Accounting beta, 25
Adjusted funds from operations (AFFO), 154, 157–161, 167, 182–183
Adjusted present value method, 7, 8
ANOVA, 23, 26–27, 29
Arbitrage Pricing Theory (APT)
   answers to chapter questions, 238
   learning objectives and questions on, 209, 210
Asset approach, 64, 67, 154
Assets
   intangible. See Intangible assets
   off-balance sheet, 65
   underlying assets in real estate entities. See Underlying assets
Band of investment method, 115–119, 121, 126
Bankruptcy
   answers to chapter questions, 237
   learning objectives and questions on, 209
   REITs, 147, 172
   subsidiaries, 77
Beta
   accounting beta, 25
   answers to chapter questions, 234, 235
   and capital asset pricing model (CAPM), 35, 37
   closely-held companies, 10, 24, 25, 31, 35
   estimates. See Beta estimates
   full-information beta estimates, 11, 15–21
   fundamental beta, 24, 25
   learning objectives and questions on, 198–202
   levered, 20, 24, 25, 35, 200, 201
ordinary least squares regression (OLS), 11–13, 22–30
proxy beta, 10, 24, 25, 31, 35
relevered, 36, 37, 40, 43, 45, 47, 173
reporting units, 10, 24, 31
unlevered, 25, 36, 172, 200
Beta estimates
   answers to chapter questions, 234
   beta estimation output, evaluating, 25, 26
downside estimates, computing, 31–33
full-information beta estimate, 11, 15–21
learning objectives and questions on, 198, 199
OLS beta, 11–13, 22–30
overview, 10
sum beta estimate, 11, 13–15
Binomial option model, 69, 71, 74
Black-Scholes option pricing model, 67, 70–73, 77
Bottom-up beta. See Proxy beta
Build-up method
   answers to chapter questions, 232
   learning objectives and questions on, 194, 195
real estate entities, 171, 172, 174
Business enterprise value, 65, 66, 68–70, 73–77, 79
Call options, 68–70, 72, 79. See also Black-Scholes option pricing model
Capital asset pricing model (CAPM)
   answers to chapter questions, 233, 235
   and beta, 35, 36
   iterative process to calculate cost of equity in WACC (changing capital structure), 49–62
Capital asset pricing model (CAPM) (Continued)
iterative process to calculate cost of equity in WACC (constant capital structure), 35–48
learning objectives and questions on, 196, 197, 201, 202
real estate entities, 172–175
Capital budgets
answers to chapter questions, 240
learning objectives and questions on, 214, 215
Capital cash flow method, 5–7
Capital structure
answers to chapter questions, 233, 234
iterative process to calculate cost of equity in WACC (changing capital structure), 49–62
iterative process to calculate cost of equity in WACC (constant capital structure), 35–48
learning objectives and questions on, 192, 193
leveraged, 67, 68
real estate entities, 109, 143–147, 149, 172, 173
Capitalization
answers to chapter questions, 230, 231
learning objectives and questions on, 190, 191
Capitalization of economic income method, 36
Capitalization rate
answers to chapter questions, 244
estimating, 121–123
income approach, 121–124
learning objectives and questions on, 225
Cash flow projections
real property (individual assets), 135–137
Cash flow to equity method. See Equity cash flow method
Cash on cash return, 116
Clean-surplus accounting statement, 8
Closely-held companies
