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

3. Development Topics

e. "Notes for Metropolitan Buildings", focus on risk management for developers/investors

Notes for Metropolitan Buildings

I. Introductory Comments

A. Hawaiian introduction to the Halekalane

B. Background and securities analyst

C. Aggressive - conservative (Martin Whitman & Martin Shubik, Random House - 1979)

II. Modern capital theory sees certain factors concerning general market, economic, and political conditions including interest rates and stock prices as unpredictable, systematic risks. Presumably the only defense is diversification within efficient market - that is where variance in excess of business cycle variance is minimimized for a given, anticipated rate of return.

A. Market efficiency assumes prices to be equilibrium prices, portfolios to be a fixed size without new injections of investment funds, and outside passive investors.

B. There is considerable doubt that real estate operates in a reasonably efficient market.

C. There is also considerable doubt that fatalism relative to systematic risk is necessary; some positioning relative to alternative scenarios of the future is possible. (simple example - fixed interest construction loans were and are available)

D. Therefore/an investment committee and therefore a program should have some explicit psychological set about the following long term issues:

1. The American response to the transition in energy resource utilization.

2. The American response to resource conservation.

3. The American response to the dilemma of incentives for those with expertise and capital versus social stabilization through redistribution of income and wealth to those without skills and capital. (Inflation as a transfer device from savers to doers)

4. The American response to shifting demographics which is changing market for education, office, residential, and recreational spaces.

5. American response to the shift in industrial, agricultural and international trade balances.

6. Implications of gradual expropriation of isolation, and loss of military parity.

III. In non-efficient investment markets there is more opportunity to improve return and control risk through careful selection and explicit risk management strategies. These opportunities are particularly true where the investor is an activist, i.e., an insider or controlling manager of specific business enterprises.

A. Securities or businesses for investment might be classified into at least five types of investment:

1. Trading investment (short term price spreads)

2. Investments in new technology (non-financial variables are primary)

3. Work-out and special situation investments (inside knowledge and bargaining positions)

4. Spendable cash investment (such as tax exempts, tax shelter, refinancing, or captive customer for services)

5. Growth investment (increasing for capital demand, established working capital, and established market outlets)

B. For each of these five the investment committee needs to develop criteria and explicit adaptations of decision roles to the following, ranked in a general order of importance:

1. Political exposure

   a. Land use and building codes
   b. Price control and profit control
   c. Vulnerability to subsidize demand
   d. Vulnerability to public competition

2. Market control

   a. Demand channeled by terrain, exclusive permit, limitation on available serv ices, etc.
   b. Control of tenant or reciprocity
   c. Market research

3. Management intensiveness

   a. Tenant turnover and responsibilities under the lease
   b. Leasing and operating skills
   c. Specialty business (restaurant, hotel, etc.)

4. Financial attriubtes

   a. Variable revenue fixed cost
   b. Degree of leverage (straddle, shelter, cost of funds, positive or negative carry)
   c. Time line for investment, income return, capital gain
   d. Appropriate rates of return measures
   e. Appropriate risk measures (breakeven, payback, payoff matrix, density model, etc.)
   f. Financial and business risk control devices to limit loss

5. Income tax attributes

   a. Shelter within investment
   b. Shelter to other income
   c. Adverse impact on investor status
   d. Potential tax traps affecting liquidity

6. Managerial integrity

    a. Consistent with image and public silhouette
    b. Necessity of association and loss of control to others
    c. Vulnerability to need for unwelcome alliances

7. Influences of estate planning requirements

    a. Liquidity
    b. Management continuity
    c. Divisibility
    d. Capacity for wealth transfer (Clifford Trust, preferred - common stock
    e. Special opportunities (step-up basis, family business valuation key man sale, etc.)

C. Basic principle: Free enterprise is the art of creating your own monopoly - every deal should have some aspect of customer control.

D. Every major assumption in a proforma budget should be subject to a risk management device.

1. Layoff by contract

2. Limited liability

3. Hedge

4. Flexibility of plan

5. Escape with defined maximum loss

6. Maximum time line

7. Maximum sunk costs

8. Convenience to central management involvement and suitable to central management expertise