Principles of Commercial Real Estate Finance

Module 1:
Risks And Opportunities;
What Is Real Estate?;
Global Real Estate

New York by Gehry, NYC

Associated Readings

Linneman Text:
Ch. 1: Risks And Opportunities
Ch. 2: What Is Real Estate?
Ch. 2 Supplement A: International Real Estate Investing

Model For Success Blog:
How To Be A Great Real Estate Finance Student

REFM Model for Success™

Professor Linneman’s Risks and Opportunities

- What is generally the primary goal?*
  - To acquire or create a source of cash flow, and to reap value from that cash flow
- What could possibly go wrong?
  - It depends…what’s your time horizon?

* Excluding not-for-profit projects

Where Do The Primary Risks Lie?

- Acquisition of an existing income-producing asset
  - Operating Costs
  - Lease Terminations/Vacancy
  - Tenants go bankrupt (remember the .com's and Lehman?)
  - Market turns against you and you need to hold longer than you wanted

Where Do The Primary Risks Lie?

- Development of an income-producing asset or units for sale (e.g., housing subdivision or condominiums)
  - Passage of Time! The world is today is not the world tomorrow
    - Construction costs
    - Market turns against you
      - Pricing
      - Absorption (Leasing/Sales)
      - Tenant base disappears
  - Construction execution
  - Land Purchase Price and Closing Timing

What Are The Primary Ways To Realize Value?

- Let Your Tenants Amortize the Property's Debt
- Streamline Operations to Lower Operating Expenses
- Ride the Rising Rent Tide
- Renovate and Reposition the Property
- Redevelop the Property to a New Use
- Hold Until Asset Valuations Increase
  - "Compression" of Capitalization Rates

Types of Real Estate

Residential
Detached single family homes
Townhomes

Commercial

Office
- Central Business District (generally highrise and midrise)
  - Class A (e.g., The GM Building in NYC)
  - Class B (increasingly lesser in quality and location)
  - Class C
- Suburban (generally midrise)
  - Class A
  - Class B
  - Class C
- Medical Office

Multifamily (apartments, condominiums and cooperatives)
- Small properties
- Suburban garden apartments
- Urban midrise
- Urban highrise

Hotels and resorts
- Limited service
- Full service (e.g., The Ritz Carlton or Marriott)
- Extended stay

Industrial
- Heavy industrial (manufacturing) facilities
- Light assembly
- Storage and distribution facilities
- Research and development facilities

Retail
- Shopping centers
  - Super regional centers (e.g., Mall of America)
  - Regional center
  - Community center
  - Neighborhood center
  - Convenience center
  - Specialty center
- Big box (freestanding) store (e.g., Home Depot)
- Strip commercial