investment entities (PICs), 84, 90, 91, 94, 96. See also Private investment company (PIC) interests
iterative process for CAPM to calculate cost of equity in WACC (constant capital structure), 35–48
liquidity, 94, 96
private company discount (PCD), 220, 242
proxy beta, 10, 24, 25, 31, 35
real estate entities, 140, 143, 159, 163–165, 172, 173, 175
Company-specific risk
answers to chapter questions, 237
learning objectives and questions on, 206–208
Constant growth model, 51, 54, 61, 162, 169
Controlling interests
answers to chapter questions, 243, 244
cost of capital data, answers to chapter questions, 242, 243
cost of capital data, learning objectives and questions on, 222, 223
learning objectives and questions on, 219
Corporations, 66, 109, 111, 140, 141, 143. See also Closely-held companies
Cost approach
real property (individual assets), 108
Cost of capital
answers to chapter questions, 229
global models, answers to chapter questions, 239
global models, learning objectives and questions on, 211, 212
implied, learning objectives and questions on, 210
learning objectives and questions on, 187–189
Cost of equity capital
answers to chapter questions, 238
“as if publicly traded,” 83, 164, 165
learning objectives and questions on, 209, 210
Country risk adjustments
<table>
<thead>
<tr>
<th>Index</th>
</tr>
</thead>
<tbody>
<tr>
<td>Diversification, 109, 140, 144</td>
</tr>
<tr>
<td>Dividends</td>
</tr>
<tr>
<td>in adjusted present value method, 7</td>
</tr>
<tr>
<td>excess return calculation for OLS and sum beta, 11, 12, 23</td>
</tr>
<tr>
<td>in invested capital method, 4, 5</td>
</tr>
<tr>
<td>in net cash flow to equity formula, 3</td>
</tr>
<tr>
<td>preferred dividends, 7, 8</td>
</tr>
<tr>
<td>private investment companies (PICs), 84, 89</td>
</tr>
<tr>
<td>real estate entities, 142, 143, 147, 152, 154, 157–175, 178, 183</td>
</tr>
<tr>
<td>in residual income method, 8</td>
</tr>
<tr>
<td>in WACC, 6</td>
</tr>
<tr>
<td>Divisions</td>
</tr>
<tr>
<td>answers to chapter questions, 240</td>
</tr>
<tr>
<td>learning objectives and questions on, 215, 216</td>
</tr>
<tr>
<td>DLOC. See Discount for lack of control (DLOC)</td>
</tr>
<tr>
<td>DLOM. See Discount for lack of marketability (DLOM)</td>
</tr>
<tr>
<td>EBIT (earnings before interest and taxes), 5, 7, 52, 55, 158</td>
</tr>
<tr>
<td>EBITDA (earnings before interest, taxes, depreciation, and amortization), 52, 55, 158</td>
</tr>
<tr>
<td>Economic income, 8, 154, 158, 159, 183. See also Invested capital method</td>
</tr>
<tr>
<td>answers to chapter questions, 229, 230, 244</td>
</tr>
<tr>
<td>learning objectives and questions on, 189, 190, 225</td>
</tr>
<tr>
<td>Economic Value Added (EVA), 9</td>
</tr>
<tr>
<td>answers to chapter questions, 241</td>
</tr>
<tr>
<td>learning objectives and questions on, 218, 219</td>
</tr>
<tr>
<td>Ellwood formula, 117–119</td>
</tr>
<tr>
<td>Equity capitalization rate, 116</td>
</tr>
<tr>
<td>Equity cash flow method, 3, 4, 60–62</td>
</tr>
<tr>
<td>Equity dividend rate, 113, 116–118, 128, 130</td>
</tr>
<tr>
<td>Equity investments in real property, forms of, 108. See also Real property (individual assets)</td>
</tr>
</tbody>
</table>
Index

