The Opera House site - what's it worth?

tA thought it would be an interesting exercise to bring together two of the hottest topics to hit the architectural scene over the past few weeks; the project for the Opera House Site and the CPD course on valuations being organised by the Kamra tal-Periti. We asked Denis Camilleri, the course co-ordinator, to have a go at analyzing the financial value of the prime site in our capital city, and to share with us some of his ideas...with apologies to the historicists among us.

SECURITIZING THE OPERA HOUSE SITE DEVELOPMENT - AN INVESTMENT MEDIUM FOR THE SMALL MALTESE INVESTOR

The present financial situation shows a Government that is cash strapped, whilst the Maltese way of life demonstrates a different scenario. Government's financial deficit presently exceeds one billion Maltese lira, whilst Maltese households have savings exceeding two billion Maltese lira in local banks alone. Ignoring foreign savings, this implies that the country, with a surplus of more than one billion Maltese lira, is far from being bankrupt.

This development appraisal demonstrates that Government can unleash the site capital potential, to undertake a capital project without providing a direct injection of funds, thus relieving the burden from the taxpayer. Not only is less reliance on tax achieved, but the Maltese public is given the opportunity to invest in a prime property development, something probably undreamt of, as property requires a huge capital outlay, out of reach for most of the small investors. Securitization overcomes the liquidity problem by its property investments into an easily tradeable paper security. In this manner the small property investor can easily assemble a reasonably diversified property portfolio with reduced market risks.

OPERA HOUSE & FREEDOM SQUARE BRIEF

Reference has been made to the Valletta Master Plan Development Permit Application Report of 19th April 2004 (PA01873/99), for the proposed uses and areas, linked to Richard England's plan for various projects envisaged in the area around the entrance to Valletta.

Following the announcement made by Minister Jesmond Mugliett, the use for the Opera House site is being indicated as a new parliament building.

Seven floors above street level together with two underlying floors are being reserved for office use, providing a total of 15,000m², instead of an 800 seat theatre. This necessitates the provision of 320 car spaces, which are to be provided by three underlying basement floors occupying an area of 8,400m².

The Freedom Square development is to provide for 14,000m² of retail space, 10,500m² of which are to be provided on the first three levels of underground development, with the remaining 3,500m² housed above ground. This development requires provision for approximately 400 car spaces, which is to be provided by three additional basement levels occupying an area of 9,000m². However, the DPA Report states that development is to be limited to six excavated levels, with parking provision not exceeding 400 spaces.

The provision of 14,000m² of office space, together with the same area of retail space, must be compared with the existing 17,118m² of retail space in Valletta. This proposed development would seriously jeopardize the sustainability of the existing shopping district. Thus, it is to be noted that the business potential of Valletta has to grow in stature. Valletta has to be considered as the capital of the Mediterranean, including the housing of Euro-Mediterranean institutions of international stature, to provide the stimulus for the necessary growth in the retail market.

CONSRUCTION COST (EXCLUSIVE OF VAT)

Opera House Site			**Lm**
Excavation/Site Works	50,000m³ @ Lm7/m³	=	350,000
Office Construction Costs	15,000m² @ Lm(80 + 150 + 70)/m²*	=	4,500,000
Car-Park Construction Costs	8,400m² @ Lm(85 + 35 + 40)/m²*	=	1,344,000
Extra for elaborate façade works	4,000m² @ Lm75/m²	=	300,000
Contingency sum allowance			1,506,000
			Lm 8,000,000
Freedom Square Development			
Excavation/Site Works	65,000m³ @ Lm7/m³	=	455,000
Office Construction Costs	14,000m² @ Lm(80 + 75 + 45)/m²*	=	2,800,000
Car-Park Construction Costs	9,000m² @ Lm(85 + 35 + 40)/m²*	=	1,440,000
Landscaping square works	3,000m² @ Lm85/m²	=	255,000
Contingency sum allowance			1,050,000
			Lm 6,000,000

TOTAL PROPOSED DEVELOPMENT COSTS (exclusive of VAT): **Lm 14,000,000**

(*Note: the bracketed construction rates represent shell construction, building finishes and building services.)

