
<td>£141.33 MM</td>
</tr>
<tr>
<td>B 2 Tranche</td>
<td>£58.67 MM</td>
<td>£283 MM</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Facility C</td>
<td>£283 MM</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Term Loan A</th>
<th>Inv Grade 1</th>
<th>Inv Grade 2</th>
<th>Inv Grade 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Amount</td>
<td>LTC(%)</td>
<td>ICR(%)</td>
<td>Amount</td>
</tr>
<tr>
<td>£600 MM</td>
<td>39.4%</td>
<td>3.01x</td>
<td>£140 MM</td>
</tr>
<tr>
<td>£141.33 MM</td>
<td>71.0%</td>
<td>1.53x</td>
<td>£100 MM</td>
</tr>
<tr>
<td>£58.67 MM</td>
<td>81.4%</td>
<td>1.21x</td>
<td>£283 MM</td>
</tr>
</tbody>
</table>

Company and Market Overview

- UK nursing home market
  - Positive demographics driving demand while supply continues to contract
  - As a result occupancy rates have remained above the 90% level with rising fee levels
- FSH Company Overview
  - 3rd largest UK operator with (19,600 beds and more than 20,000 employees)
  - Portfolio well diversified with 402 care homes and 13 specialized centres across the UK
  - Current occupancy of 87.8% below market but expected to rise with new management in place

www.educorporatebridge.com