JAMES A. GRAASKAMP COLLECTION OF TEACHING MATERIALS

V. INDUSTRY SEMINARS AND SPEECHES - SHORT TERM

I. Other Presentations In Which Either The Date And / Or Sponsoring Organization Is Missing

1. Risk Management/Investment Related Topics

1. "Guide to Real Estate Investment Analysis", Tampa, Florida, January 10, 1974

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Guide to Real Estate Investment Analysis
Tampa, Florida
by Professor James A. Graaskamp
January 10, 1974

I. Any measure of yield requires careful definition of what is an annual profit and what will be included in resale proceeds and an explicit assumption about the opportunity cost of money or the reinvestment rate.

A. Refer to definitions on page of Case problem #2.

B. Refer to alternative definitions of annual profits and sales proceeds as found in limited partnership agreements by Stephen Roulac.

"Annual Returns"

1. Taxable income,
2. Net profit only (i.e. not net loss),
3. Taxable income calculated on the basis of straight line depreciation,
4. Net profit calculated on the basis of straight line depreciation,
5. Cash available for distribution before allowance for reserves,
6. Cash available for distribution after allowance for reserves,
7. Cash actually distributed,
8. Cash available for distribution before allowance for reserves plus the amount of that year's principal payment on the mortgage debt,
9. Cash available for distribution after allowance for reserves plus the amount of that year's principal payment on the mortgage debt,
10. Cash actually distributed plus the amount of that year's principal payment on the mortgage debt,
11. Cash available for distribution before allowance for reserves plus the tax liability or the tax shelter benefits of the taxable income calculated for a specified tax bracket,
12. Cash available for distribution after allowance for reserves plus the tax liability or the tax shelter benefits of the taxable income calculated for a specified tax bracket.
13. Cash actually distributed plus the tax liability or the tax shelter benefits of the taxable income calculated for a specified tax bracket,
14. Cash available for distribution before allowance for reserves plus the tax liability or the tax shelter benefits of the taxable income calculated for a specified tax bracket plus the amount of that year's principal payment on the mortgage debt,
15. Cash available for distribution after allowance for reserves plus the tax liability or the tax shelter benefits of the taxable income calculated for a specified tax bracket plus the amount of that year's principal payment on the mortgage debt,
16. Cash actually distributed plus the tax liability or the tax shelter benefits of the taxable income calculated for a specified tax bracket, plus the amount of that year's principal payment on the mortgage debt.

Definitions of "Sales Proceeds"

1. Gross sales price,
2. Gross sales price less closing costs and real estate sales commissions, also known as the net sales price,

3. Net sales price less beginning mortgage balance,
4. Net sales price less mortgage balance at time of sale,
5. Net sales price less purchase price,
6. Net sales price less the mortgage balance at time of sale less the initial equity investment,
7. Net sales price less the mortgage balance at the time of sale less the initial equity investment plus the sum of returns, however defined, distributed to the limited partners,
8. Net sales price less the partners' basis for tax purposes (the purchase price less accumulated depreciation),
9. Net sales price less the partners' basis for tax purposes less the amount necessary to pay taxes at some specified rate,
10. All cash, after payment of mortgage balance at time of sale, including refund of working capital, unused reserves, and unallocated reserves.

C. Suggestions for the appraiser looking for a standard on which to base valuation judgments:

   1. Relate to purpose of appraisal and significance of hard dollar and soft dollars to the viewpoint to be served
   2. Ellwood method
   3. EDUCARE standard models for the investor/buyer
   4. Standard assumptions to be promulgated by SEC
   5. The appraisal customer's ideal preferences

II. Modern management defines risk as the potential variance between expectations and realizations, i.e., between proforma prospects and balance sheet and P & L statements:

A. Dynamic risks can produce profit or loss and are best controlled by the finesse of management execution of a plan.

B. Static risks are those which can only cause a loss due to surprise upset of a plan.

C. Risk management has two objectives:

   1. Conservation of existing enterprise assets despite surprise events
   2. Realization of budgeted expectations despite surprise events

D. The process of risk management involves:

   1. Identification of significant exposures to loss
   2. Estimation of potential loss frequency and severity
   3. Identification of alternative methods to avoid loss
   4. Selection of a risk management method
   5. Monitoring execution of risk management plan

E. Alternative methods for surviving potential risk losses:

   1. Eliminate uncertainty (research or confirm)
   2. Reduce frequency or severity of loss contingencies (incentive contracts)
   3. Combine risks to increase predictability (reserves for expenses or pool investments)

III. Previous Page(s) Not Found.

IV. The marketing of syndications in recent times has shown a rapid rate of innovation since the day of a few friends of the broker with its high cost or the investment seminar.

