CHAPTER NINE

Real Estate

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MONEY, BANKING AND FINANCIAL MARKETS A MODERN INTRODUCTION TO MACROECONOMICS

Dale K. Cline and Sandeep Mazumder

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Real Estate in the Economy

Real Estate

Property consisting of land and buildings.

Real estate represents 20% of the value of all assets in the U.S.

Real estate is the largest asset in value that most people own.

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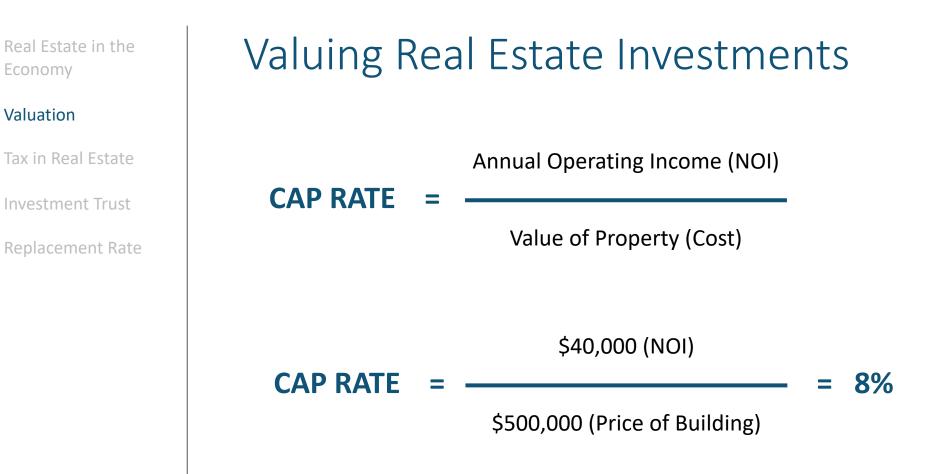
Investment Trust

Replacement Rate

Valuing Real Estate Investments

Investors should always consider the following when exploring interest in a property acquisition:

- Net Operating Income (primary)
 - The total income generated from owning a property minus its associated operating expenses
 - Defines cash flow after payment of all annual operating expenses
- Interest Rate (secondary) Determines the overall return on the investment



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Valuing Real Estate Investments

Methods to value real estate:

- The Income Capitalization Approach
 - Capitalization of Income a type of real estate appraisal method that estimates the value of a property based on the current operating income the property generates
 - Determines the value based upon how much rent will be produced
 - Extrapolates a future market value from the current net operating income
 - Uses the capitalization rate to develop a market sale price for the property

Capitalization Rate = Annual operating income (NOI) / value of property (cost)

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Methods to value real estate:

- The Discounted Cash Flow Approach
 - Discounted Cash Flows an appraisal method that determines the value of real estate today based on projections of how much income it will generate in the future
 - Calculated by developing projected cash flow data followed by discounting the future expected operating income back to the present to determine the current value

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Taxes do not determine market value for a particular property.

Taxes do impact net profit.

Depreciation

The reduction in value of real estate over time due to wear and tear.

• A tax deduction applied to allocate the cost of wear and tear over a property's useful life

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Two types of rental property tax:

- *Net Taxable Income* Tax from operating income property is generally subject to income tax at ordinary tax rates
- *Capital Gains Tax* Tax applicable to any gain realized on properties when they are sold

Investors pay professionals to handle the taxes of real estate properties.

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Real Estate Investment Trust

Real Estate Investment Trust

A company that owns, operates, or finances income-generating real estate.

A real estate investment trust influences the growth of the real estate industry.

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The Replacement Rate

Replacement Rate

Number of people that must be born to replace the number of people that died.

Current replacement rate = 2.1 (estimated)

Replacement rate is a key economic indicator.