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## Introduction

## Situation and objective

Vacant properties are a normal part of a functioning real-estate market. The liquidity of the market, in the form of disposable property, is a prerequisite for the interplay of supply and demand and the resulting formation of prices. Structural change in national economies may, however, lead to a surplus of specific types of property for which there is no immediate or an insufficient immediate demand. Such vacancies pose the question of the alternative use or repurposing of real estate.

In the transitional phase of such transformations, temporary usage schemes are often employed. The following will demonstrate how vacant properties and properties under temporary use are handled in the context of property valuation and how various forms of temporary use impact property value.

## Types of property

Structural causes for commercial property remaining unoccupied vary but are usually linked to the type of property. A distinction between two basic types of property can be made:

- **Industrial real estate** and industrial sites: former manufacturing sites of the secondary economic sector for which no users can be found due to structural economic change and which consequently require repurposing.
- **Office space**: older buildings with a substantial share of vacant units where tenants are difficult to find because of the competitive situation and the properties' decline in value due to their outdatedness.

The following is an examination of the role vacancy and temporary use play in valuating these types of property in the context of their transformation process and of how these types may affect the properties' recoverability and their owners' strategic choices.

## Types of temporary use

There are various ways to handle and manage the temporary use of real estate. The worst-case scenario involves squatters taking possession of the property against the owners' will, resulting in the need to have the premises cleared by police. The best-case scenario is temporary use under a contract, with the temporary user vacating the premises at the contractually agreed time.

Three basic usage strategies can be distinguished for the transitional phase:

- **No temporary use**: this strategy may be intentionally chosen or unintentionally occur and may be termed conservative vacancy management.
- Temporary use under a **loan-for-use contract**: the property or parts thereof are surrendered as a loan for use in accordance with art. 305 of the Swiss Code of Obligations.
- Temporary use under a **lease**: the property or parts thereof are rented out with any right to extension under art. 272a, section d, of the Swiss Code of Obligations precluded.

Depending on scope and complexity, mixed types are possible, of course, for example if only some of the spaces are rented out or if the contract type needs to be adjusted for specific target groups.

## Case differentiation

A motivation for temporary use usually exists as a result of the transformation process taking up an extended period of time. The more complex and time-consuming the planning process for the intended repurposing is, the better the case for temporary use under a contract may be.

A simple repositioning of office spaces usually takes place within a fixed period in which there is little opportunity for temporary use between construction work and the acquisition of new tenants. If a larger site is being repurposed, however, the resulting extended planning timeline may almost necessitate temporary use.

Due to a variety of situational aspects arising from the type of property and timeline, it is advisable to differentiate between cases. That way, basic cost-benefit relations can be highlighted from a qualitative viewpoint.

		Timeline / type of process	
		1–2 years	3–5 years or longer
		Repositioning, no repurposing	Repurposing involving special planning measures
Type of property	<b>Industrial sites</b> Several buildings with various typologies	<b>Relatively rare:</b> E.g. immediate re-use as an industrial park, temporary use <b>not</b> advisable	<b>Typical case:</b> Classic case of site repurposing, timeline allows for the property to be put to <b>temporary use</b>
	<b>Office space</b> An individual building	<b>Typical case:</b> The property has declined in value due to outdatedness, is to be repositioned without being repurposed, temporary use <b>not</b> advisable	<b>Relatively rare:</b> The office space is repurposed due to major deficits compared to the competition, e.g. conversion to housing

## Discussion

### Valuation method

Usually, the DCF (discounted cashflow) method is used to value commercial properties. In DCF valuation, a property's current market value is determined by adding up all net earnings expected for the future discounted for the present day.

For vacant properties, a re-renting period is determined during which the property will remain unoccupied while the owners take steps to find new tenants for the space. The longer the period, the greater the loss in value. At a share of the value of 20 %, the first 5 years have relatively great impact on the current market value if DFC valuation is used. This means that, if there is no income within the first 5 years starting from the date the valuation is based on, the property's present-day value is roughly 20 % lower than it would be if the property were fully occupied. As a result, even for an investor with long-term plans, the earnings side of the matter is relatively important during the first few years.

### Vacancy costs

Properties generate income, but there are costs as well. If a property is vacant, there will be no income but the costs remain. This does not just include the owners' overhead, which may not be passed on to tenants anyway according to tenancy law, but also any costs usually borne by the tenant, for example heating. Also, additional costs may arise from providing site security for the vacant property as well as measures necessary to keep it from falling into disrepair.