ESTIMATED RENTAL VALUES FOR PROPOSED DEVELOPMENT

Opera House Site			**Lm**
Lettable office space	85% of (15,000m² @ Lm120/m²)	=	1,530,000 pa
Car spaces	320 in No @ Lm275/car space	=	88,000 pa
Freedom Square Development			
Retail outlets	65% of (14,000m² @ Lm75/m²)	=	682,500 pa
Car park net earnings (see below)			100,000 pa
Total gross proposed development earnings			**Lm 2,400,500 pa**

Total net development earnings after deducting
7.5% for annual management & maintenance costs — Lm 2,220,463 pa

Presently office rentals in Malta vary from a low of Lm25/m² up to a high of Lm100/m². Considering this to be the most prime site for office markets, a rental market of Lm120/m² is considered to be sustainable for this location, with the right marketing overseas. The average European office rents presently stand at Lm250/m², typical of Frankfurt and Athens, with higher rentals registered in London at Lm700/m².

Shopping malls in Malta rent out from as low as Lm30/m² up to Lm175/m²; again the importance of marketing is stressed to obtain rentals in the region of Lm75/m². The European average, on the other hand, is much higher at Lm1,250/m², considering the higher turnover targets achieved.

GROSS INCOME FOR 400 PUBLIC CAR PARK

			Lm
Customers paying on annual basis	100 car spaces @ Lm250pa	=	25,000
Customers paying on a daily basis	75 spaces @ Lm2.50/day * 300 days	=	56,250
Customers paying on 1/2 daily basis	125 spaces @ Lm1.50/day * 300 days	=	56,250
Customers paying on an hourly basis	400 spaces @ Lm0.60/hr * 300 days	=	72,500
			Lm 210,000

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OPERATIONAL EXPENSE FOR PUBLIC CAR PARK (400 SPACES)

	Lm
Management & profits/overhead fee	31,500
Staff 7 in no. @ Lm 7000 pa	49,000
Maintenance	10,000
Water & Electricity	14,500
Depreciation on machinery	5,000
	Lm110,000

Estimated Net Annual Income for car-park (400 spaces) **Lm100,000**

RESIDUAL METHOD OF VALUATION TO OBTAIN LAND POTENTIAL VALUE (EXTRACT ONLY)

	Lm
Market Value of Development on Completion	38,827,429
Total Development Costs (inc. construction, fees, VAT, interest and profit)	-28,546,502
Residual value for and value considered in 3.5 yrs time	10,280,927

Vacant Land Value today considering PV for 3.5 yrs @ 7% **Lm 8,113,141**

Above residual method is most sensitive to the lettings agreed upon, as if these are less than 12.5% of the above estimated lettings, then developer's profit falls down to zero. Again if construction costs are 27.5% higher than those estimated above then developer's profit is again reduced to zero.

SETTING UP OF A SHARE INVESTMENT SECURITIZATION COMPANY FOR THE OPERA HOUSE PROPOSED DEVELOPMENT

Government is to provide the site, together with the project management necessary for the proposed development. As the project would not be income-generating during its development period, estimated between 2.5 to 3.5 years, Government is to further guarantee that investors would obtain a minimum dividend return in the region of 3.5 to 4%.

From the above residual valuation, the development potential when fully let is estimated at Lm38,827,429.

Government's share is fixed by the land value and the project management fee given by Lm10,280,927 + Lm1,941,371 = Lm12,222,298.

The investor's share is given by

Lm38,827,429 – Lm12,222,298 = Lm26,605,131.

Thus Government will earn 31.5 cents for every Lm1 of income received, with the investors receiving the remaining Lm0.685.

As development costs, from the residual valuation, total Lm28,546,502, this amount would be raised via a share issue. Considering that the Government has been successful over the past years in issuing various bond issues, presently with a dividend in the region of 5%, Government could commit itself to pay out a minimum dividend in the region of Lm1,070,000 per annum, secured for a period of 2.5 years. As this dividend payment will be out of shareholders' funds, the success of this share issue should not be in doubt.

From this development, Government's dividend amount totals 0.315 times the net income at Lm2,220,463 namely Lm699,445. This amount is to be fully paid up prior to the shareholders receiving further funds out of dividend allotment.

Once the development is fully let out the shareholders dividend is estimated at

Lm2,220,463 – Lm699,445 = Lm1,521,018

This dividend amounts to Lm1,521,018/Lm26,605,131 = 5.717% return on the original investment of the investor. This return is considered to be realisable within a 2.5 to 3.5 year period. Leases would then be agreed upon, such that the rental income increases in the region of 10% to 15%, every 3 years or so. Rents, like wages, track inflation quite closely. Rent is an overhead which businesses afford to increase at the rate of their wage bill. This means that after this 3 year period the dividend return is expected to increase to 6.29%, with 6.92% expected after 6 years and so on after every 3 year period. This increasing dividend return over the years plus a greater value expected on redemption of shares due to property capital appreciation, should appeal to investors.

