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.**