

# 17

## REAL ESTATE INVESTMENTS AND BUSINESS OPPORTUNITY BROKERAGE

### 1 LEARNING OBJECTIVES

2 *When you have completed this unit, you will be able to accomplish the following.*

- 3 ■ Define key investment terms and distinguish among the different types of real estate investments.
- 4 ■ Identify the advantages and disadvantages of investing in real estate.
- 5 ■ Distinguish among the various types of risk.
- 6 ■ Describe the similarities and differences between real estate brokerage and business brokerage.
- 7 ■ Describe the types of expertise business brokerage requires and distinguish among the methods of
- 8 appraising businesses.
- 9 ■ Describe the steps in the sale of a business.

### 10 KEY TERMS

appreciation	equity	liquidity
asset	going-concern value	real estate investment trust
basis	goodwill	(REIT)
capital gain (or loss)	leverage	risk
cash flow	liquidation analysis	tax shelter

### 11 INTRODUCTION

12 This unit is an introduction to investment real estate. Investors consider different  
13 factors in their attempt to achieve various investment objectives according to their indi-  
14 vidual financial status, income tax bracket, motives for investing, and access to credit.  
15 Different types of real estate offer various abilities to meet investor objectives.

### 16 17.1 NEED FOR REAL ESTATE INVESTMENT ANALYSIS

17 Knowledge of real estate investment analysis is important to a licensee in Florida  
18 because a real estate licensee is allowed to sell investment property. The public regards  
19 a real estate broker or sales associate as an expert in all types of properties. While the  
20 rewards of negotiating the purchase or sale of investment property are often greater than

1 they are for other types of real estate, so are the liabilities for untrained or unknowledge-  
2 able people. Cases have gone to court because real estate licensees either gave bad advice  
3 or did not properly analyze an investment before recommending a course of action that  
4 could have been avoided by a knowledgeable professional.

5 Real estate investment analysis is the process of determining the extent to which real  
6 estate investments achieve an investor's objectives. Potential investors go to real estate  
7 professionals for help and guidance. Licensees must be qualified to provide the needed  
8 expertise when they accept the trust and confidence of a client. At the beginning of this  
9 book, the point was made that real estate licensees have one major commodity to offer  
10 the public—expertise. But part of being a professional also includes knowing when to  
11 consult a specialist (e.g., an attorney or an accountant) and when to have one's seller or  
12 buyer consult a specialist. The purpose of this unit, therefore, is familiarization, a first step  
13 toward developing expertise in real estate investment matters.

## 14 INVESTMENT TERMINOLOGY AND TYPES OF REAL ESTATE 15 INVESTMENTS

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16 **Appreciation** is the increase in property value over a period of time due to economic causes.

17 **Assets** are the entire resources of a business, including tangibles and intangibles such  
18 as accounts and notes receivable (promissory notes), cash, inventory, equipment, real  
19 estate, and goodwill. The difference between assets and liabilities is net worth.

20 **Cash flow** is the total amount of spendable income generated from an investment. It  
21 is the total amount of money remaining after all expenditures have been paid. Expenses,  
22 for example, include property taxes, operating costs, and maintenance. The cash flow is  
23 determined by at least three important factors: the income received, operating expenses,  
24 and the method of debt repayment. Cash flow may be positive or negative.

25 **EXAMPLE 1:** A rental property has an annual income of \$100,000 and operating  
26 expenses of \$90,000. The property has a positive cash flow of \$10,000.

27 **EXAMPLE 2:** A rental property has an annual income of \$100,000 and operating  
28 expenses of \$110,000. The property has a negative cash flow of \$10,000.

29 **Equity** is the property's value minus mortgage debt. A property worth \$500,000 has  
30 outstanding debt of \$375,000. The investor's equity is \$125,000.

31  $\$500,000 \text{ value} - \$375,000 \text{ mortgage debt} = \$125,000 \text{ equity}$

32 **Leverage** is the use of borrowed funds (often called *other people's money*) to finance  
33 an investment. Investors use leverage to increase purchasing power. An investor wants  
34 an investment property to produce cash flow in excess of the cost of borrowing the funds.  
35 Leverage can be positive or negative, based on whether or not the benefits from borrowing  
36 exceed the cost of borrowing. Generally, an investor can receive a maximum return from  
37 an initial investment by making a small down payment, paying a low interest rate, and  
38 spreading mortgage payments over a long period of time. Positive leverage occurs when  
39 the benefits from borrowing exceed the costs of borrowing. Negative leverage occurs when  
40 the borrowed funds cost more than they are producing.

