

Institutional Foundations for Emerging Securities and Real Estate Capital Markets

Presented by

Lawrence A. Souza

Professor of Real Estate Finance and Development

San Francisco State University

Director of Research

Presented to

Guang Dong Province Scholars

Friday June 2, 2000

Presentation Outline

- Institutional Foundations for Efficient Capital Markets
- Prerequisites for Efficient Securities Markets
- Prerequisites for Efficient Real Estate Markets
- Role of Institutional Investors in Allocation of Capital
- Role of the Real Estate and Financial Economist
- Hypothetical Capital Market Research Program

Capital Markets in a Social, Cultural and Economic Context

Interdisciplinary/Cross-Sectional Approach to
Capital Market Analysis:

- Philosophical Systems (Ethics/Morality)
- Legal Systems (Rule of Law and Contract Enforcement)
- Political Systems (Democratic/Authoritarian)
- Economic Systems (Capitalism/Socialism)
- Financial Systems (Capital Markets)

Institutional Foundations for Efficient Capital Markets

“Efficient real estate and securities capital markets require strong public and private sector cooperation, disclosure of government and corporate financial conditions, and institutional and individual investor confidence in financial and political institutions.”

Institutional Foundations for Efficient Capital Markets

- Clear Determination and Communication of economic and political policy goals.
- Government commitment to long-term financial stability.
 - Monetary and Fiscal Policies that promote capital formation.

Institutional Foundations for Efficient Capital Markets

- Price stability promoting consumer confidence and savings.
- Privatization and Securitization of New and Used Capital Stock.
- Strict Governmental and Corporate Disclosure Requirements
 - Standardized reporting systems for examination.

Prerequisites for Efficient Securities Markets

“Efficient security markets require a strong macroeconomic infrastructure based on the enforcement of private property rights.”

Prerequisites for Efficient Securities Markets

- Accepted medium of exchange for low cost investment transactions.
- A strong macroeconomic infrastructure consisting of:
 - Developed legal system (Contract/Corporate/Securities Law).
 - Standardized Accounting and Disclosure Requirements (GAAP).
 - Equitable and Efficient Regulatory Tax System (Progressive).
 - Government oversight of public and private financial institutions and markets (Adverse Selection/Moral Hazard).

Prerequisites for Efficient Securities Markets

- Independent Central Banking System
 - Price Stability
 - Interest Rate Stability
 - Currency Stabilization
 - Lender of Last Resort

Prerequisites for Efficient Securities Markets

- Financial Market Liberalization
 - Convertible Currency
 - Market Liquidity
 - Rights of Ownership
 - Privatization and Securitization

Prerequisites for Efficient Securities Markets

- Outcomes
 - Capital Formation
 - Financial Innovation
 - Efficient Allocation of Resources
 - Wealth Creation and Distribution

Prerequisites for Efficient Real Estate Markets

“Efficient real estate markets require a strong financial and legal system based on the enforcement of private property rights and land-use restrictions.”

Prerequisites for Efficient Real Estate Markets

- Market Research, due diligence and risk analysis.
- Accepted Valuation Methodologies and Market Information.
- Innovative and Enforceable Deal (Tax) Structures.
- Development Capabilities (Land) and Companies (Management).
- Public and Private Mortgage Institutions (Credit Enhancement).
- Title Transfer, Recordation and Insurance System (Liquidity).

Role of Institutional Investors in Allocation of Capital

“Efficient real estate and security markets require strong institutional investor interest based on clearly defined risks and rewards.”

Role of Institutional Investors in Allocation of Capital

- Institutional Investors
 - Corporations
 - Pension Funds
 - Insurance Companies
 - Commercial Banks
 - Real Estate Investment Trusts
 - Stock Mutual Funds

Role of Institutional Investors in Allocation of Capital

- Institutional Investor Requirements
 - Measurable Risks and Returns
 - Macroeconomic and Local Market Stability
 - Clearly Defined Ownership Rights
 - Corporate Transparency and Communication
 - Portfolio Diversification Strategies and Risk Management Tools
 - Exit Strategy: Convertibility and Liquidity

Role of Institutional Investors in Allocation of Capital

- Institutional Investor Outcomes
 - Lower Information and Capital Costs.
 - Increased Liquidity and Market Efficiency.
 - Financial Intermediation and Innovation.
 - Efficient Allocation of Resources
 - Public and Private Market Discipline
 - Increased Social Welfare

Securities and Real Estate Capital Market Analysis in an Economic and Financial Context

Research Prerequisites and the Role of Real Estate and Financial Economists:

- **Fundamental Analysis**
 - Economic/Demographic Analysis and Forecasting
 - Real Estate Market Analysis and Forecasting
- **Technical Analysis**
 - Financial Market Analysis and Forecasting
 - Financial Engineering (Risk Management) and Innovation

Capital Market Research Objectives

The mission of Capital Market Research

“to improve the quality of information provided to corporate management and stockholders for decision making purposes.”

“to identify economic, demographic and capital market trends for investment opportunities and portfolio diversification.”

Capital Market Research Program

Goals of Capital Market Research:

- **Create Value through Management and Stockholder Satisfaction**
 - Improve the degree of accuracy in economic, demographic and capital market forecasts.
 - Commitment to improve the productivity, quality and diversity of research information provided.
 - Improve investment and portfolio diversification and yield enhancement through risk mitigating strategies.
- **Information Systems**
 - Assure the quality of information by maintaining a state-of-the-art analytical, computer hardware, software, database and reporting system.

Capital Market Research Program

Role and Responsibilities of the Real Estate and Financial Economist:

- **Role**
 - **Act as an independent agent representing the long-term interest of the shareholders through objective and unbiased research.**
 - **Conduct ongoing economic and capital market research, providing timely guidance for secondary market investments, initial public offerings, and risk and portfolio management programs.**

Capital Market Research Program

- **Responsibilities:**
 - Provide research assistance to Corporate management.
 - Analyze portfolios for over/under concentration in market, economic and geographic risks, and conduct portfolio optimization.
 - Target markets and investments for future acquisition and underwriting based on fundamental economic and demographic demand, and capital market dynamics.
 - Maintain databases, and generate and write market research reports on a timely basis.

Capital Market Research Program

Research Projects:

- **Capital Market Research Reports:** analyze and prioritize target markets and investment for future investments and underwriting.
- **Economic and Capital Market Portfolio Diversification:** measures economic and industry concentrations, and correlations between employment and investment return trends across capital markets and investment in the portfolio.
- **Portfolio Optimization:** *Passive Strategy*; measures portfolio diversification against the index, *Active Strategy*; measures portfolio diversification based on required return, risk tolerance and market constraints.
- **Future Market Expansion:** analyzing and prioritizing foreign and domestic capital markets and/or company investment.

Capital Market Research Program

Report and Services Production:

- **Corporate Management/Strategic Planning**
 - Capital market research (WACC) and securities analysis.
 - Market/economic analysis.
 - Product market research and business development.
- **Portfolio Management**
 - Economic base diversification.
 - Fundamental and technical stock and real estate market research.
 - Market monitoring and reporting.
- **Acquisitions (Investment)/Dispositions (Exit Strategies)/Development (Underwriting)**
 - Due Diligence reporting
 - Economic and real estate market analysis
 - Market timing (cycle) strategies and analysis.
- **Investor and Client Relations (Marketing)**
 - Public relations (Professional Organizations)
 - Investor relations.