As a consequence, it is not only the loss of income that squeezes down on property value with a negative cashflow but also costs. If we return to our example with a 5-year timeline, the devaluation may be around 1–2 % greater, depending on the vacancy costs. These additional vacancy costs can be avoided if a temporary use for the property can be professionally implemented.

### Loan-for-use contract

A loan-for-use contract in accordance with art. 305 of the Swiss Code of Obligations makes it possible to cover utilities during temporary use of a property and avoid vacancy costs pushing property value down. This is a type of contract under which the borrower, that is, the temporary user of the spaces, has no right to extension. This makes the owner's situation more secure as they may terminate the borrower's temporary use at any time or at a time specified in the contract, enabling them to proceed with their intended repurposing process, for example converting or replacing buildings, without delay.

The borrower will reimburse the owner for utilities according to how much they consume and handle minor maintenance tasks. However, the owner may accrue no earnings as this would make the contract a lease. Still, this solution may be in the owner's economic interest as it means they will not only save vacancy costs in terms of utilities but also any costs for providing site security. Also, the property will be protected from falling into disrepair and damage caused by trespassers and squatters. The temporary use of the property may even elevate its public image and increase its value going forward.

### Lease for temporary use

Entering into a lease is the next level of organized temporary use. The lease should take the form of a temporary-use contract in accordance with art. 272a, sec. d, of the Swiss Code of Obligations. This enables the owner to preclude any right to extension of the lease on the part of the temporary user, provided a legally binding building permit has been issued. As this type of contract is exclusively regulated by tenancy law, however, some residual risk of delays cannot be fully ruled out. This constitutes a certain legal disadvantage for the owner compared to a loan-for-use contract.

Purely from the standpoint of economic optics, the temporary-use contract is, however, the most interesting option for the owner as it not only ensures a cost-covering operation of the property during the planning process but also yields a small return. This is especially welcome in cases of large-area developments, where developers and investors are faced with pre-investments required for the purchase of land. Interest payments arising from this may be at least partially covered by the temporary use of the property, particularly if planning takes longer than anticipated or an investor decides, re-evaluating the market situation or changing their priorities, to postpone planning work for the repurposing project.

### Conclusion and cost-benefit analysis

The effect of temporary use on property value is not clear-cut. Depending on the property and planning timeline, different evaluations are possible. Such an evaluation may well land on the side of a positive impact, considering utility coverage and income generation. In some cases, an investor's evaluation might go the other way, particularly in the case of office spaces with a short planning timeline, should the owner give higher priority to the availability of the spaces.

Advantages and disadvantages of various types of temporary use, including a qualitative evaluation of its impact on property value, are summarized in the following table:

		Advantages	Disadvantages	Impact on property value or impact on purchase price
Type of temporary use	<b>No temporary use</b> Conservative vacancy management	<ul style="list-style-type: none"> <li>- No contractual obligations</li> <li>- Unlimited availability of spaces</li> </ul>	<ul style="list-style-type: none"> <li>- No income</li> <li>- Overhead to be borne by the owner</li> <li>- Risk of the property falling into disrepair</li> <li>- Paying for site security may be necessary</li> </ul>	<ul style="list-style-type: none"> <li>- Theoretically negative impact due to costs for security and utilities during vacancy</li> <li>- Depending on the buyer, the spaces' unlimited availability may affect their value favorably</li> </ul>
	<b>Loan-for-use contract</b> (Acc. to art. 305 of the Swiss Code of Obligations)	<ul style="list-style-type: none"> <li>- Flexibility in terms of time: temporary use may be terminated at any time or on an agreed-upon date</li> <li>- The user has no right to extension</li> <li>- Utilities covered</li> </ul>	<ul style="list-style-type: none"> <li>- No income (but coverage of utilities and minor maintenance work)</li> </ul>	<ul style="list-style-type: none"> <li>- Slightly positive impact on value due to utility savings</li> </ul>
	<b>Lease</b> (Temporary use acc. to art. 272a, sec. d, of the Swiss Code of Obligations)	<ul style="list-style-type: none"> <li>- Income: spaces can be rented out at market price</li> <li>- Temporary use can be terminated if there is a legally binding building permit</li> </ul>	<ul style="list-style-type: none"> <li>- Residual risk because tenancy law applies (despite art. 272a, sec. d, of the Swiss Code of Obligations)</li> </ul>	<ul style="list-style-type: none"> <li>- Positive impact on value</li> <li>- The financial support provided by temporary use is beneficial to large-area developers in particular</li> </ul>

## Sources

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