Commercial Real Estate Analysis for Investment, Finance and Development

4th Edition

Chapter 1

Introduction to Commercial Real Estate Investment

Two branches of economics will be applied to the analysis of commercial real estate at the micro level.

Financial Economics: deals with long term value and benefits of owning real estate. Real estate competes within the capital markets where we must compare expected risks and returns. The returns are based on claims to potential future benefit flows measurable in monetary terms. Timing of benefits matters a great deal.

Urban Economics: Brings in the spatial dimension of real estate as affected by amenities, transport costs and location attributes.

Learning Objectives

Understand the structure/functioning of the investment industry.

Understand investor objectives, constraints, and concerns.

Know the types of investment products/vehicles.

Know the difference between an underlying asset and an investment product.

Know the similarities and differences in investment products

Know the four major traditional investment asset classes

Understand investment performance of major asset classes in recent decades

Know the historical trends/events influencing real estate investment

Why invest?

Future consumption or supporting future uses.

What is the time horizon of investors ?

Varies by age and institution.

Requires sacrificing current consumption or donations.

Investor objectives and risk preferences will change over time.

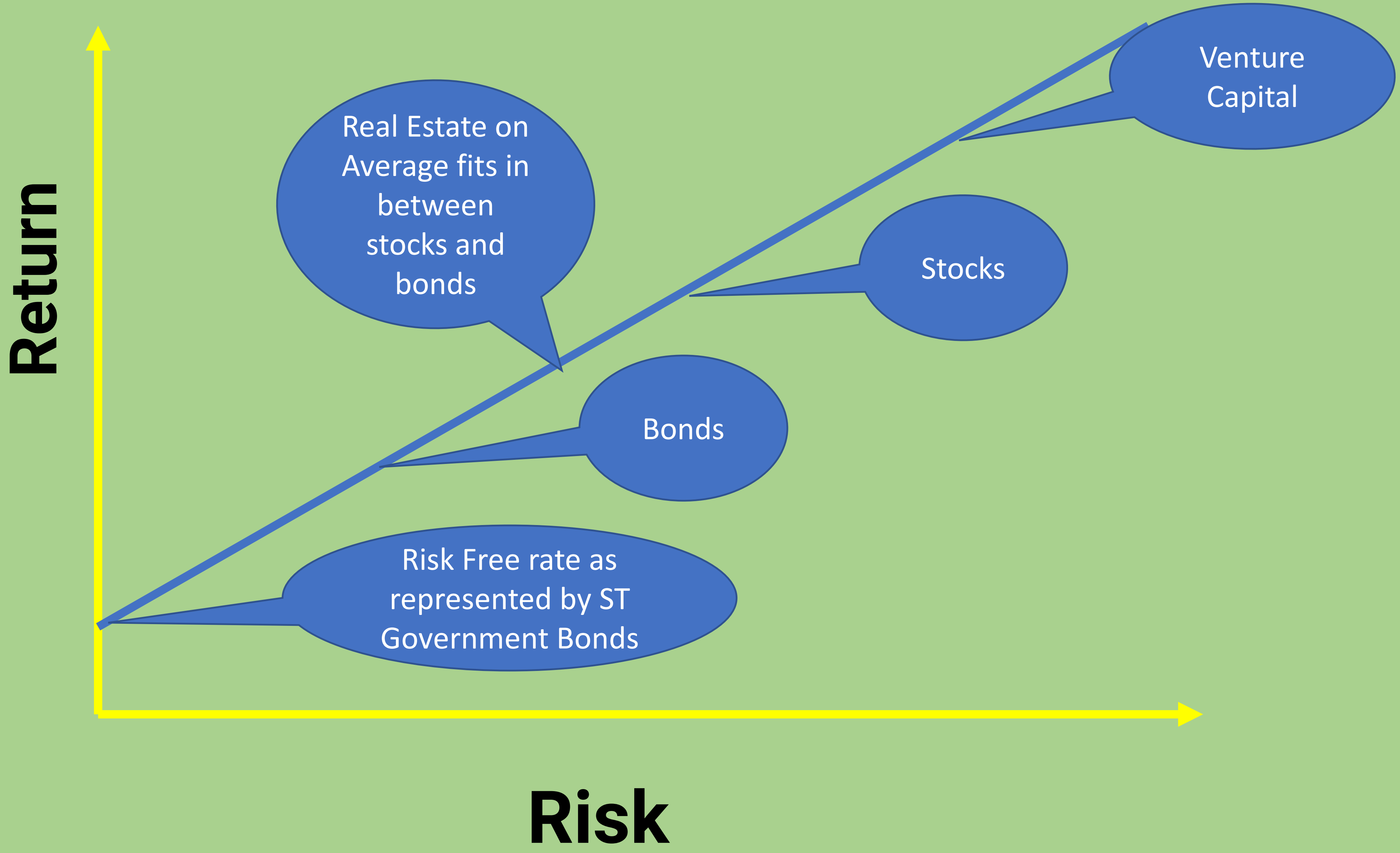
Two major considerations: current income versus growth?

Both are not possible at above average levels. The more growth is expected the lower will be current income.