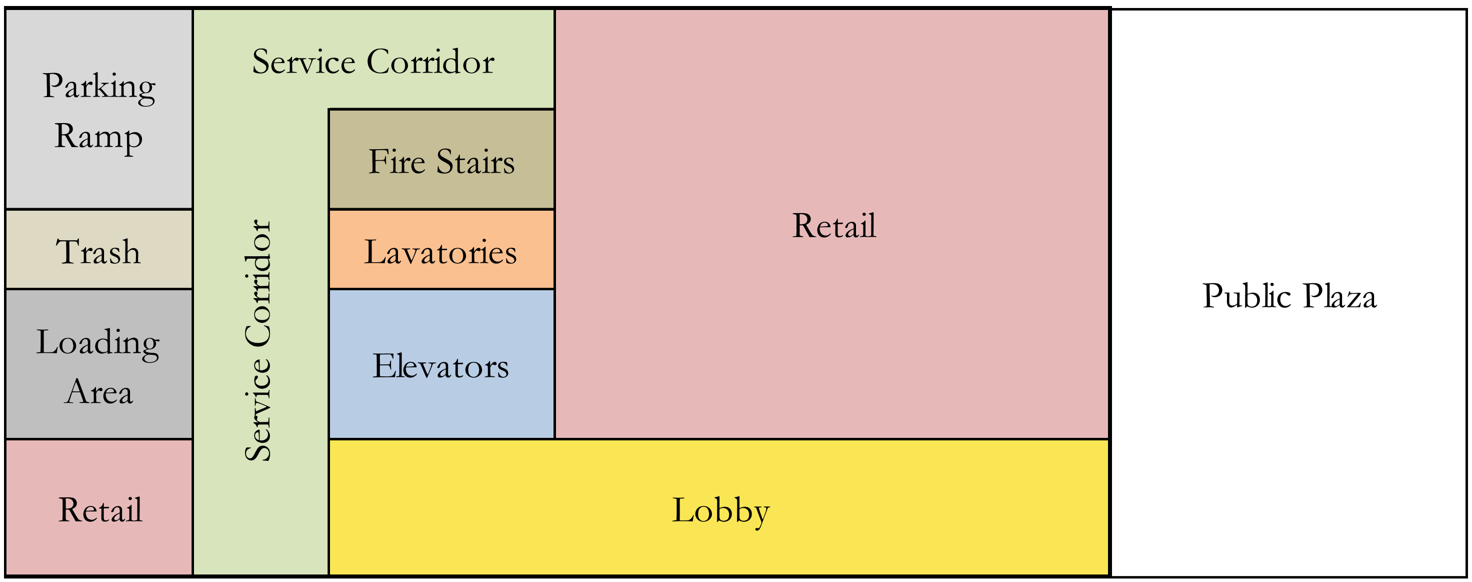
Other
- Golf courses
- Assisted living
- Student housing
- Land
- Health Care
- Institutions

Gross vs. Net Measurement

Building Footprint (building area at grade)

Gross vs. Net Measurement

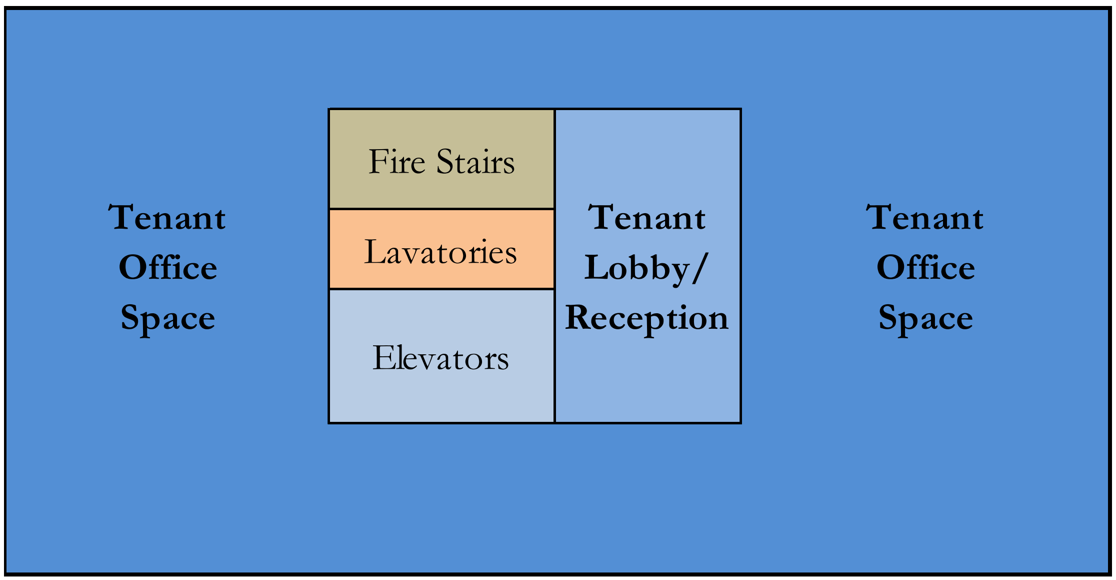
Ground Floor Plan - Rentable SF Other Than Retail: 0 SF!



