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Addenda Packet
Seminar Description

One of the most thoroughly analyzed issues in the investments literature is how the financing decision affects market value and investment performance. Much of that literature focuses on the impact of the debt equity mix on the value of publicly traded companies. There is a parallel though less extensive literature that addresses the same finance, value, investment performance relationship in real estate markets. This is not surprising, considering that debt-to-equity ratios (or, equivalently, loan-to-value ratios) tend to be higher in real estate markets than in any other investment category.

The importance of financing is reflected in real estate appraisal practice in various ways. Most visible is the assumption of “typical financing” that underlies most definitions of market value. Appraisal practice also includes a number of models and estimation techniques that explicitly reflect the financing mix. Examples include the band-of-investment and finance-explicit discounted cash flow models. There are also techniques like “cash equivalency” designed to separate the value of favorable financing from the value of the real property.

Appraisers are exposed to these approaches in various courses and seminars throughout their education and training. The objective of this seminar is to pull these materials together in a single, cohesive presentation. This objective is addressed in two basic ways. First, we spend time identifying the conceptual foundations underlying the finance, value, and investment performance relationship. Second, we frame these ideas in the context of appraisal practice, emphasizing the why as much as the how.

You will find this to be a fast-moving, hands-on day. There will be plenty of class discussion, and a lot of problems to solve. Your day begins with a discussion and accompanying problems that address the question of how leverage impacts market values, risk, and expected return. Along the way you will be exposed to the concept of breakeven and indifference points, and how the financing decision “rearranges” the sources of return. Where appropriate, this will be related to appraisal methodology, especially the band-of-investment model, and you will return to the question of why market value definitions routinely assume typical financing. You will also revisit the cash equivalency model, and address the question of whether the use of debt creates tax sheltered cash flow, and why that may occur.

The seminar uses a combination of lecture, discussion, and problem solving. At the end of the day you will be able to critically analyze the impact of the financing decision, and how that decision affects appraisal practice and investment consulting.