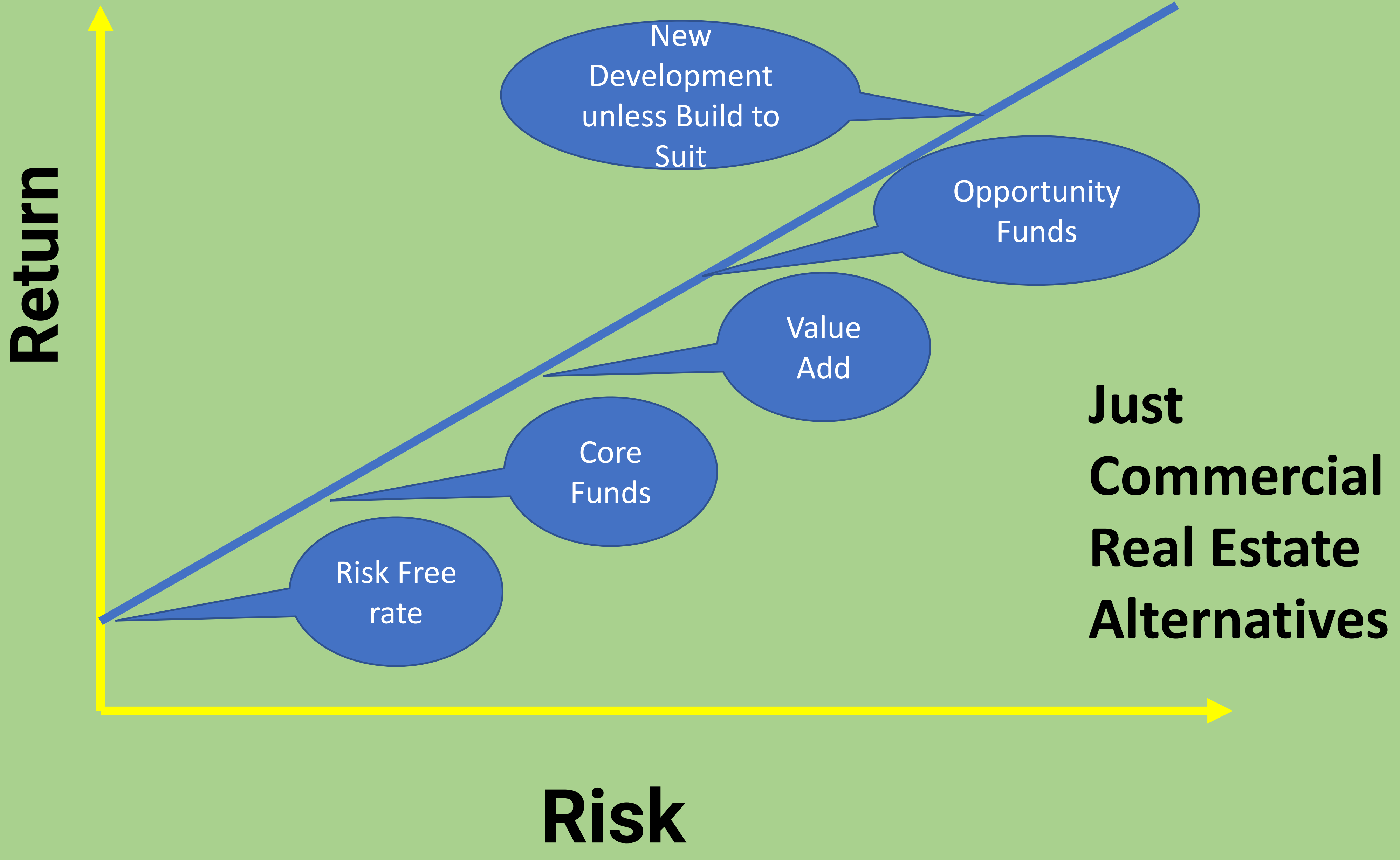
Risk perceptions will affect investment pricing

Higher risk investments require a premium return in order to attract capital.

See the capital market lines on the next two slides.



Return
Venture Capital
Real Estate on Average fits in between stocks and bonds
Stocks
Bonds
Risk Free rate as represented by ST Government Bonds
Risk


Return
New Development unless Build to Suit
Opportunity Funds
Value Add
Core Funds
Risk Free rate
Just Commercial Real Estate Alternatives
Risk

Some Key terms

Liquidity: The ability to convert to cash money without severe loss of principal in a reasonable period of time. The quicker this can happen with preservation of principal the more liquid the asset.

"Investable" Only real estate that is 3rd party owned and rented or rentable by a tenant is considered investable. Most manufacturing plants, for example, are so specialized that they are owner occupied. Some headquarters are owner occupied for long term control but if they are sold and leased back, i.e. "sale lease-back" then they become an investable asset.

Public versus Private: Public assets are those which have been securitized and can be bought and sold often via one of the stock exchanges or some open platform. Private assets are sold by owners or brokers directly to other parties, often represented by brokers as well.   REITs sold on the major stock exchanges are examples of public securities. Private REITs are not traded on any public trading platform and will be less liquid requiring a request for redemption of shares and time to find alternative buyers.