Equity risk premium (ERP)
- answers to chapter questions, 233, 234
- learning objectives and questions on, 197, 198

Excess earnings method
- answers to chapter questions, 243, 244
- learning objectives and questions on, 223, 224

Fair market value
- of business enterprise, 65, 66, 68–70, 73–77, 79
- nonmarketable investment company evaluation (NICE) method, 84, 85, 105. See also Nonmarketable investment company evaluation (NICE) method
- PIC interests, 84, 85, 101, 103–106 in underlying assets approach, 155
- for U.S. federal income tax purposes, 64–66
- valuation approaches, 64, 66

Fair value
- answers to chapter questions, 240
- learning objectives and questions on, 216

Fama-French three-factor method
- answers to chapter questions, 238
- learning objectives and questions on, 209, 210

Family limited partnerships (FLPs), 84, 86, 89

Feasibility analysis, 123

Feasibility studies
- answers to chapter questions, 240
- learning objectives and questions on, 214, 215

Financing
- capital financing, 4, 5, 7
- real estate entities, 141, 144–154, 163, 164, 167, 169, 175
- real property (individual assets), 108, 109, 123, 127, 133
- Four Quadrant model, 144

Free cash flow to equity, 4. See also Equity cash flow method

Free cash flow to the firm, 5

Fundamental beta, 24, 25

Global cost of capital models
- answers to chapter questions, 239
- learning objectives and questions on, 211, 212

Gordon Growth Model, 162, 163, 169

Guideline public companies
- equity fair market value estimation, 68, 70–72
- full-information beta estimates, 11, 15–21
- potential value of worthless securities, 67, 70–77
- proxy beta estimates for closely-held companies, 35

Historical time series data, 24, 25

Implied cost of capital
- answers to chapter questions, 238
- learning objectives and questions on, 210

Income approach
- answers to chapter questions, 229
- band of investment method, 115–119, 121, 126
- capitalization of economic income method, 36
- capitalization rate, 121–124
- debt coverage ratio (DCR), 119–121
- direct capitalization method, 111–124, 135, 138
- discounted cash flow method. See Discounted cash flow (DCF) method
- Ellwood formula, 117–119
- fair market value of business, 64–67
- income capitalization approach, 157–162
- learning objectives and questions on, 188, 189
- nonmarketable investment company evaluation (NICE) method, 84, 105
- PIC interest, 103–105
- potential value of worthless securities, 66, 67
Index

