

## THE ANALYSIS OF THE REAL ESTATE INVESTMENTS IN THE CURRENT ECONOMIC ENVIRONMENT

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**Abstract:** *Real estate investments are one of the most attractive business opportunities in the context of the contemporary economy, generally marked by economic recession and especially by monetary and financial instability. Last years international reporting concluded that deepening the global economic crisis determined an increase of the real estate request, while despite all expectations one did not assist a crash of the prices. Economic reality showed that real estate assets value (buildings, land) kept proportions with economic reality over time. A comparison between stock exchange market and the real estate market shows that while an movables investor (investments in stocks, bonds or life insurance) might lose completely his initial investment, the investments in real estate assets, such as buildings, would keep their quality as goods and would also keep a value to better resist shocks and thus allowing an increase of the capital. When appreciating the value of an investment the first things to analyze are the return, liquidity and risk criteria, which are essential in real estate investments too. Stimulating real estate market must be not only a wish but also a reality of global economy, since it can correct many of the aggregated indicators of a country. Containing scientifically detached from economic practice, this article is addressed to readers with interests in real estate investment. The language is usually referred particularly to the qualitative side of the real estate market approach. The feasibility of the real estate investments is being conditioned by their capacity to generate important profits, on the background of the reduction of the duration of recovery of their value. The economic instability from the last couple of years has generated fears and failures but, paraphrasing Johann Wolfgang von Goethe, courage is a mixture of genius, magic and power that helps us succeed in everything we set our mind to. The investments on the real estate market usually have a long period of recovery, compared to the placements at the stock market or to the commercial business. The structure of investments in the field of real estate is complex and depends on several factors: the fiscal and financial policies of a country, elements that are specific to the constructions sector, the fluctuations of the real estate market, the development degree of a nation, the free circulation of people, the evolution of the exchange rate etc. The international statistics show that the real estate sector represents one of the most profitable businesses from the last two decades. Even now the real estate sector seems to be profitable, especially for the speculators, in the measure in which there are financial sources and enough information about the market.*

**Keywords:** *real estate investment; return of investment; investment liquidity; real estate investment risk; fair value; real estate market.*

**JEL classification:** *D50; E22; M40; M42; R30; R31.*

## 1. Overall considerations

The start of global crisis generated major changes in the policies of economic entities and development strategies because the new context and the intervention factors in the market changed radically. The economic trends, that seemed unshaken before 2007-2008, started shaking until they had no value, at least in the present conditions when the vectors of the economic action are still confused.

Investment markets which had become during the last decade a tax haven for potential investors used to financial speculations became inert, weakly volatile, beyond the liquidity they had known so far. And so investors recently assuming financial risks and exponential increase benefits of financial transactions too, withdrew one by one from this scene leaving well-known stock exchanges in lethargy and with no hopes of quick recover. In economic theory there is proved that in conditions of a global crisis, the first deeply affected markets are the financial ones, especially the stock exchange markets, and they are the last to react to the economic increase. In other words, „first out, last in”. The stock exchange, a very attractive tax haven for experts, is the first link of an economic chain to feel the crisis shock and the last to react favorably and intensively to the economic increase of a state. The financial analysis indicate the fact that the cycles of the real estate market are in an inverted relationship with the evolution of the prices and they can extend on periods of time between two or three years and up to 20 years. The frequency of the two opposable markets – stock exchange and real estate – could be hardly balanced to reduce the difference between them. This is the fact influencing the interest of the investors to pass from one field of investment to another when it is necessary to increase the efficiency of the savings and returns. *In an empirical manner it was observed that the real estate investments have a sinusoidal trajectory, that is closely related to the **regularity** of the national economies, of the global economy in general, but the amplitude of the fluctuations is attenuated compared to the evolution of other economical segments. The financial analysis indicate the fact that the cycles of the real estate market are in an inverted relationship with the evolution of the prices and they can extend on periods of time between two or three years and up to 20 years.*

For decades we have been witnesses to the everlasting phenomenon of balancing between stock exchange and real estate investments. When the stock exchange has a downward, instability trend, the investors give up their “unreliable” shares in favour of real estate buildings.