41 **EXAMPLE:** Consider a property that costs \$500,000 and produces a net income of  
42 \$50,000 per year. If purchased for cash, the investor's annual rate of return on the equity  
43 invested is 10% ( $\$50,000 \text{ income} \div \$500,000 \text{ equity}$ ). Assume that this investor leverages  
44 the purchase by borrowing \$375,000 at 5% (\$18,750 interest) annually and makes a down

1 payment of \$125,000. The \$50,000 income earned from the investment is reduced by the  
2 cost of financing (\$18,750). The income remaining after mortgage expense is \$31,250. The  
3 resulting return on equity investment is an attractive 25%.

4  $\$31,250 \text{ income after financing costs} \div \$125,000 \text{ equity} = .25 \text{ or } 25\% \text{ rate of return on}$   
5  $\text{equity}$

6 The investor made a greater return on equity investment by leveraging the invest-  
7 ment. Positive leverage is the result.

8 **Liquidity** refers to the ability to sell an investment very quickly without loss of capital.

9 **Basis** is an investor's initial cost of the property. The basis is adjusted by adding any  
10 capital improvements made to the property and deducting depreciation expenses taken on  
11 tax returns during the years of ownership.

12 **EXAMPLE:** An investor purchases a property for \$900,000. Improvements to the  
13 property during ownership total \$100,000. During the ownership period, the investor took  
14 \$125,000 in depreciation. The investor's adjusted basis is \$875,000.

15  $\$900,000 \text{ cost} + \$100,000 \text{ capital improvements} - \$125,000 \text{ depreciation} = \$875,000$   
16  $\text{adjusted basis}$

17 **Capital gain (or loss)** is the difference between the adjusted basis of property and  
18 its net selling price. A capital gain or capital loss has tax consequences for the owner of  
19 investment property.

20 The term **tax shelter** describes the advantages of owning real estate investments. An  
21 investment is a tax shelter when it shields income from payment of income taxes.

22 **Real estate investment trusts (REITs)** offer investors the opportunity to invest in  
23 income-producing real estate properties. Individual REITs generally specialize in a par-  
24 ticular type of property, such as multifamily communities, retail malls and shopping cen-  
25 ters, office properties, and so forth. They provide a means for individuals to pool resources  
26 for investment in a professionally managed portfolio of real property and/or mortgages  
27 secured by real property. REITs are attractive because they offer diversification and liquid-  
28 ity, they are similar to mutual funds, and they offer the advantages of skilled centralized  
29 management and continuity of operation. REITs may be purchased through a stockbroker.

30 **Risk** is the chance of losing all or part of an investment. Generally, investors demand  
31 a higher return for higher investment risk.

## 32 Types of Real Estate Investments

33 **Residential.** Investments in residential properties include single-family homes, condo-  
34 miniums, apartments, and other multifamily complexes. Most experts agree that investing  
35 in an apartment project (or other income-producing property) is economically feasible  
36 when the projected future net income over a predetermined period will permit return of  
37 the investment (recover invested capital) and allow the investor an appropriate rate of  
38 return over the investment period.

39 In assessing the desirability of an apartment complex, several criteria should be con-  
40 sidered, including the following: location, effective gross income, operating expenses, and  
41 property taxes. Existing properties should be inspected carefully, and repair and mainte-  
42 nance records should be studied to ensure that the property has been well maintained. A  
43 lack of proper maintenance is called *deferred maintenance*.

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1 **Commercial.** This category includes retail and office properties. Retail properties include  
 2 downtown commercial properties, shopping centers, and regional malls. A shopping  
 3 center's economic characteristics depend on the nature of existing leases and on operating  
 4 expenses. An investor should study all leases carefully to find out how much of the original  
 5 term remains, whether investors participate in tenant income from sales, and whether  
 6 the leases provide for appropriate costs to be shifted to tenants. Long-term leases and a  
 7 tendency on the part of tenants to renew their leases are among the main attractions of  
 8 investing in office properties.