- What is not shown here that further reduces Rentable SF?

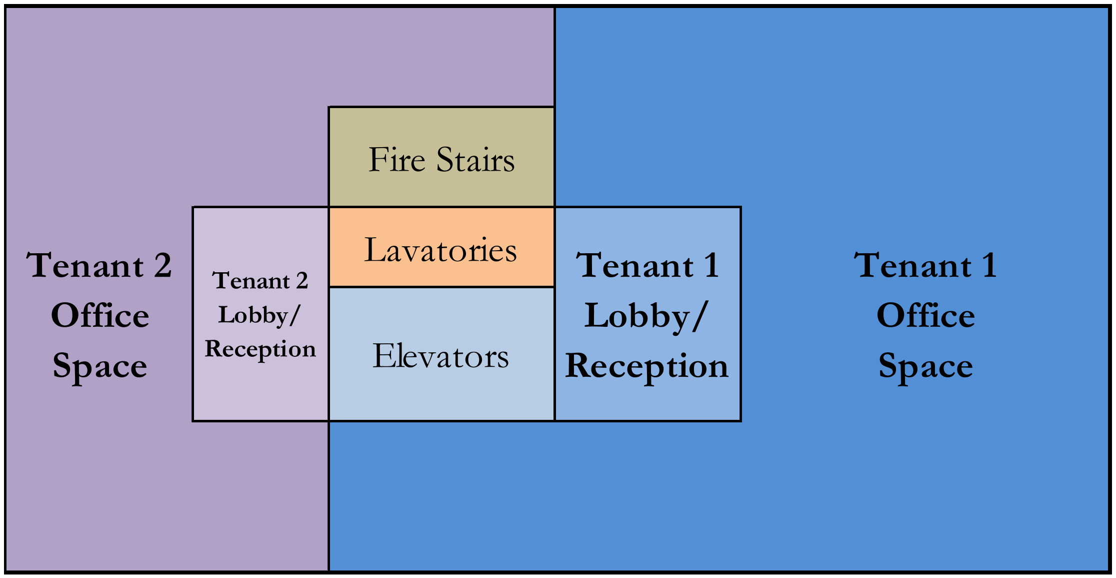
Gross vs. Net Measurement

Typical Single Tenant Plan - Rentable SF at 90% Efficiency



Gross vs. Net Measurement

Typical Multi-Tenant Plan - Rentable SF at 90% Efficiency



Gross vs. Net Measurement

Floor Type	Floor Count	Gross SF	Efficiency	Rentable SF	Overall Efficiency
Ground Floor	1	20,000 GSF	45%	9,000 RSF	
Single Tenant Floors	3	60,000 GSF	90%	54,000 RSF	
Multi-Tenant Floors	1	20,000 GSF	90%	18,000 RSF	
	5	**100,000 GSF**		**81,000 RSF**	**81%**

Floor Area Ratio (FAR)

- Better to think of it as **Floor Area to Lot <u>Size</u> Ratio**

- Dictated by the zoning of the property; limits the amount of **above-grade Gross SF** that can be consumed by the building

- Calculated by multiplying the "FAR Ratio" by the Lot Size
  - **8.0 FAR** * 10,000 SF = 80,000 "FAR" (Gross SF) allowed above-grade

Physical vs. Economic Occupancy

- Physically occupied vs. receiving rent
  - Expansion space – not occupied but rent being paid
  - Vacated space – not occupied but rent being paid
  - “Free rent” – occupied but no rent being paid
  - Bankruptcy – occupied but no rent being paid

International Real Estate Investing

- Up to 60% of investment-quality real estate lies outside of the U.S.

- The world's tenant base is globalizing

- However:
  - Markets are not as liquid as the U.S. market
  - Information is scarce and unreliable
  - The rules can change rapidly due to the government

International Real Estate Investing

- Unknowns are magnified
- Foreigners are no less intelligent than you or I
- Local partners can hold the key, but this can backfire on you if they renegotiate terms
- Currency risk becomes a variable