Years before, the history of economic thinking pointed out that economy is inherently cyclic, meaning no matter the class of human society, it can't keep developing in one way (increase or decrease). In this context, the crisis should not be seen as a frightening phenomenon but as a state, a part of economy seen as a whole. Albert Einstein claimed it was good “not to ask things to change as long as we do the same. Crisis is the most blessed situation that can appear for countries and people, because it means progresses. Creativity is born of the necessity as day follows night. In crisis inventions, discoveries and big strategies are born. Without a crisis there is no duel, without a duel the life is a routine, a slow agony”.

What can be truer than the novelty elements which are always sources of surplus value and of distinction on the market, regardless of its phase: release, growth, maturity or decline?

## **2. Features of the real estate market**

The real estate market has many characteristic features and that imposes prudence and an analytic way of thinking from the investors:

- the real estate properties have a reduced liquidity degree because they involve complex procedures of transfer of the right of property and transactions with large amounts of money.
- the prices of the real estates and the decisions to buy or to sell are significantly influenced by the financing offers of the creditors, by the volume of the offered credits, by the financial costs, by the size of the deposit, by the duration of the reimbursement.
- the high value of the real estate properties takes time to analyse the financing manner and to check the reliability of the clients, and this leads sometimes to the missing of opportunities.
- through their nature, the information regarding some similar transactions are not available immediately, and for this reason the real estate market can be considered an imperfect one.
- the real estate assets have a long life-duration, that can be measured in centuries sometimes.
- from an accounting point of view the value of the lands cannot be damped, but the value of the buildings is damped in time.
- each real estate property is unique through its geographical location, its emplacement, usage value, dimension and financing form.
- the buying capacity of the investors has to be big, because the value of the real estate assets is high.
- the real estate market is characterized by important fluctuations of prices, due to their sensitivity to the establishing of the incomes, the unemployment rate, the size of the wages income, the evolution of the exchange rate, the interest of the investors.

The Russian researcher E.I. Tarasevici (2011) considers that the real estate market is an essential element of any national economy. In his papers he emphasized the belonging of the real estate assets to the category of merchandise and the close correlation that exists between the real estate market, the attraction of financial capital and the way of using the resources that are involved in this field.

Knowing the stage of the real estate market is a compulsory condition for the elaboration of the strategy regarding the real estate investments. An effective investment policy means the capitalization not only of the opportunities that exist on the market, but also a good evaluation of the investment objectives, and the adoption of some preventive measures of the potential threats generated by the installation of a negative dynamics of the market. Such an approach allows an evaluation that is well fundamented of the potential risks and the development of an investment strategy that is based on an optimum diversification.

## **3. Real estate - gold mine for investors solvable**

The real estate market became lately an interesting alternative for potential investors. Investing in buildings and slightly in land ensures the capital a good a long time protection against monetary erosion. Real estate investments are a very attractive business opportunity, based on the latest political, social, economical, legal

and financial evolutions as the reports and analyses in the filed show. For potential investors they might be the object of adopting the best strategies for the future.

Any investor knows that during crisis he can make the best investments. A Fata Morgana of real estate market, in a negative cycle, is hunting the minimum. Why? Because no one knows which is minimum and when it is reached.

Real estate investments have *many advantages* for potential investors because they are firstly long term patrimony elements, bringing extra incomes that contribute to meeting the needs, improving the quality of life long after the professional activity ends.

Even if risky, the decision of investment is supposed to have willingness and determination as triggering elements. Regardless the investor's level, experienced or beginner, he can immediately see the way to cleverly invest, with no previous important treasury. There are few persons affording to purchase a building and pay in cash, because the value of a building most often needs important savings and this is an impossible condition to most active people earning insufficient money to anticipate some major investments. Saving almost half of monthly income to open a bank deposit in order to purchase a house is a long time process, sometimes impossible and inefficient.

The financial credit is the solution to this problem. On condition of respecting the terms to pay debts back in time and totally, anyone could purchase a house and use it by means of loans.