present value, 66, 132, 135
real property (individual assets), 108, 111–124, 131–138
underlying assets, real estate entities, 155–157. See also Real estate entities
underwriter’s method, 119
Income capitalization approach, 157–162
Incremental rate of return for lack of control (IROC), 92, 93, 101, 106
Incremental rate of return for lack of marketability (IROM), 95–99, 101, 106
Inflation
rate, 109, 120, 125, 126, 137, 166
and real estate investments, 149, 150, 163–166, 171
risk, 110, 171
Intangible assets
answers to chapter questions, 242
learning objectives and questions on, 217
real estate entities, 140, 142, 155, 157, 177, 178
in underlying assets approach, 155
and worthless securities, 64, 67
Invested capital method, 4, 5, 38, 39
Iterative process to calculate cost of equity in WACC
changing capital structure, 49–62
constant capital structure, 35–48
Joint ventures, 108, 141, 156, 180, 181
Liabilities
in net asset value, 155, 156
off-balance sheet, 66
Limited liability companies (LLCs), 84, 140, 143
Liquidating value, 64–72, 77–79
Liquidation
private investment companies, 84–89, 98, 104, 106
Net asset value (NAV)
private investment company (PIC) interests, 84, 86, 90, 91, 99–101, 105
real estate entities, underlying assets, 140, 155–157, 159, 171, 174, 178
Net cash flow
adjusted present value method, 7, 8
answers to chapter questions, 229, 230, 245
capital cash flow method, 5–7
equity cash flow method, 3, 4, 60–62
estimating, learning objectives and questions on, 226
invested capital method, 4, 5, 38, 39
Market capitalization, REITs, 142, 147, 158–160, 166, 167
Market (comparable sales) approach
fair market value of business, 64
private investment companies (PICs), 84
real property (individual assets), 108
Mean reversion, 86–89
Mergers and acquisitions
answers to chapter questions, 241
learning objectives and questions on, 216, 217
Minority interests. See also Discount for lack of control (DLOC); Discount for lack of marketability (DLOM)
answers to chapter questions, 241, 242
cost of capital data, answers to chapter questions, 242, 243
cost of capital data, learning objectives and questions on, 222
learning objectives and questions on, 219
in private investment companies (PICs), 83, 89
Morningstar data, 91, 92, 106
answers to chapter questions, 239, 240
learning objectives and questions on, 212–214
Mutual funds
growth of, 144
mean reversion, 87–89
rate of return, 90–92
Net asset value (NAV)
Net cash flow (Continued)
learning objectives and questions on, 189, 190
residual income method, 8, 9
Net cash flow to equity, 3, 4, 225, 244
Net cash flow to invested capital. See
Capital cash flow method; Invested
capital method
Net cash flow to the firm, 4. See also
Invested capital method
Net cash flow to unlevered equity, 7
Nonmarketable investment company
evaluation (NICE) method, 84–106
Ordinary least squares regression (OLS)
beta estimates, 11–13, 22–30
regression output, evaluating, 26–30
Ownership rights
real property (individual assets), 108,
131
Partnerships, 84, 86, 106, 108, 139–141,
143–145, 156, 164, 174, 175, 180,
181, 183
Pass-through entities
answers to chapter questions, 244
dividends, 23
learning objectives and questions on,
222, 223
real estate entities, 143, 163, 164,
173, 180
PICs. See Private investment company
(PIC) interests
PIPEs (private investment in public
equities)
answers to chapter questions, 242
learning objectives and questions on,
221, 222
Potential value, 64, 66, 67, 73–77, 79
Preferred dividends, 7, 8
Preferred stock, 3–6, 78, 145, 146, 155,
163
Premiums, 60, 86, 88, 90, 96, 97, 100,
142, 153, 156, 172–174. See also
Risk premiums
Present value
adjusted present value method. See
Adjusted present value method
direct capitalization formulas, 111,
112
in discounted cash flow method,
69–71, 125
in equity value calculation, 61
income approach, 66, 132, 135
Private company discount (PCD). See
also Closely-held companies
answers to chapter questions, 242
learning objectives and questions on,
220
Private equity investments
answers to chapter questions, 242
learning objectives and questions on,
221, 222
Private investment company (PIC)
interests
curve of best fit, 104–106
lack of control, 83, 84, 89–93
lack of marketability, 83, 84,
93–99
long-term investments, 86
net asset value (NAV), 84, 86, 90, 91,
99–101, 105
nonmarketable investment company
evaluation (NICE) method,
84–106
overview, 83, 84, 105, 106
private investment companies (PICs),
84, 85
time to liquidity event and value
relationship, 85–89
valuation example, 99–105
Private investment in public equities
(PIPEs)
answers to chapter questions, 242
learning objectives and questions on,
221
Project selection
answers to chapter questions, 231
learning objectives and questions on,
188, 189
Projection (capital recovery or holding)
period
real property (individual assets),
132–135
Property discount rate (property yield
rate), estimating
real property (individual assets), 126–130
Proxy beta, 10, 24, 25, 31
Public company beta estimates. See Beta estimates

Rate of return (ROR)
mutual funds, 90–92
private investment company interests, 84–106
real estate entities, 175
real property (individual assets), 109, 125–130, 132, 133, 136
required rate of return (RROR), 84–86, 92, 93, 101–104, 106

Real estate entities
adjusted funds from operations (AFFO), 154, 157–161, 167, 182, 183
build-up method, 171, 172, 174
capital asset pricing model (CAPM), 172–175
capital structure, 109, 144–147, 149, 172, 173
capitalization rate estimation, 158–162
categories of REITs, 141, 142
close-held REITs, 173
cost of equity capital “as if publicly traded,” estimating, 164, 165
defined, 140–143
discounted cash flow method (DCF), 162, 163
dividends, 167–171
funds from operations (FFO), 152, 154, 157–161, 163, 165–167, 169, 181–183
income capitalization approach, 157–162
legal structure, 143, 144
long-term dividend and total return analysis, 173–175
market capitalization, 142, 147, 158–160, 166, 167
net cash flow, measuring, 154, 177, 178
overall cost of capital, computing, 163–165

overall direct capitalization, x
overview, 139, 140, 175
projected cash flow, 178–180
projected net cash flow, 180
real estate cycles, 147–153
REIT defined, 141
underlying assets approach, 155–157, 159, 171, 174, 178
valuation of, 154–175, 177–183
weighted average cost of capital (WACC), 163–165