9 **Industrial.** Industrial uses of real estate in urban areas generally involve manufacturing,  
 10 assembly, and/or distribution. To be suitable for industrial use, a site should be located  
 11 near transportation facilities such as railroad stations, expressways, and airports because  
 12 of the need to receive and ship by rail, truck, and air.

13 **Agricultural.** Agricultural properties are often purchased by a farsighted investor-  
 14 developer looking for large tracts of land that lie in the path of foreseeable urban growth.  
 15 However, the holding period to realize such development potential may be many years.

16 **Business Opportunities.** One of the categories that Chapter 475, F.S., defines as real  
 17 estate is "any interest in business enterprises or business opportunities." This category  
 18 includes the sale or lease of a business and goodwill of an existing business, including busi-  
 19 ness assets such as the stock of a corporation.

### Practice Questions

1. The difference between assets and liabilities is \_\_\_\_\_.
2. \_\_\_\_\_ is the type of real estate investment that involves the sale or lease of a business.
3. \_\_\_\_\_ results when the cost of borrowed funds exceeds the rate of return on the investment.

## 17.2 REAL ESTATE AS AN INVESTMENT

### Advantages of Real Estate as an Investment

Real estate investments have the following advantages (see Figure 17.1):

- *Rate of return.* Historically, real estate has produced an above-average rate of return for owner-investors compared with other types of investments.
- *Tax advantages.* Real estate investments receive certain tax benefits.
- *Hedge against inflation.* Historically, real estate prices have increased (property appreciation) at a faster pace than inflation. If a parcel of real property is acquired at market value or less, an owner will normally find that the sale price increases faster than other prices. This ability to maintain or increase purchasing power is one reason real estate is regarded as one of the best protections against inflation.
- *Leverage.* Real estate is typically highly leveraged. An investor can usually borrow 70% to 75% of the appraised value to finance a real estate investment. The goal of leveraging is to increase one's yield (return) on equity (investor's own capital) by using borrowed funds.
- *Equity buildup.* As a property appreciates in value and the mortgage debt is reduced, the investor's equity grows.

**FIGURE 17.1 ■ Advantages and Disadvantages of Real Estate Investments**

Advantages	Disadvantages
Usually above-average rate of return	Lack of liquidity (illiquid)
Tax advantages	More localized market
Hedge against inflation	Expenses associated with expertise
Leverage of borrowed money	Need for active management
Equity buildup	Relatively high degree of risk

### 1 Disadvantages of Investing in Real Estate

2 Following are some of the disadvantages of investing in real estate (see Figure 17.1):

- 3 ■ *Illiquidity.* Real estate is not considered a liquid investment over the short term.
- 4 Therefore, it is said to be illiquid.
- 5 ■ *Market is local in nature.* The real estate market is more local in nature compared
- 6 with other investments. An investor usually is interested in a particular property
- 7 type and geographic area. Other types of investments, such as stocks, are bought
- 8 and sold in an international marketplace.
- 9 ■ *Need for expert help.* Many expenses are associated with investing in real estate,
- 10 including the need for property managers, financial consultants, and legal
- 11 experts.
- 12 ■ *Need for active management.* Real estate requires active management. Properties
- 13 must be cared for, rents collected, and so forth.
- 14 ■ *Risk.* An investor must weigh the chance of losing invested capital. Real estate
- 15 investment involves a high degree of risk compared with other investments.
- 16 Tenant turnover, increasing property taxes, and increased costs associated with
- 17 operations are a few examples of the types of risk to which a real estate investor
- 18 is exposed.

### Practice Questions

4. One disadvantage of real estate as an investment is that it is \_\_\_\_\_ in the short term.
5. An advantage of real estate investments is that they are a good \_\_\_\_\_ against inflation.

## 19 17.3 ASSESSMENT OF RISKS

20 Investors have a target rate of return in mind when they invest in real estate. Factors  
 21 out of the control of an investor, such as inflation, rising interest rates, and so forth, create  
 22 uncertainty that the actual rate of return an investment will provide will meet the inves-  
 23 tor's target. This uncertainty is what we call risk. **Risk** is the chance of unfavorable events  
 24 or outcomes. Some degree of risk is always associated with an investment.