At the end of credit period, the buyer is assured of owning the good and passing it to his descendants.

Selecting from specialized studies, we can point out the advantages of locative placements. "The stone", as an expert in real estate market said, is a respected investor of savings, the only one able to generate credit, despite all other investment forms (shares, bonds, life insurance etc.). By this loan we avoid the necessity to create own treasury to ensure the money for buying the building and we can set up gradually a solid patrimony as we pay back the debts. So a first advantage of real estate investments is to make up for the entire amount by long term credits (up to 30 years) and these credits are now in many countries more and more attractive due to low interests.

Despite all ups and downs, the real estate market has been growing for the past 15 years. Unlike a company current on stock exchange, when the investor might lose his initial investment once the capital market crashes, "the stone has a safety net". The advantage is that the capital assets are firstly goods unlike securities which are "a piece of paper" with a virtual value. When every thing goes well, the immovable asset serves its basic goal, to house one or more people.

An advantage of locative buildings bought on quality criteria, meaning "best location", in a good neighbourhood and connected to all facilities (public transportation, stores, schools, electricity, running water networks, sewerage system, resting centres) is that they will create value over time better resisting to possible market shocks, no matter what caused them.

Locative placements have also the advantage to provide a future income that might add up the pension income. At a current acquisition, the immovable assets generate a lower income, but as the credit is paid back, the building keeps its value.

Economic reality shows the buildings' prices in crisis don't drop as much as believed and this is the result of the exchange rate. Generally speaking, the buildings' price increases by every percent the national currency decreases as salaries and other

incomes are paid in national currency and this devaluation is equivalent to lowering the purchasing power and raising prices for houses. One conclusion is that the crisis deepening over the past years have determined a rise of prices in real estate investments not their crash.

Actually the buildings' value neither rises nor decreases but it is directly proportional to its economic utility. One condition to reduce real estate investment prices is to reduce the volume of the bank credits. In absolute amount, these can be reduced either by higher interests or by hardening the credit conditions. The lack of liquidities in the monetary market might lead to imbalance between supply and demand. Although the relation between the two market forces tends to change the price frequently, it is important to say that increasing real estate prices is merely speculative, mainly determined by the potential buyer who gives up on emotion: the express wish for a certain area, the attachment to a pre-seen building, insufficient information about the area prices, lack of time in making up a buying decision etc. Actually *the price must reflect the fair value*, based on impartial criteria.

#### **4. The features real estate investments**

Regardless of the geographical position of the investor, as it is well known, the value of the real estate investments as well as all investments must be estimated based on the following criteria:

- **Return on investment;**
- **Liquidity of the investment;**
- **Investment risk.**

**4.1. Return on investment**, generally on a placement is directly determined by the "health" of the market. In real estate sector a technical and economical analysis is necessary regarding: the placement type (houses, villas, offices, ongoing investment, land, woods etc.), the state of the asset (age, technical aspects, earthquake resistance, usage and the possibility to change it, access to facilities etc.) or geographical position (cities, capital, villages). As it is about long term investments, analyzing the future return involves anticipating the evolution of the market for a long time, an aspect hard to predict but of a real use.

When it is about preferences regarding the locative investments, the option is *old or new*? A motto worth following is: "A good investment is location". The answer to the previous question depends on the investor's interest and on the advantages created by one or another building.

International experience led to the following conclusions:

Investors direct to *new investments*, thanks to a sum of advantages, the most relevant are:

- National legislation directs to cheaper bank credits, with profitable interest rate for new buildings;
- Getting some important benefits in terms of quality, security, isolation or technical standards;
- Granting guarantees, in some countries up to two years, to cover the risks in case of damages when the investors move in the new building;
- Granting guarantees up to ten years to cover the risk of tightness and building resistance;

- Applying fiscal measures attractive to investors;
- Financial advantages: financial tax-free for 1-2 years, lower notarial expenses, the State grants facilities in case of renting the buildings etc.

