

# RISK ANALYSIS

**Risk:** The higher the **Variability of Expected Returns**, the greater the **Risk** of an **Investment**. The lower the **Variability of Expected Returns**, the lower the **Risk**.

**Risk Averse:** **Investors** are generally **Risk Averse**, which means they require a higher **Expected Return** (probability weighted mean return) as compensation for incurring more **Risk** (i.e., higher **Variability / Volatility / Uncertainty of Expected Returns**).

**Risk vs. Return:** This is the key **Investment** consideration. When comparing potential **Investments**, their **Internal Rate of Return (IRR)** or projected **Net Present Value (NPV)** must be viewed in light of the **Risks** associated with each potential **Investment**.

**Investment Risks:** **Economic Risk** (global, national, and local), **Business Risk**, **Financial Risk**, **Interest Rate Risk**, **Liquidity Risk**, **Inflation Risk**, **Management Risk**, **Environmental Risk**, **Legislative Risk**, **Pandemic Risk**, etc.

**Due Diligence:** The **Process** of identifying the various **Risks** and potential **Returns** of an **Investment** by evaluating all the relevant and available **Information** to assess and determine whether the potential **Returns** are sufficient for you in light of those **Risks**.

**Due Diligence** on a **Property** would include a review and analysis of a **Market Study**, the **Rent Roll**, major **Leases**, **Physical Inspection**, **Design and Engineering**, **Title and Survey**, **Zoning and Code Compliance**, **Taxes**, **Insurance**, **Litigation**, etc.

**Sensitivity Analysis:** **Modifying** key **Assumptions** about future **Investment Performance** (e.g., **Rent Levels**, **CPI**, **Vacancy Rates**, exit **Cap Rate**, **Sale Timing**), often done two at a time, to see their impact on the **IRR** and **Equity Multiple**. The **Assumptions** can be changed to model various scenarios in light of the potential **Risks**. The **Sensitivity Analysis** will show how sensitive the **Expected Return** (e.g., **IRR**, **NPV** or **Equity Multiple**) is to changes in your **Assumptions**.

**Partitioning the IRR:** Determining the portion of the **Investment Return** that comes from the annual **Cash Flow** and the portion that comes from the **Sale/Residual Value**.