### 25 Risks Associated With General Business Conditions

26 **Business Risk.** Business risk reflects the possible unsuccessful operation of a particular  
 27 project. It is the probability that projected income will not be achieved or will not be  
 28 adequate to meet operating expenses. This category of risk is associated with the degree of  
 29 variance between projected income and expenses and actual income and expenses.

1       **EXAMPLE:** A regional shopping center that is fully rented under long-term net  
2       leases has less business risk than raw land to be developed into a hotel sometime in the  
3       future.

4       **Financial Risk.** Financial risk is the risk of defaulting on borrowed funds used to finance  
5       an investment. Financial risk is the potential inability of the investment's income to cover  
6       the required debt service. The more borrowed funds used to purchase an investment, the  
7       greater the financial risk.

8       **Purchasing-Power Risk.** Purchasing-power risk is inflation risk. Purchasing power risk  
9       reflects the fact that inflation may cause the investor to be paid back with less valuable  
10      dollars. If the rents are fixed by the lease, the gross income may not keep pace with infla-  
11      tion, while the operating expenses increase at the inflation rate.

12      **EXAMPLE:** A well-established restaurant with a loyal customer base that can  
13      adjust menu prices to cover increasing food costs during inflation has less purchasing-  
14      power risk than a warehouse leased for 20 years.

15      **Interest-Rate Risk.** Assume that the only change in a real estate investment is that the  
16      interest rate is raised by the lender. The property remains unchanged, the owners remain  
17      the same, and management remains in place. However, with the increase in interest rates,  
18      the value of the property as an investment goes down. That is interest-rate risk at work.  
19      Investments tied to a fixed-rate mortgage loan have less interest-rate risk than one lever-  
20      aged with an adjustable rate mortgage.

## 21      **Risks That Affect Return**

22      Historically, businesses and individuals have put money in investments that offer the  
23      highest return commensurate with the liquidity and safety of the money.

24      **Liquidity Risk.** Real estate investments are particularly susceptible to liquidity risk.  
25      Liquidity risk is the risk that a quick sale will not be possible or that a significant price  
26      reduction will be required to achieve a quick sale.

27      **Safety Risk.** Safety risk is the possible loss of invested capital (return of investment)  
28      and/or expected earnings (return on investment). Safety risk is composed of market risk  
29      (possible loss of invested capital) and risk of default (possible loss of earnings):

- 30      ■ *Market risk* is the type of risk associated with a decrease in the market value of an  
31      investment as a result of increased interest rates (the interest-rate risk at work).  
32      Often, market risk is magnified by long periods of time. Investments that have  
33      earnings exposed to the cyclical gyrations of the money markets over extended  
34      periods experience increased market risk.
- 35      ■ *Risk of default* is the risk that the investment will not generate enough income to  
36      sustain itself.

37      Each investment opportunity has with it risks. Some types of risk are more likely with  
38      certain types of investments. If everything were equal, an investor would prefer a liquid,  
39      short-term investment because less risk would be involved. However, the possibility of a  
40      higher yield will induce some investors to commit funds to a less-liquid, long-term, riskier  
41      investment. It is a basic economic premise that risk and the desired rate of return are  
42      directly related (e.g., high risk, high return).

## Practice Questions

6. Safety risk is composed of \_\_\_\_\_ risk and risk of \_\_\_\_\_.
7. \_\_\_\_\_ risk is associated with the variance between \_\_\_\_\_ income and expenses and \_\_\_\_\_ income and expenses.
8. \_\_\_\_\_ risk is risk of defaulting on borrowed funds to finance an investment.

## 17.4 BUSINESS BROKERAGE

Real estate licensees who engage in the sale, purchase, or lease of businesses are called business brokers. This real estate activity is sometimes called business opportunity brokerage. Business opportunity brokerage involves the sale or lease of existing businesses. In Florida, an active current real estate license is required to sell or lease business opportunities.

### Similarities to Real Estate Brokerage

Business brokerage almost always involves the sale of real property or an assignment of a long-term lease. Business brokerage activities require a real estate license under Chapter 475, Part I, F.S.

475.01, F.S.

### Differences From Real Estate Brokerage

Business brokerage differs from real estate brokerage in at least three ways (see Figure 17.2).