In case of old locative buildings the advantages are:

- The neighbour's „karma”, the mirage of old times,
- Location downtown, next to historical sites, cultural and social traditional centres
- Reduce liaisons when negotiating the prices, because the owners themselves make the sale
- Attractive tax deductions,
- A significant number of investors interested in old vestiges,
- Satisfy different requests: wide rooms with high ceiling, small traditional cottages in villages with old history,
- Generate an important return of investment ,
- Lower prices compared to new buildings, although the accommodation conditions and fittings are comparable etc.

Regardless of the choice, *new or old*, the real estate investments compared to stock exchange market represent tangible assets, placed over time in the same location, with a value of usage and meant to self usage or to rent. In the opinion of specialists, the real estate assets are sure assets which even in the most tempestuous situations allow capitalizing and returning of capital. As shown previously in this paper the immovable buildings, if they abide by the legal settlement, they always return important positive benefits.

From an economical point of view, the global capitalization of an investment in this field comes from the summation of the capitalization rates that come from the renting of the real estate and of the valorization rate of the respective good, after the deduction of the expenses made with it.

The capitalization rate that is afferent to the renting is determined as a ratio between the value of the rent and the value of the good. This is bigger in the case of the so called “professional” buildings that have a lucrative destination, than in the case of the real estates that are inhabited or of the agricultural plots. Moreover, it is superior in the case of the areas that are situated in the central parts of the cities compared with the ones from the peripheral areas. Also there are significant differences between the urban and the rural areas.

**4.2. The liquidity of the investment** is another essential coordinate in establishing the area of interest of the future owner. If between the forces of the market the equilibrium is hard to reach, it is understood without saying that the real estate investment floats on a flat line. Even if the fast recuperation of the investment is not an immediate purpose for the investor, still it is a criterion for fundamental analysis. This happens because the value of the assets is determined by the rapport that exists between the demand and the offer that exist on the market. Thus on a market in which the offer exceeds the demand, the liquidity will not be obtained unless there is a great diminution of the price. In the field of the real estate investments, the capitalization can only be directly proportional with the liquidity.

So if it is necessary, it is very important the study of the “lever effect of the credit”, in other words the analysis of the principle of the multiplication of the sum that is brought by the investor as a contribution to the financing of the investment. For

example, at a contribution of the investor of 5% from the value of the financed project, the lever effect will be 20.

The efficiency of an investment depends on the correlation between the liquidity and its capitalization. According to the objective, the investment will have to define the type of capitalization sought: it is recommended to choose between a high renting rate (e.g.: offices) or a good potential to capitalize (e.g. buildings from the big cities that have good fittings and facilities). For a good appreciation of the efficiency it is suggested a fulfillment of the economical analysis with the determination of the financial and fiscal incidence of the selected variables, including the managing expenses, the maintenance, repairs, as well as the taxes and the customs that come with every chosen investment.

In order to answer the question “why is the real estate market considered to be a prosperous one?” we will have to make a synthesis of the previous arguments. The real estate investments, unlike other business, have a rare opportunity to fail, unlike other business where the prosperity can last for a long time or a really short one. Like in any other business, the economical periods that alternate, with positive amplitudes, followed by negative ones, influence the real estate market, but does not produce big fluctuations, so that the good offers last. There will always be a supplier that will meet a buyer. The statistical data prove that the current economical crisis there is a growth engine for the real estate market.

**4.3. The risk of the investment.** Like any other business, behind any investment there is a risk. The investment in the real estate properties imposes precaution measures that will reduce, when it is possible, to a minimum the risk of exposure. The risk of real estate investment aims the following components:

- The risk of gain that is determined by the failure to rent or by the nonpayment of the rent;
- The risk of capital that is related to a diminishing of the demands on the support market, given by the excess of constructions, by the modification of the behavior of the users, by the restrictive regulations;
- The risk of sub diversification of the owned patrimony, given by the necessary sum for the investment, its size being the condition to the access to this type of placement.