Real estate (individual assets). See Real property (individual assets)
Real estate investment trusts (REITs). See Real estate entities
Real property (individual assets)
band of investment method, 115–119, 121, 126
capitalization rate, estimating, 121–123
cash flow projections, 135–137
cost approach, 108
direct capitalization method, 111–124, 135, 138
discounted cash flow method (DCF), 125–126, 132, 138
Ellwood formula, 117–119
equity investments, forms of, 108
financing, 108, 109
income approach, 108, 131–138
market (sales comparison) approach, 108
overview, 107, 108
ownership rights, 108, 131
projection (capital recovery or holding) period, 132–135
property discount rate (property yield rate), estimating, 126–130
rate of return, 109, 125–130, 132, 133, 136
residual capitalization rate methods, 123, 124
risk, 109–111
transactions, structure of, 108, 109
valuation approaches, 108
valuation steps, 131–138

Regression analysis. See Ordinary least squares regression (OLS)
Related party debt, 77, 78
Reporting units
  answers to chapter questions, 240
  learning objectives and questions on, 216, 217
proxy beta, 10, 24, 31
Required rate of return (RROR), 84–86, 92, 93, 101–104, 106
Residual income method, 8
Residual value, 132, 169
Risk
  answers to chapter questions, 231
  company-specific, answers to chapter questions, 237
  company-specific, learning objectives and questions on, 206–208
  country risk adjustments, answers to chapter questions, 239
  country risk adjustments, learning objectives and questions on, 211, 212
  learning objectives and questions on, 191, 192
  premiums. See Risk premiums
  real property (individual assets), 109–111
Risk premiums
  in adjusted present value method, 7
  answers to chapter questions, 233, 234
  in beta estimates, 25
  in build-up method, 172
  in CAPM, 35, 40, 41, 43, 45, 47
  and economic uncertainty, 161
  in equity value, 60
  learning objectives and questions on, 197, 198
  property discount rate, 126, 128
  REITs, 173
Risk-free rate, 109, 110, 171–173
S corporations, 143
Single-stage growth model, 162. See also
  Constant growth model; Gordon Growth Model
Size effect, 153, 161, 172
  answers to chapter questions, 235, 236
learning objectives and questions on, 202–205
Sole proprietorships, 143
Special-purpose entities, 143
Spreadsheets
  beta estimates, 11–21
  iterative process for equity value, 60–62
  iterative process using CAPM to calculate cost of equity in WACC (changing capital structure), 52–60
  iterative process using CAPM to calculate cost of equity in WACC (constant capital structure), 39–48
Standard Industrial Classification (SIC) codes
  full-information beta estimates, 16, 17
Standard of value
  U.S. federal income tax, 64, 65
Sum beta estimate, 11, 13–15
Tax deduction for worthless securities, 64, 79
Terminal value, 51, 54, 62, 74, 169, 170
Transfer pricing
  answers to chapter questions, 241
  learning objectives and questions on, 217
Underlying assets
  liquidating value of business, 64, 65, 67
  private investment companies, 87, 101
  real estate entities, 140, 145, 146, 154–157, 159, 161, 167, 171, 174, 178
Underwriter’s method, 119
Valuation approaches
  cost approach, 107
  income. See Income approach market. See Market (comparable sales) approach
  real estate entities, 154
  real property (individual assets), 107
Value, standard of for U.S. federal income tax purposes, 64, 65
Venture capital
  answers to chapter questions, 242
  learning objectives and questions on, 221–222

Weighted average cost of capital (WACC)
  answers to chapter questions, 240, 241
  assumptions, 50
  iterative process to calculate cost of equity (changing capital structure), 49–62
  iterative process to calculate cost of equity (constant capital structure), 35–48
  learning objectives and questions on, 210, 211
  pre-interest-tax-shield, 6
  in residual income method, 8, 9

Worthless securities
  liquidating value, 64–72, 77–79
  overview, 79
  potential value, 64, 66, 67, 73–77, 79
  related party debt, 77, 78
  tax deduction for, 64, 79