1. *Business brokerage assets often include personal property and goodwill. Goodwill is attributed to a business's reputation and the expectation of continued customer loyalty. Goodwill is an intangible asset because goodwill does not have physical existence (it cannot be seen or touched) and yet its "value" to a business opportunity is very real. The value of an intangible asset is in what it represents to the business, such as what the brand name "Kleenex" means to Kimberly-Clark. The value of goodwill is approximated by subtracting the value of tangible assets from the value of the business. Other intangible assets that add value include licenses, franchises, copyrights, and patents.*
2. *The value of the business may differ from the value of the real estate. In other words, the total going-concern value may be different from the real estate value. Going-concern value is the value of an established business property compared with the value of just the physical assets of a business that is not yet established.*
3. *Markets for business enterprises are typically wider in geographic scope than markets for individual parcels of real estate.*

**FIGURE 17.2** ■ Business Brokerage Compared With Real Estate Brokerage

Similarities	Differences
Sale of real property or assignment of a long-term lease	Assets include personal property and goodwill
Active real estate license required	Going-concern value may differ from real estate value
	Wider geographic market

### Practice Questions

9. List two ways real estate brokerage and business brokerage are similar.
1. \_\_\_\_\_
  2. \_\_\_\_\_
10. \_\_\_\_\_ value is the value of an established business property compared with the value of the physical assets of a business that is not yet established.
11. An \_\_\_\_\_ asset does not have physical existence, meaning it cannot be seen or touched.

## 17.5 EXPERTISE REQUIRED IN BUSINESS BROKERAGE

The expertise required in business brokerage includes the following:

- Corporate finance
- Business accounting
- Valuation of businesses

### Corporate Finance

To become a reputable, successful business broker requires training and experience. People with corporate backgrounds or business education are able to draw upon those experiences. The business broker works in conjunction with CPAs and attorneys to provide the expertise required in the purchase and sale of businesses. Expertise in corporate finance includes knowledge of the following:

- *Classes and characteristics of corporate stock* [common (required of all corporations) and preferred]
- *Securities analysis and valuation*
- *Management of working capital* (the difference between total current assets and total current liabilities)
- *Budgeting* (an estimate of anticipated income and expenditures over a definite future period)

### Business Accounting

Some areas important to business accounting are the following:

- *Income statement analysis.* The income statement is a concise summary of all income and expenses of a business for a *stated period of time*. It is designed to show the results of business operations over a specific period and to provide the basic data for analyzing the reasons for a firm's profits or losses.
- *Balance sheet analysis.* The balance sheet shows the company's financial position at a *stated moment in time*, the close of business on the date of the balance sheet. The balance sheet shows assets, liabilities, and owner's equity (net worth). It is customary to prepare an income statement and a balance sheet at the same time. This allows the net income or loss shown on the income statement for the prior period to be reflected on the balance sheet as of that particular moment.
- *Cash flow analysis.* Cash flow is the total amount of money generated from an investment after expenses have been paid. Operating expenses include reserves



1 for replacement and payment of mortgage principal and interest. Cash flow disre-  
2 gards depreciation because depreciation does not involve an outlay of cash.

- 3 ■ *Asset depreciation.* Business brokers must be able to separate the depreciable assets  
4 of a business into real property and personal property.
- 5 ■ *Taxation.* Anyone interested in buying or selling a business knows the critical  
6 role taxes play in the success or failure of that business. Business brokers must be  
7 alert to recommending that clients seek expert tax advice.

## 8 Valuation of Businesses

9 The methods used to estimate a business's value are similar to those used in appraising  
10 real property.

- 11 ■ *Comparable sales analysis.* Where records reveal previous sale prices for businesses  
12 with a high degree of similarity, the appraiser can use professional judgment to  
13 account for existing differences and to arrive at a close approximation of the  
14 market value of a business.
- 15 ■ *Cost approach.* This method is appropriate for estimating the value of improve-  
16 ments of any type. When reproduction cost is used as a basis, the appraiser cal-  
17 culates the amount required to duplicate exactly the business or building being  
18 appraised. When replacement cost is used, the appraiser calculates the cost that  
19 would result in a business's (or building's) having the same use and capabilities  
20 as the one being appraised, even though the new business/building might differ  
21 physically.
- 22 ■ *Income analysis.* Most income-producing properties derive a large portion of their  
23 value from their ability to produce an income stream. This method of apprais-  
24 ing attempts to estimate accurately the present value of expected future benefits  
25 (earnings and appreciation of assets) by converting the anticipated income  
26 stream into a present value through the use of a capitalization rate. The income  
27 approach is the best approach for valuing a business.
- 28 ■ *Liquidation analysis.* The liquidation of a business may become necessary because  
29 of failure of a business, the death of a sole proprietor, the dissolution of a part-  
30 nership, a court order, or any number of other reasons. In a **liquidation analysis**,  
31 business brokers and financial experts must consider such factors as the ability  
32 of the firm to pay off short-term obligations, the value of the inventory on hand,  
33 and the liquidation value of preferred stock.

