CHAPTER 17
Real Estate Investments and Business Opportunity Brokerage
• Most important consideration:
  • Economic soundness
  • Land use controls
    • Zoning
    • Deed restrictions
    • Permitting requirements
  • Economic force
    • Population growth
    • Foreign capital
    • Impact of taxation
Investment Analysis

- Advantages
  - Income
  - Equity build up
  - Appreciation in value
  - Tax benefits
  - Positive leverage
  - Prestige
• Disadvantages
  • Illiquidity
  • Immobility
  • Expense/overhead
  • Additional expertise from
    • Real estate brokers
    • Tax accountants
    • Attorney’s etc.
Types of Investment Properties

- Agricultural
- Business Opportunities
- Commercial
- Industrial
- Office
- Residential
  - Condominiums
  - Villas
  - Single family homes
  - Apartment complexes
Real Estate Investment Trust (REIT)

- Individuals pooling their resources for investment
- Professionally managed portfolio
  - Real property
    - Office buildings, apartment complexes, retail centers
  - Mortgages secured by real property
- Similar to mutual fund
Static vs. Dynamic Risks

- Dynamic risk
  - Associated with general market conditions
  - Cannot be shifted to an insurer
- Static risk
  - Can be transferred to an insurer
  - E.g. fire, theft or vandalism
Dynamic risk comes in many forms:

- Business
- Financial
- Inflationary
- Interest rate
- Liquidity
- Market
• Use of borrowed funds, or OPM - other people's money; (AKA "trading on the equity")

• **Positive leverage**
  • Rate of return greater than interest rate (increased return by borrowing)

• **Negative leverage**
  • Rate of return less than interest rate
<table>
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<tr>
<th>Financial Category</th>
<th>Formula</th>
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<tbody>
<tr>
<td>Potential Gross Income</td>
<td>PGI</td>
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<tr>
<td>Vacancy and Collection loss allowance</td>
<td>- V&amp;C (or GI)</td>
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<td>Other Income</td>
<td>+ OI</td>
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<tr>
<td>Effective Gross Income</td>
<td>EGI</td>
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<td>Operating Expenses</td>
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<td>Annual Debt Service</td>
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<td>Before Tax Cash Flow</td>
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<tr>
<td>After Tax Cash Flow</td>
<td>ATCF</td>
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Fixed Expenses
• Property Taxes
• Hazard Insurance

Variable Expenses
• Maintenance
• Utilities
• Management fees

Reserve for Replacements
• Noncash expense
• Use in the future to replace worn out components

Operating Expenses
Operating Expense Ratio

Operating Expenses
Effective Gross Income

Provides for comparison with similar properties
Loan to Value Ratio

Shows the % of value the lender agrees to lend
Calculating Profit on Investment

\[ \frac{\text{Made}}{\text{Paid}} = \text{Profit or loss \%} \]

An investor paid $300,000 for a parcel of land and sold it for $200,000. What was the percentage of profit or loss?

\[ \frac{\$100,000}{\$300,000} = 33\% \text{ loss} \]
An investor paid $300,000 for a parcel of land and sold it for $400,000. What was the percentage of profit or loss?

\[
\frac{\text{Made}}{\text{Paid}} = \text{Profit or loss } \% \\
\frac{\$100,000}{\$300,000} = 33\% \text{ profit}
\]
• An investment that shields income from taxation
• Positive Cash Flow as property appreciates is ideal
• Tax shelter obtained by deducting interest and depreciation - especially depreciation - from net operating income
• Analyze financial statements
  • Reconstructed operating statements
  • Balance sheets
  • Income statements
• Business brokers
  • Sale, purchase or lease of a business
  • Must hold real estate license
• Business Enterprises
  • Transactions over $200,000
• Business Opportunities
  • Transactions under $200,000
• Sales frequently involve
  • Shares of stock
  • Limited partnership interests
  • Securities
• Be careful
  • May violate securities laws
  • Requires separate license
• Comparable Sales Approach
• Cost-Depreciation Approach
• Income Approach
• Liquidation Value Approach
  • Value a failing business
  • Sell assets, pay liabilities
  • Minimum value of a profitable business
Appraisal Methods

• **Going Concern Value**
  - Value of an established, profitable business in excess of the value of the physical assets
  - Includes:
    - Real estate
    - Personal property
    - Licenses
    - Franchises,
    - Non-compete contracts
• Sale / Purchase, etc.
• Obtain loan / insurance
• Condemnation
• Buy-sell agreements
• Property settlements
• Estate settlement
• Assign values for stock option plans

Reason for a Business Appraisal
• Standardized rules that regulate commercial transactions throughout the U.S. pertaining to personal property

• Two documents:
  • **Bill of Sale** – used to identify property being conveyed
  • **Security Agreement** – financing of the business

Uniform Commercial Code
• **Assets**
  - Tangible & intangible resources
• **Liabilities**
  - Short-term & long-term obligations
• **Owners' equity**
  - Assets minus liabilities
• **Capital**
  - Owner's equity or net worth

**Accounting Terms**
• **Tangible assets**
  • Buildings, furniture, equipment, etc.

• **Intangible assets**
  • Stock shares
  • Trademarks
  • Copyrights
  • Research & development expenses
  • Franchises
  • Goodwill
Steps in the Sale of a Business

- Acquire the listing
- List the assets
- Valuation
- Deduct liabilities
- Valuation of stock
- Legal compliance
- Close the transaction
Coffee Break
15 Minutes