The Government on the other hand is obtaining a market return for the land, whilst Government's project management services are also compensated for. Moreover, it is to be noted that as the investors have not purchased the land, the value of the land in 3.5 years time is taken for share apportionment, not the discounted present site value.

If and when net income exceeds the expected amount, it is apportioned in the ratio of 0.315 being Government's share and the ratio of 0.685 being the shareholders' share.

CONCLUSIONS

The securitization of the Opera House Site should be the first for Malta, but from above findings, probably not the last. For example, securitization or private public partnership in the housing sector would secure more residential units to be constructed for the affordable housing market. This would then place a lower housing strain on the buyer being transmitted into a lower demand for wage increases, thus assisting Malta's competitiveness.

Could property securitization be the solution to Malta's faltering economy, which has shown a minimal growth rate, with even negative growth occurring during one quarter, since Malta's accession to the European Union? In the first 7 years following Independence in 1964, Malta had experienced the following growth rates:

2.5% pa in the gainfully occupied population

11% pa in foreign trade exports

10% pa in the gross national product

The present fiscal deficit reduction is being carried out at the expense of the taxpayer and capital projects are being kept on hold. This is not the solution for the expected economic growth, which is causing more hardship to the local population with a greater proportion falling below the poverty line, as a reduction in the quality of life for Maltese households occurs.

Securitization of property would give the opportunity to the Maltese investor to participate in improving economic growth, with capital projects being undertaken. This is possible as Government takes advantage of the open market land value. This has already occurred in Singapore with a high population density and no natural resources. Malta could then move to first world status and Valletta truly vie as the capital of the Mediterranean.

Perit Denis H. Camilleri

Proposed opera house site 'worth millions' in rental value

Fiona Galea Debono

The cost of the proposed opera house site and Freedom Square developments has been estimated at Lm14 million, according to an article in the winter issue of the Chamber of Architects' official journal, The Architect.

The government recently suggested that the opera house site be developed into a new Parliament, provoking criticism from all fronts.

In his analysis of the financial value of the capital city's prime site, architect Denis Camilleri estimates that the construction of the opera house area would cost Lm8 million, including excavation works, offices, the car park, the façade and a contingency sum. The Freedom Square development would cost Lm6 million.

The journal felt it would be an interesting exercise to tackle the hottest topics to hit the architectural scene recently. In its article The Opera House Site – What's It Worth?, it goes on to list the estimated rental values for the proposed development.

The total gross earnings would amount to Lm2.4 million *per annum*, reduced to Lm2.2 after deducting 7.5 per cent for annual management and maintenance costs.

The opera house site's lettable office spaces would mean an income of Lm1.5 million a year and its car spaces (320 at Lm275 per car space) would bring in Lm88,000 *per annum*.

The Freedom Square development retail outlets would mean a revenue of Lm682,500 *per annum*, while net annual income from its 400-space car park would amount to Lm100,000, according to annual, daily, half-daily and hourly costs, after deducting operational expenses.

The Opera House site: "Securitisation of property would give the Maltese investor the opportunity to participate in improving economic growth, with capital projects being undertaken," according to architect Denis Camilleri.

Chris Sant Fournier

Mr Camilleri's calculations are based on the fact that office rentals vary in Malta between a low of Lm25 per square metre to Lm100 per square metre.

According to the government's brief, the site would include seven floors above street level and two underlying ones – 15,000 square metres – for office use, while the Freedom Square development would provide for 14,000 square metres of retail space.

According to Mr Camilleri "the proposed development would seriously jeopardise the sustainability of the existing shopping district, meaning that the business potential of Valletta has to grow in stature.

"Valletta has to be considered as the capital of the Mediterranean, housing Euro-Mediterranean institutions of international stature to provide the stimulus for the necessary growth in the retail market," he said.

Given that Maltese households are far from bankrupt, despite the government's financial debt in excess of Lm1 billion, "the site capital potential could be unleashed to undertake a capital project, without providing a direct injection of funds, thus relieving the burden from the taxpayer".

Not only would less reliance on tax be achieved but also the public would have the opportunity to invest in a prime property development.

The idea would be to set up a share investment securitisation company for the opera house proposed development, with the government providing the site, together with the project management necessary.

The securitisation of the opera house site would be a first for Malta but probably not the last, Mr Camilleri concludes.

"Securitisation of property would give the Maltese investor the opportunity to participate in improving economic growth, with capital projects being undertaken.

"It is possible as the government takes advantage of the open market land value, as has already occurred in Singapore, with its high population density and no natural resources.

"Malta could then move to first world status and Valletta truly vie as the capital of the Mediterranean," Mr Camilleri says.