34 In addition to all the activities mentioned, a business broker is required to observe the  
35 many regulatory provisions, including Chapter 475, F.S., and state and federal securities  
36 laws.

## Practice Questions

12. The expertise required in business brokerage includes \_\_\_\_\_ finance,  
\_\_\_\_\_, and \_\_\_\_\_ of businesses.
13. Working capital is the difference between total current \_\_\_\_\_ and total  
current \_\_\_\_\_.
14. The two types of corporate stock are \_\_\_\_\_ and \_\_\_\_\_ stock.

## 17.6 STEPS IN THE SALE OF A BUSINESS

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The sale of a business generally can be described as a series of steps. In the case of an outright purchase (and sale), the following 12-step sequence usually occurs:

1. *The listing.* List the business for sale.
2. *Identify all assets of the business.*
3. *Valuation of the business.*
4. *Deduct liabilities.* Subtract the value of all short-term and long-term liabilities (including the value of preferred stock) from the value of the business.
5. *Valuation of stock.* If a corporation is being sold by transferring shares of stock, the share value must be determined. Divide the net value of the business by the number of common shares of stock outstanding. Most small businesses are sold as an asset sale even if the business is held as a corporation.
6. *Legal compliance with all pertinent laws.*
7. *Market (advertise) the business.*
8. *Secure a buyer.* Have the buyer sign a confidentiality (nondisclosure) agreement before releasing the name, location, and financial information regarding the business.
9. *Enter into a contract with both parties.*
10. *Due diligence period.* Buyer inspects the financials of the business.
11. *Closing preparation.* If real estate is not sold with the business, an assignment of the lease or a new lease from the landlord is prepared; if real estate is included in the sale, title work is ordered.
12. *Coordinate a date for closing the transaction.*

### Practice Questions

15. Once all of the \_\_\_\_\_ of a business are identified, the \_\_\_\_\_ are deducted from the value of the business.
16. To protect a business's confidentiality regarding sale, the buyer should be required to sign a \_\_\_\_\_ agreement before releasing financial information regarding the business.
17. A \_\_\_\_\_ period is established to allow the buyer to inspect the \_\_\_\_\_ of the business.

## 17.7 SUMMARY OF IMPORTANT POINTS

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- Real estate investment analysis is the process of determining the extent to which real estate investments achieve an investor's objectives.
- *Appreciation* is the increase in property value over a period of time due to economic causes.
- *Assets* are the entire resources of a business. An asset is anything of value. A tangible asset can be touched and has actual substance. An intangible asset has value but does not have physical substance, such as the goodwill of a business. The difference between assets and liabilities is net worth.

