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Return on Cash

Cap rates are volatile, by its very nature, as it is a measure, a gauge of price movement in the real estate market, which we know over the course of the past 3 years is very unpredictable, for each subclass i.e. multi-family, office, farming, single-residential. As many are aware, cap rate = NOI, or the pre-tax, cash flow before servicing, much similar to the EBIT figure in company financials, divided by the market value of the property.

Now, if an investor wanted to purchase a million dollars in bonds, selling at par, one typically assumes an unleveraged investment. It is rarely assumed the investor is purchasing on margin, so the YTM, which is the annualized return from interest+bond appreciation+reinvestment yield assumption/price of the bond, is rarely modified into a separate "unlevered" YTM. The price of the bond is assumed to be a cash investment, with no consideration of leverage.

However, real estate, since the face amount is large, on a per unit basis versus $1,000 per bond, a clear distinction is made between levered return, or total invested capital, and unlevered, or equity investors pure cash investment, also known as cash over cash return. So I submit this question, which is more important, return on total invested capital, or return on equity cash?

It would be unreasonable to compare ROIC in real estate, versus an unlevered purchase of 100 shares of a stock. It is these very tidbits, which makes it difficult to switchover from equity to real estate investment and vice-versa, but the underlying principles are the same.

Real estate is so attractive, in many ways since it is the closest than an average investor can get to running a LBO business model. Where else can investors put in 20% equity, to purchase an investment that can be fixed, renovated, to generate higher earnings and then sold in a matter of a couple years and receive a +20% IRR, while taking into consideration the effect of interest payment and expense items? It is a packaged LBO model, a scaled down version. The real estate brokers are the investment bankers, the mortgage co. is the syndicate bank, the rental revenue/renovation cost is the cash flow from operations and the disposition price is the disposition price. There may be less people involved with MBAs and CPA, CFAs, but it is 80% identical.

Unfortunately, I haven't found an investment blog that is focused on real investment, at least not related to Excel based, numbers oriented real estate investment analysis, when there are numerous solid, reliable sites for equities and bonds. So I came to the decision, why shouldn't SN Valuation be able to start such a venture? A section, specifically geared toward analyzing the return on an investment for real estate. We are slowly, but surely attempting to construct a platform for equities and bonds, so we feel, we should pursue a similar venture for real estate.

It has taken 3 years, for us to come to develop the process to do what we are doing right now. To many, it might not seem like much, which is beyond the point of the overarching goal of this site. We are here to learn, we are here to internalize the basic principles of investment through and through different asset classes, so that the readers and interns and analysts may be equipped with the tools to make correct investment decisions in the future, thereby avoiding the embarrassing fiasco we experienced in 2007-2009.