

Glossary

Commercial Real Estate Investment Terms

Amortization

The repayment of loan principal through equal payments over a designated period of time consisting of both principal and interest.

Annual Debt Service (ADS)

The total amount of principal and interest to be paid each year to satisfy the obligations of a loan contract.

Appraised Value

An opinion of a property's fair market value, based on an appraiser's knowledge, experience, and analysis of the property.

Appreciation

The increase in the value of a property due to changes in market conditions, inflation, or other causes.

Assessed Value

The valuation placed on property by a public tax assessor for purposes of taxation.

Assignment

When ownership of the mortgage on the property is transferred from one company or individual to another.

Assumption

The term applied when a buyer assumes the seller's mortgage.

Broker/Dealer

An individual or firm that is in the business of buying and selling securities. Broker/dealers are registered with the Securities and Exchange Commission (SEC).

Capital Expenditures

Property improvements that cannot be expensed as a current operating expense for tax purposes. Examples include a new roof, tenant improvements, or a parking lot.

Capital Gain

Taxable income derived from the sale of a capital asset.

Capitalization

A method of determining value of real property by considering net operating income divided by a predetermined annual rate of return.

Capitalization Rate (CAP rate)

A percentage that relates the value of an income-producing property to its future income, expressed as net operating income divided by purchase price.

Cash Flow

The net cash received in any period, taking into account net operating income, debt service, capital expenses, loan proceeds, sale revenues, and any other sources and uses of cash.

Cash-on-Cash Return

A return measure that is calculated as cash flow before taxes divided by the initial equity investment.

Common area maintenance (CAM)

Charges paid by the tenant for the upkeep of areas designated for use and benefit of all tenants.

Compounding

A type of calculation in which interest earned is reinvested and earns additional interest.

Cost Approach

A method of determining the market value of a property by evaluating the costs of creating a property exactly like the subject.

Debt-Coverage Ratio (DCR)

Ratio of net operating income to annual debt service. Expressed as net operating income divided by annual debt service.

Demographics

Characteristics of human populations as defined by population size and density of regions, population growth rates, migration, vital statistics, and their effect on socio-economic conditions.

Depreciation

The loss of utility and value of a property.

Discount Rate

The percentage rate at which money or cash flows are discounted.

Diversification

A method of reducing risk by investing in unrelated (uncorrelated) assets.

Dividend Reinvestment

A method that allows shareholders to automatically reinvest dividends and capital gains distributions, thereby accumulating more stock while avoiding brokerage commissions.

Due Diligence

The process of examining a property, related documents, and procedures conducted by or for the potential lender or purchaser to reduce risk.

Earnest Money

The monetary advance by a buyer of part of the purchase price to indicate the intention and ability of the buyer to carry out the contract.

Estoppel Certificate

A legal instrument required by a mortgagor to be executed by an individual leasing a property, which verifies the major points (e.g., base rent, lease commencement and expiration) existing in the lease between the landlord and tenant.

Exchange

Under Section 1031 of the Internal Revenue Code, like-kind property used in a trade or business or held as an investment can be exchanged tax-deferred.

Financial Leverage

The use of borrowed funds to acquire an investment.

Financial Risk

The possible change in an investment's ability to return principal and income.

Future Value (FV)

The amount to which money grows over a designated period of time at a specified rate of interest.

Income Capitalization Approach

A method to estimate the value of an income-producing property by converting net operating income into a value. The cap rate is divided into the net operating income to obtain the estimated value. $\text{Value} = \text{net operating income} \div \text{capitalization rate}$

Internal Rate of Return (IRR)

The percentage rate earned on each dollar that remains in an investment each year. The IRR of an investment is the discount rate at which the sum of the present value of future cash flows equals the initial capital investment.

Leverage

The use of borrowed funds to finance a portion of the cost of an investment.