- 1 ■ *Cash flow* is the total amount of spendable income generated from an invest-  
2 ment. It is the total amount of money remaining after all expenditures have been  
3 paid. Cash flow may be positive or negative.
- 4 ■ *Equity* is the property's value minus debt.
- 5 ■ *Leverage* is the use of borrowed funds to finance the purchase of an asset. Positive  
6 leverage occurs when the benefits exceed the cost of borrowing. Negative lever-  
7 age occurs if the borrowed funds cost more than they are producing. *Liquidity*  
8 refers to the ability to sell an investment very quickly without loss of capital.
- 9 ■ *Basis* is an investor's initial cost of the property. The basis is adjusted by add-  
10 ing any capital improvements made to the property and deducting depreciation  
11 expenses taken on tax returns during the years of ownership.
- 12 ■ *Capital gain (or loss)* is the difference between the adjusted basis of property and  
13 its net selling price. A capital gain or capital loss has tax consequences to the  
14 owner of investment property.
- 15 ■ *Tax shelter* is the term used to describe advantages of owning real estate invest-  
16 ments. An investment is a tax shelter when it shields income from payment of  
17 income taxes.
- 18 ■ Real estate investment trusts (REITs) offer investors the opportunity to invest in  
19 a pool of income-producing properties under professional management.
- 20 ■ Investors can choose from several types of real estate investments: residential,  
21 commercial, industrial, agricultural, and business opportunities.
- 22 ■ Advantages of real estate investment include the following: rate of return, tax  
23 advantages, hedge against inflation, leverage, and equity buildup.
- 24 ■ Disadvantages of investing in real estate include the following: illiquidity, local  
25 market, need for expert help, management requirements, and risk.
- 26 ■ *Risk* is the chance of losing all or part of an investment.
- 27 ■ Risk associated with general business conditions include the following: business  
28 risk, financial risk, purchasing-power risk, and interest-rate risk.
- 29 ■ Business brokerage and real estate brokerage similarities include (1) the sale of  
30 real property or assignment of a long-term lease may be involved, and (2) an  
31 active real estate license is required for business brokerage and real estate  
32 brokerage.
- 33 ■ Business brokerage differs from real estate brokerage in three ways. Business  
34 brokerage (1) may include personal property and goodwill assets; (2) the going-  
35 concern value may differ from real estate value; and (3) business brokerage may  
36 have a wider geographic market.
- 37 ■ *Going-concern value* is the value of an established business property compared  
38 with the value of just the physical assets of a business that is not yet established.
- 39 ■ An *income statement* is a concise summary of all income and expenses of a busi-  
40 ness for a stated period of time. A *balance sheet* shows the company's financial  
41 position at a stated moment in time.
- 42 ■ Expertise required in business brokerage includes corporate finance, business  
43 accounting, and valuation of businesses.
- 44 ■ The methods of appraising a business are comparable sales analysis, reproduction  
45 or replacement cost, income analysis, and liquidation analysis.

# UNIT 17 EXAM

1. Investors who want to invest in office buildings and apartment complexes but want the advantages of liquidity and diversification often consider investing in
  - a. a real estate investment trust.
  - b. a large property management company.
  - c. a mutual fund that invests in the broad stock market.
  - d. none of these.
2. A case in which the interest paid for borrowed funds is less than the overall rate of return to an investor is an example of
  - a. loan-to-value ratio.
  - b. positive leverage.
  - c. negative leverage.
  - d. yield.
3. Business risk is chance of loss associated with the
  - a. variance between projected and actual income and expenses.
  - b. ability to pay all operating expenses from proceeds generated by the investment.
  - c. increase in interest rates during the period of investment.
  - d. effect of inflation on purchasing power.
4. Intangible assets of a business do NOT include
  - a. goodwill.
  - b. customer loyalty.
  - c. trademarks.
  - d. improvements.
5. A firm's working capital is customarily defined as the difference between the firm's total
  - a. current assets and total current liabilities.
  - b. current liabilities and total cash on hand.
  - c. short-term liabilities and total cash on hand.
  - d. long-term liabilities and total accounts receivable.
6. How does business brokerage differ from real estate brokerage?
  - a. An appraisal is usually needed.
  - b. An interest in real property is involved.
  - c. Intangible assets must be considered.
  - d. A real estate license is required.
7. The financial report that indicates a firm's financial position at a stated moment in time is the
  - a. operating statement.
  - b. balance sheet.
  - c. working capital statement.
  - d. statement of net earnings.
8. The value of an established business property, compared with the value of just the physical assets of a business that is NOT yet established, is called
  - a. going-concern value.
  - b. goodwill.
  - c. business enterprise.
  - d. tangible assets.
9. The advantages of real estate as an investment do NOT include
  - a. a generally good rate of return compared with other types of investments.
  - b. a hedge against inflation.
  - c. income tax considerations.
  - d. the need for active management.
10. A concise summary of all income and expenses of a business for a stated period of time is the
  - a. balance sheet.
  - b. income statement.
  - c. cash flow statement.
  - d. asset sheet.
11. All the resources of a business, including tangibles and intangibles, are called the
  - a. net worth.
  - b. capital.
  - c. gross income.
  - d. assets.
12. The market value of an apartment building is \$975,900. The investor has leveraged \$731,925. What is the investor's equity in the property?
  - a. \$178,925
  - b. \$197,759
  - c. \$243,975
  - d. \$731,925