



UCEM Institutional Research Repository

Title	Discounted Cash Flows – Challenges to making it mainstream in real estate
Author(s)	David Hourihan, David Hourihan, David Hourihan and David Hourihan
ORCID	https://orcid.org/0000-0003-1405-3130 ; https://orcid.org/0000-0003-1405-3130 ; https://orcid.org/0000-0003-1405-3130 ; https://orcid.org/0000-0003-1405-3130
Type	Conference or Workshop Item
Publication title	
Publisher	
ISSN/ ISBN	
Publication Date	10 April 2024
Version	
DOI	
Repository link	https://ube.repository.guildhe.ac.uk/id/eprint/199/
Link to publication	

Copyright:

UCEM aims to make research outputs available to a broader audience via its digital [Repository](#). Where copyright permits, full text material held in the Repository is made freely available. URLs from GuildHE Research Repositories may be freely distributed and linked to. Please refer to each manuscript for any further copyright restrictions.

Reuse:

Copies of full items can be used for personal research or study, educational, or not-for-profit purposes without prior permission or charge provided that the authors, title and full bibliographic details are credited, a hyperlink and/or URL is given for the original metadata page, and the content is not changed in any way.



Key findings of the latest RICS DCF guidance Paper



Key findings of the latest RICS DCF guidance Paper

Charles Golding



Summary

- Senior Specialist, Valuation and Investment Advisory, RICS Professional Practice and Development.
- Member of the Royal Institution of Chartered Surveyors.
- Regular speaker on Valuation topics for RICS.
- Author of articles and insight for RICS Property Journal and Journal of Building Survey, Appraisal & Valuation. Author of RICS insight paper - valuation of flexible workspace.
- Acted as surveyor advocate and expert witness in the Valuation Tribunal and Upper Tribunal – Lands Chamber.
- **Previous roles include:**
 - Technical and Policy Adviser, VOA.
 - Surveyor – Mixed Use Development and Investment, GL Hearn.
- Graduated with BSc Real Estate from Nottingham Trent University in 2007.

David Hourihan



Summary

- Programme Leader for the MSc Real Estate at UCEM.
- 17 years of commercial real estate experience across the UK and Ireland.
- Specialist in investment, office agency, retail asset management and valuation.
- Previous positions with international firms including JLL and Colliers International.
- Acquisition and asset management instructions for clients including Société Générale, Metzler Bank, Mobil Oil, Scottish Widows, Aviva and British Land.
- Fellow of the Society of Chartered Surveyors Ireland and Royal Institution of Chartered Surveyors.
- RICS Governing Council geographical seat holder for the UK and Ireland.
- Visiting Professor, Ecole Supérieure des Professions Immobilières (Paris Campus).
- Graduated with an MSc in Property Investment from UCEM in 2008.
- APC Chairman / Assessor for SCSi and RICS.
- RICS Inspire Ambassador.

Discounted Cash Flows – Challenges to making it mainstream in real estate

1 Fear of change

Valuers in the UK market have traditionally used the 'Hardcore' (or 'Layer') method or the 'Term & Reversion' method to carry out Red Book valuations or non-Red Book appraisals.

2 Inconsistency of use

Models used can vary in complexity eg annual in arrears versus quarterly in advance.

3 Lack of transparency on risk

The traditional methods apply risk implicit adjustments, which are problematic for non-real estate investors who are used to more transparent adjustments for risk. Risk in context of property can be defined as either specific or systematic. The drive to net zero carbon is highlighting specific risk in the form of obsolescence in buildings while systematic risk is currently very evident in the form of volatility in local markets and global economies. Geo-political risk also impacts on the valuation as a form of systematic risk. The DCF model can more explicitly address these various forms of risk.

4 Future Rental Growth not explicitly factored in

A DCF model of appraisal or valuation differs from the traditional methods of valuation as it adopts the market's assessment of future growth in an explicit way. This future income stream is then discounted back at a discount rate (Hurdle Rate) to establish market Value. The traditional methods only use today's rental values and discounts the income at a rate based on analysis of comparable transactions.

5 Analytic tools are too basic

'Stress testing' techniques have also been heuristic in nature. Scenarios used but other forms of risk analysis (sensitivity, probability) should be more widely adopted.

6 Confusion between IV and MV

Typically used for IV rather than MV in many markets and the two bases can get confused.

7 Lack of supporting data

Market data for variables such as estimated rental growth (ERV), rental growth and yield growth data can be difficult to source.

Key findings of latest RICS DCF guidance Paper

Background

- IVS 105, 50.2. states that the DCF method discounts the forecasted cash flow back to the valuation date, resulting in a present value of the asset.
- IVS 400, 60.4. states that for real property interests, various forms of discounted cash flow models may be used. **These models vary in detail** but share the basic characteristic that the cash flow for a defined future period is adjusted to a present value using a discount rate. The sum of the present-day values for the individual periods represents an estimate of the capital value. The discount rate in a discounted cash flow model will be based on the time cost of money and the risks and rewards of the income stream in question.
- Dec 2021 - The **Independent Review of Real Estate Investment Valuations** (led by Peter Pereira Gray), was produced by RICS in the public interest to future-proof practices in the valuation of real estate assets for investment purposes. This review called for a much more analytical profession and one that uses DCF **as the principal approach to valuation**.
- April 2022 - the RICS established a dedicated sub-committee called **Valuation Review Implementation Committee (VRIC)**. Its purpose was/is to implement all recommendations from the Valuation Review and **to ensure market confidence and trust in the use of the investment method of property valuation**.
- November 2023 – RICS publishes a global practice information paper entitled '**Discounted cash flow Valuations**' and the report entitled '**Discounted cash flow valuations – Basis for conclusion**'.

Useful Link

<https://www.rics.org/profession-standards/rics-standards-and-guidance/sector-standards/valuation-standards/discounted-cash-flow-valuation>



Key findings of latest RICS DCF guidance Paper

Key Findings

- Traditional use of DCF to calculate investment worth.
- Use of DCF in calculation of Market Value.
- Relationship between traditional methods and DCF method.
- Transition to use of DCF with software.
- Geographic variations in usage.

Frequently Asked Questions (Source: RICS)

- Is RICS mandating the use of discounted cash flow in valuation?
- I've always used valuation methods other than DCF, can I still do so?
- How will RICS' proposals around DCF impact small and medium firms?
- What DCF training is available?

To support the new standard for valuing investment property using DCF RICS has developed a DCF 'Transition Hub' to upskill Chartered Surveyors globally with a particular focus on territories where DCF is currently underutilised.



Upcoming Property Webinars:

- **Using DCF for Red Book valuations – A discussion with a Professional Valuer**

17th April 2024 | 11:00am BST

- **How to construct a Hurdle rate for DCF Appraisals**

24th April 2024 | 11:00am BST



info@bayfieldtraining.com



www.bayfieldtraining.com/webinars



Bayfield Training



Get more out of our Free Webinars with our Hub of Property Webinars Subscription

- 24/7 access to the property webinar recordings
- Download the webinars slides
- Access to webinars summaries
- Further relevant reports
- Previous years webinars' insights



£20 + VAT per annum