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Valuing long-term leases: The option to redevelop

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Abstract

Long-term leases on property are popular in many jurisdictions, both with private vendors and with local governments who want to retain future control over land use. A puzzling issue for vendors and purchasers has been how to value these leased properties relative to fee-simple properties. Simple present-value models suggest that there should be little difference between the price of fee-simple land and the price of long-term leases. Transaction prices in Canada on 80-year to 100-year residential leases, however, are 20 percent to 40 percent less than comparable fee-simple properties. We outline a financial model for valuing leased properties. The value of the option to upgrade or redevelop is considered. We show that the large part of the discount of leased properties from fee-simple properties can be explained by this option to redevelop.



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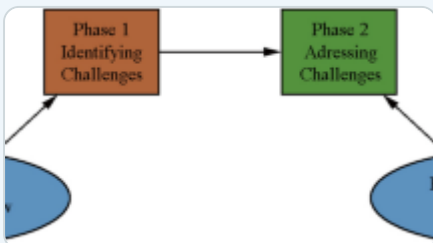
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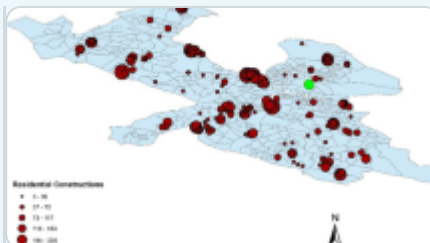
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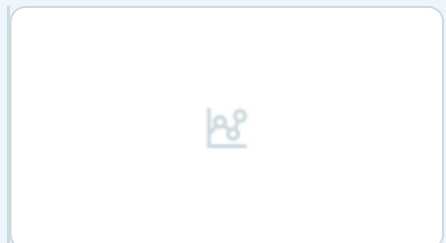
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