Limited Partnership

A business organization with a general partner who is responsible for managing the business and assumes legal debts and obligations, and one or more limited partners who do not participate in day-to-day operations and are liable only to the extent of their investments.

Liquidity

The ability to convert an investment into cash quickly without loss of principal.

Listed Security

Traded on an exchange, such as the NYSE or AMEX.

Loan-to-Value Ratio (L/V)

The amount of money borrowed in relation to the total market value of a property. Expressed as the loan amount divided by the property value.

Market Data Approach

A method of determining the property's value by analyzing recent sales or rental prices of comparable properties.

Market Risk

The possibility that downward market trends will reduce an investment's market value.

Market Value

The most probable price that a property would bring in a competitive and open market under fair sale conditions.

Negative Leverage

Borrowed funds are invested at a rate of return lower than the cost of funds to the borrower.

Net Present Value (NPV)

The sum of all future cash flows discounted to present value and netted against the initial investment.

Non-Disturbance Agreement

The tenant signs this to prevent himself from being evicted if the property owner does not pay its mortgage to the bank.

Owning

A means of obtaining the full economic use of a property for an unspecified period by obtaining an ownership interest.

Portfolio Income

Income from interest, dividends, royalties, or the disposition of property held for investment.

Positive Leverage

Borrowed funds are invested at a rate of return higher than the cost of the funds to the borrower.

Present Value (PV)

The sum of all future benefits or costs accruing to the owner of an asset when such benefits or costs are discounted to the present by an appropriate discount rate.

Rate of Return

The percentage return on each dollar invested.

Real Estate Cycles

The regularly repeating sequence of economic downturns and upturns and associated changes in real estate market transactions tied to market dynamics and changing macroeconomic conditions, whose phases include (in order) recession, recovery, expansion, and oversupply.

Real Estate Investment Trust (REIT)

An investment vehicle in which investors purchase certificates of ownership in the trust, which in turn invests the money in real property and then distributes any profits to the investors.

Recourse

The right of a lender, in the event of a default by the borrower, to recover against the personal assets of a party who is secondarily liable for the debt.

Relinquished Property

The property "sold" by the Exchanger in a 1031 exchange. This is also sometimes referred to as the "exchange" property or the "downleg" property.

Replacement Cost

The estimated cost to construct, at current prices, a building with utility equivalent to the building being appraised, using modern materials and current standards, design, and layout.

Replacement Property

The property acquired by the Exchanger in a 1031 exchange. This is sometimes referred to as the "acquisition" property or the "upleg" property.

Reversion Value

A lump-sum cash benefit that an investor receives or expects to receive upon the sale of an investment.

Risk

The probability that actual cash flows from an investment will vary from the forecasted cash flows.

Sale-Leaseback

A leasing and financing strategy in which a property owner sells its property to an investor, then leases it back.

Sales Comparison Value

An estimate of value derived by comparing the property being appraised to similar properties that have been sold recently, applying appropriate units of comparison, and making adjustments to the sales prices of the comparable based on the elements of comparison.

Securitization

The phenomenon of indirectly investing in real estate markets in ways that minimize risk (for example, investments made collectively with pooled money or the use of investment packages/funds, such as mortgage backed securities sold on the secondary financial market) as opposed to direct investments where investors own property or hold mortgages; a long-term trend that has had significant impact on real estate values.

Subordination Agreement

As used in a lease, the tenant generally accepts the leased premises subject to any recorded mortgage or deed of trust lien and all existing recorded restrictions, and the landlord is often given the power to subordinate the tenant's interest to any first mortgage or deed of trust lien subsequently placed upon the leased premises.

Tenant Improvements

Preparation of leased premises prior to or during a tenant's occupancy, which may be paid for by either the landlord or tenant.

Tenancy in Common

Ownership of property by two or more individuals, each of whom has an undivided interest, without the right of survivorship.

Volatility

The rate at which the price of a security moves up and down.

Yield

A measure of investment performance that gauges the percentage return on each dollar invested.