We must remember that the risks of the locative investments must be completely considered. As we have shown, the efficiency of the real estate investments is in a direct correlation with the investor’s possibilities to rent the property and to collect the income from the rents. In the conditions of the crisis, prudence must be manifested because in certain areas the finding of tenants is a problem, especially in the regions in which the economical activity is reduced. The prolonging of the periods of no rental coincides with a lack of capitalization of the investments. Another major risk is the fact that although the property is rented, the cashing of insufficient rent does not allow the investor to make the necessary maintenance work and repairs or the integral payment of the monthly installments that come with the loan. Other unwanted situations can be considered the nonpayment by the tenants of the debts from the holiday periods, their entrance into insolvency due to the lost of their jobs, the appearance of the conflicts between the tenants and the landlords that lead to financial and time loses to solve in a court of law the litigations, the appearance of damages and unexpected repairs.

It is vitally important the risk of general capital that is generated by the decay of the surroundings and the decrease of the value of the buildings or of the rents in the area, the appearance of natural risks, unforeseen in the area, the identification of the expropriation risks or the diminishing of the locative demand for various reasons, non known to the investor in the moment of purchasing the propriety.

The specialists recommend the investment in real estate assets with "capitalization" and not in the properties that are the most expensive on the market, because it is considered that in the next 25 years the main source of capitalization will be the revalorization of the property. The study of the profitability of the real estate investments is necessary and it needs prudence regarding their sustainability. For example the construction regulations evolve very rapidly and they tend towards energetic renovations of the buildings. In the moment of acquisition the investor has to integrate into the costs the expenses for the rehabilitation of the buildings and only then he can determine their real efficiency.

As we have shown above the dynamics of the real estate market is conditioned by the banking policies. The reduction in certain periods of the given credits is a real reason for the limitation of the real estate investments. This is due either to the increasing of the harshness of the banking institutions, through the tightening of the criteria for giving a loan, or though their rise though the increase of the interests.

In conclusion behind any investment there is an accumulation of risks. An unwanted risk is the losing of the investments due to different causes. When it is chosen a real estate investment, since the beginning there is a risk of losing it. For this reason, the risks must not be perceived as an obstacle in making the investment, but as a warning for the initiation of its beneficiaries in the good handling of them.

## **5. Conclusions and proposals**

The bibliographical sources that I studied and practical observations have lead me to the following conclusions:

- now the real estate market is the barometer of evaluating the well-being of any nation
- in the real estate field the equilibrium between demand and offer is more difficult to be reached and it is very perishable due to the large values that are vehiculated
- the dynamics of the real estate investments is conditioned by the fiscal, monetary and financial policies, as well as the degree of occupation of the active population
- the real estate investments depend on the real power to buy and on the development degree of the work market
- real estate investments generate benefits after long periods of time
- in many situations the real estate market is overrated, due to the subjective criteria of approaching the problematic content in this field.

The development of the real estate investments is a premision of the global development of the human kind. From this perspective I consider that it is necessary to have a coherence at the level of gouverment policies through the adoption of some transparent and durable laws, through the stimulation of financing and fiscal relaxation, that will support the real estate market and it will offer the bigger chances to the interested investors. Above all the risks the real estate market is a big enhancer of the rise of the national economy. Beyond the obvious benefices brought

in time to the investors, the real estate market is an influent environment for the PIB, a source of reduction of unemployment through the creation of jobs in constructions, a source of incomes for the banking institutions and not last, an important contributor to the state budget. It is no wonder that the newest statistics indicate in the last years an important dynamism of the real estate investors in the poorer areas of the Globe. The internationalization of the real estate investments is a good example regarding the new tendencies of the global businesses. But real estate markets in most countries are not as organized or efficient as markets for other, more liquid investment instruments. Individual properties are unique to themselves and not directly interchangeable, which presents a major challenge to an investor seeking to evaluate prices and investment opportunities. For this reason, locating properties in which to invest can involve substantial work and competition among investors to purchase individual properties may be highly variable depending on knowledge of availability. Information asymmetries are commonplace in real estate markets. This increases transactional risk, but also provides many opportunities for investors to obtain properties at bargain prices. Real estate entrepreneurs typically use a variety of appraisal techniques to determine the value of properties prior to purchase.

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