

# CFAspace

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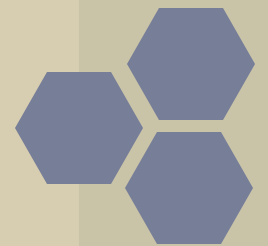
**Academy of Professional Finance 专业金融学院**

## **CFA Level II**

**Private Real Estate Investments**

**Part I**

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# Content

## **Private Real Estate**

**(Los a, b, c, d, e, I)**

Basic forms of real estate investments

Characteristics and classification of real estate

Role in a portfolio / value determinants / principle risks

Commercial property types

Income / cost / sales comparison approaches



# Private Real Estate Investments

## Basic forms of real estate investments

*Larger investments, illiquid*

*Require property management*

*Equity investors require a higher return than mortgages lenders*

	Equity	Debt
Private	Direct ownership or partnership	Mortgages (lender)
Public	shares of real estate investmnet trusts (REITS)	MBS

*No need of management expertise*

*Diversify, more liquid*



# Private Real Estate Investments

## Characteristics and classifications

*Heterogeneity* – no two properties are exactly the same

*High unit value* – difficult to construct a diversified portfolio

*Active management* – maintenance, leases and rents

*High transaction costs* – involve appraisers, lawyers, brokers

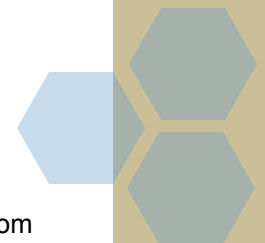
*Depreciation and desirability* – buildings wear out over time

*Cost and availability of debt capital* – adversely impacted by i.r.

*Lack of liquidity* – illiquid, takes time to complete sales

*Difficulty in determining price* – no identical properties and less  
efficient market

REITS can solve most of the problems above



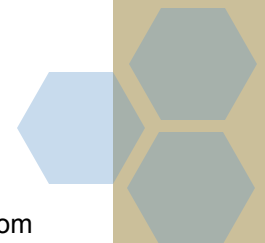


# Private Real Estate Investments

## Characteristics and classifications

### ***Classifications***

- residential (homes, apartments)
- non-residential (commercial properties, higher operational risk)  
e.g. office, warehouse, hotels, etc.
- Farmland and timberland





# Private Real Estate Investments

## Role in a portfolio / value determinants / principle risks

### ***Benefits to invest in real estate***

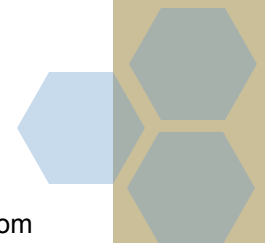
- current income (rents)
- capital appreciation
- inflation hedge
- diversification
- tax benefits

### ***Role in the portfolio***

- similar to bonds and stocks
- risk and return are between that of bonds and stocks

### ***Role of leverage***

- total return will increase as long as return is greater than i.r.
- risk is higher because lenders have a priority to cash flow



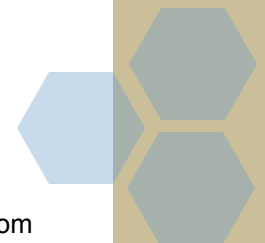


# Private Real Estate Investments

## Role in a portfolio / value determinants / principle risks

### ***Principle risks***

- business conditions (economic factors, GDP, i.r.)
- new property lead time (market conditions may change)
- cost and availability of capital
- unexpected inflation
- demographic factors
- lack of liquidity
- environmental issues
- availability of information
- management expertise
- leverage





# Private Real Estate Investments

## Commercial property types

### **Office**

- depend on job growth
- gross lease: owner pays the operating expenses  
net lease: tenant pays the operating expenses (lower rent)

### **Industrial**

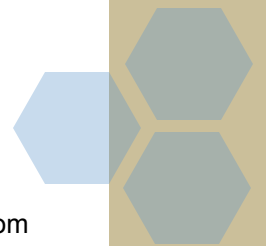
- depend on overall economy and import / export
- net leases are common

### **Retail**

- depend on consumer spending
- tenants are required to pay additional rent for sales above a certain level (percentage lease or percentage rent)

### **Multi-family**

- depend on population growth
- cost of buying vs. renting





# Private Real Estate Investments

## Income / cost / sales comparison approaches

### ***Cost approach***

- value of the land + replacement cost of building - depreciation
- most useful when the property is new

### ***Sales comparison approach***

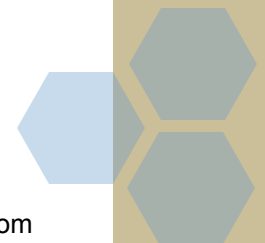
- sales prices of comparable properties + / - adjustments
- most useful when comparable properties sold recently

### ***Income approach***

- present value of future cash flows
- most useful in commercial real estate transactions

### ***Highest and Best use***

- select the one that produces the highest implied land value
- implied land value = value of the property – cost of constructing



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**Thank You!**

