April 11, 2019

Real Estate Finance Course

Group 4: Lender

Class Notes – Lecture 1

Primary market

* New, reconstructed

Secondary market

* Existing,

April 18, 2019

Rent vs Buy

NOI – difference between a property’s revenue and expenses

GOI = TR + vacancy and credit loss

Equity – interest an owner has in total assets, can grow or reduce depending on the market

2007 – 50% of homebuyers in Calgary have a negative equity

Leverage – debt you have outstanding

ROE – money being made in an investment

Capitalization rate – calculated by the dividing the net operating income by the sale price

Capitalization – expected risk and return

As interest rates fall off it provides people with a higher purchasing power

Discount rate – convert future cash flows to present dollars

Gross VS Net Area

Gross building area – all above grade floors – used for cost

Net rentable/saleable area are used for revenue

Gross parcel area – everything you own

Valuation Methods

3 methods

1. Income approach
2. Direct comparison
3. Capitalization method
4. Cost approach

2 types of Revenue

1. Rental/operating revenue (income approach)
2. Sales revenue (direct comparison approach)

How can there be vacancy, but the rates go up?

* Does not offer the same product/quality of assets
* Landlord/ownership is a competitive market
* Pushing boundaries
* Gives time to improve their property

Finding rental rates

Capital Approach

* Most common and stable income property
* Cap – rate = risk of return

**April 25, 2019**

**Rent vs Buy**

Condo cost – 600,00 Rent - $3000/month

Down payment = 20% = 120, 000

Closing costs = 20, 000 (3% of purchase price + 3000 land transfer costs)

Mortgage = 80% @ 4%

Monthly payments = interest + principal for 25 years = $2524.90

Condo fees = $1055/monthly

Property taxes = $300/month

Annual maintenance = $600

Total = $3900

Value of buying – investment, equity in the property

1. Principal
2. Value growth

Opportunity cost = 140, 000/4% annum = 5600/12 = 466

May 2, 2019

Cap Rate Example

$25, 000 sgft

96% occupied, market vacancy 7%

Avg, rental rate in $27 psf NNN

25000 st x 27 (rental rate) = 675, 000 (Gross Income) x 7% (vacancy) = 47, 250(vacancy)

= $627, 750 (EGI) – 2% (non-recoverable) = 12555

627, 750 – 12, 555 = 615, 195 NOI

Present Value calculation

Year 5 = $558, 223 (DCF)

0 Year x (1.06)x(1.06)^2 x(1.06)^3x(1.06)^4

X = 417, 144

The difference between the nominal to effective dollars is inflation or deflation

The value of the building is the terminal amount (see slide example for numbers)

**Sensitivity Analysis Example**

Build a 10-storey office building

2 floors retail

Reminder is offices

Site size = 1.3 acres – FAR (floor area ratio) 8.0

Assume efficiency of 93%

Construction time line = 30 months – 18 months to build – 6 months preliminary work – 6 months lease up for sale

Land costs = $5.5m

Hard cost = $256/sqft

Soft costs (engineer, architect, etc) = 18% of hard costs

Parking req = 1 stall/500 leasable sqft

Parking cost underground = $25, 000/stall

Quarterly discount rate = 2.5% (annually ~10%)

Lease rate = $25/sqft NNN

Parking rental = $300

Vacancy = 5%

Non-recoverable expenses = 5%

Cap rate = 5.5%

NPV? IRR?

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**Things a Lender needs to ask**

Project

Experience

Liquidity/Net worth