A. As offerings became larger they attracted the attention of the security regulators with the result that they are extensively regulated by the SEC and state securities laws and require registration as a security salesman.

B. The expenses of organization, registration, and control of sales methods has led to several trends.

1. Pooling property for a large offering
2. Blind pooling to create a fund for future purchase of a real estate portfolio
3. Development of a master prospectus for a chain (Royal Inns) which would permit a supplemental prospectus or amendment describing each new additional purchase. Thus it combined the advantages of a non-specified property fund in terms of efficiencies of scale while investors could commit to a specific property in a geographic area of their choice.

C. A significant exception to the need for securities sales people is the developer selling his own interests so that many builders became packagers in order to cash out of developments they were constructing.

1. To pass through deductions during construction they might have the investor put in a small down payment on his share and pay the balance in one or two installments and later tax periods. This led to the FRB proposing to regulate margin requirements under regulation T.
2. State and federal regulators differed on the use of financial projections, the SEC banning them, but the state view is winning out for real estate purposes.
3. More recently condominiums sold as second homes or units for rental have also been defined as securities.

D. A non-public offering must be to no more than 25 persons with sales to no more than 10. The exception requires that these persons have a pre-existing personal relationship and the capacity to take a risk in terms of net worth and private experience.

1. Another consideration is whether the project is logically part of a larger project which is being phased, in which case federal regulation might apply.
2. More emphasis on improving investment characteristics due to sales compensation techniques.

E. Limited partnerships sensitize people to thinking of real estate of all forms as essentially security investments and this trend will probably continue. There are some that argue that even the single family home will be thought of as a security.

F. Once real estate is viewed as primarily an investment security, there will be a significant shift in the sophistication and marketing techniques utilized in real estate valuation. The SEC is the first agency to sue an appraiser for mistakes rather than fraud and disclosure will require developers to reveal their profit centers and the justification for key assumptions for projections.

H. Private guaranty give the lender on a 95% loan the same risk position he would have had with a 75% lpan:

1. Cushion coverage claim in excess of appraised value, fall in appraised value, or consistent bias of loan officers relative to neighborhood or borrower.
2. Makes high ratio loans legal under regulatory structure while avoiding FHA.
3. Qualifies loans for sale in secondary market increasing lender resources.
4. 20% option leaves lender with title and he may make something additional on the sale or lose if his loan had been very bad indeed.
5. Copensation requires lender to obtain marketable title of property in good re;air so lender still has exposure to catastrophe loss.
6. Frequency loss ratio increases with high ratio loans and all additional costs may not be covered.
7. Borrower pays premium but is now exempt from deficiency judgment and generally will avoid suits for a specific performance or damages.
18 Lender can now service a broader potential market of homw owners and builders with profit centers in other divisions such as construction loans, compensating balances, etc.

V. Rapid growth did involve some mistake, primarily in diversification through holding companies and investment strategy. Foreclosure losses relatively light in single family homes.

A. Diversification useful to provide perspective on profitable residential lines.

1. Mobile home guarantees depended too much on dealers who were unregulated.
2. Commercial mortgage and lease insurance could not depend on borrower or tenant, only on general use alternatives of property.
3. Guaranty of municipal bonds or industrial development mortgages securing development bonds indicated value of guaranty in improving liquidity of collateral bailout.

B. Investment policies fail to follow traditional insurance philosophy of making investments with covariance relationship to earn premium income and foreclosure losses.

1. Common stocks, insured savings accounts, long term buys.
2. Inflation kills stocks, sent interest rates soaring devaluing bonds and disintermediation was against marketing policy.
3. Given interest trends companies should have moved into low yield government short term when premium volume was high and into high yield long term when interest rates are high and business volume low to stabalize earnings per share.
4. Holding companies warehouse mortgages on short term bank credit and were killed.
5. As a result security image is tarnished by roller coaster prices for common stock.