**Distressed Real Estate Investing**

**Professors Christopher Mayer, Ronald Kravit, and David Sherman**

**SPRING 2021- A Term (Tuesdays 5:40-8:55 pm)**

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**Office Hours:** After class and by appointment

**Course Objectives**

The goal of this course is to make you knowledgeable and conversant about the principles of real estate investing as applied to purchasing distressed assets. The Covid crisis is only the most recent example of how changes in the economy or capital markets can have a profound impact on real estate investors. During the Great Recession and the US Savings and Loan crisis before that, real estate assets suffered appreciable losses, and thus also provided an opportunity for investors to find new opportunities to recapitalize and reposition troubled properties and companies. The class will cover both US and international distressed investments and across traditional and niche sectors. The goal is to provide students with the tools to identify and purchase distressed real estate assets globally and to target superior risk-adjusted rates of return.

Real estate is a long-lived asset that depends on attractive financing, rental increases, and long-term appreciation to maintain its value. However, shocks to the rental or capital markets can lead assets to trade at appreciable discounts due to illiquidity, negative cash flow, tenant bankruptcies, over-leverage, lack of financing to purchase or rollover debt, or uncertainty about the future. These factors lead to the inability of management to meet obligations, uncertainty about valuations, and sometimes, few potential buyers.

This class will help provide knowledge in key areas to help build expertise that can be used to purchase distressed real estate assets. For example, it is important to understand debt structures, as many assets are acquired when a property is unable to meet its borrowing obligations and a mezzanine lender or CMBS special servicer is in a position to determine the future of an asset. Similarly, when assets are suffering from key problems, it is even more critical to be able to understand and manage risk and conduct appropriate due diligence.

Distressed real estate investing has been a theme that has endured over time. Capital flows can be volatile and lenders and investors move in and out of markets. Real estate continues to face disruption due to advances in technology and changes in the way people live and work, a pattern that started prior to COVID. Online shopping has fundamentally shifted how we interact with retailers and will continue to do so. The potential of driverless cars and trucks may fundamentally impact property values and how people value location. New short-term leasing and flexible leases have changed office properties. As millennials bring new patterns and desires and COVID has disrupted the way people work, apartment and office owners try to quickly adjust. And as sea levels rise and the climate changes, people will need to (re)consider where and how they live and work. Disruption and thus distress may well be a constant theme in the years ahead.

This half-term course is designed to provide you with an intensive dive into the changing fundamentals of real estate as applied to investing in distressed real estate.

**Class Expectations and Operation**

Pre-Requisite: *Real Estate Finance must be completed, or the waiver exam passed, prior to enrolling in this class.* This pre-requisite will not be waived under any circumstances. Real Estate Transactions and Real Estate Debt Markets are recommended but not required.

Attendance is required at all sessions and for the duration of the session. If for some reason, you are not able to attend or have to leave early, please notify the faculty. Missing two sessions (other than for excused absences) will result in a one-grade reduction. Missing three or more sessions will result in a loss of credit.

Class starts on time. Students are expected to be in their seats or on Zoom when class begins. Arriving late disrupts the class and is disrespectful to everyone who has arrived on time. The class will offer a regular break, although the specific timing will depend on the progress of the class.

Preparation. Please come to class having read required materials and completed assignments prior to class, while being fully prepared to discuss.

**Assignments and Grading:**

Grading will be based on Class Participation (10%), Individual Homework Assignments (35%), Group Cases and Presentation (55%).

Readings and Assignments for the course will be posted on CourseWorks. Required work for each session will be clearly identified on the syllabus or announced via email and on CourseWorks.

Reference book: *Real Estate Finance and Investments: Risks and Opportunities* by Peter Linneman (5th Edition). The book is not required reading, but it can help enhance material covered in class.

Form a group: You can form groups prior to the start of class or on the first day of class. Groups should have 3-4 members (groups greater than 4 will not be allowed) and group members should join together via Courseworks. Groups may be asked to present cases in class.

Individual Homework Assignments: Students may discuss homework assignments with other classmates or students in a general manner. However, the sharing of written or computer work product between students for individual assignments is prohibited.

Group Cases: Cases must be submitted at least one hour prior to the beginning of class. Page limits may be provided with each Case and will be strictly enforced. Students should be prepared to discuss all Cases in class. Group members may discuss Cases with other classmates or students outside their Group in a general manner. However, the sharing of written or computer work product between students outside their group is strictly prohibited.

Class Participation: Questions are encouraged to clarify what we are discussing. In addition, you and your fellow students bring valuable perspectives to the class that can benefit everyone. Please remember that it is important that everyone has an opportunity to participate, so no one should dominate the conversation and please be respectful of other’s comments. Constructive comments in class will increase your participation grade, while consistently bad or irrelevant participation or participation that negatively affects others will decrease your grade. Absences or late arrivals will negatively impact your participation grade.

Honor Code: Students are expected to follow the honor code at all times, including rules for individual and group work. Violations of the honor code will result in referral to the Student Leadership and Ethics Board. See: <http://www8.gsb.columbia.edu/honor/resources>.

**Core Courses:** The course content will utilize, build on, and extend concepts covered in the following core courses:

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| **Core Course** | **Connection with the Core** |
| Corporate Finance | 1. Time value of money 2. Risk 3. CAPM 4. Modigliani & Miller Theorem 5. Arbitrage pricing and the law of one price 6. Efficient Markets 7. Financial frictions |
| Managerial Economics | 1. Maximization and marginal analysis 2. Complex decision‐making under uncertainty 3. Market competition and equilibrium |
| Managerial Statistics | 1. Statistics and data analysis 2. Conditional probability 3. Modeling uncertainty |
| Global Economic Environment I | 1. Inflation and monetary policy 2. The business cycle 3. The role of financial markets in the economy |

Students will be expected to have mastered these concepts and be able to apply them in the course.

**Summary of weekly sessions** (Preliminary; individual items subject to change)

**January 12: Session 1- Introduction to Distressed RE Investing**

Themes: History of distress/cycles; Definition of distressed investing; Current market update; Introduction to the key elements of approaching a distressed investment opportunity.

1. Review of periods of distress across previous real estate cycles.
2. Capital markets overview with focus on interest on purchase or sale of distressed assets.
3. Guest speaker – Current capital markets environment.
4. Example- Hotel with a first mortgage and facing challenges due to COVID.
5. Examine the key principles of distressed investing.
6. Discussion, questions, and summary of key take aways.

*Individual Homework assignment: Pre-Readings on Courseworks*

**January 19: Session 2- Asset Underwriting and Due Diligence During Periods of Distress** Themes: Deep dive into how to analyze an asset in times of distress, with a focus on cash flow and valuation at stabilization in the future. Also, how to measure risk and conduct due diligence effectively.

1. Review homework assignment
2. How to project cash flows and value an asset during an uncertain time. Walk through the analytical process in detail with a specific example of a supermarket-anchored shopping center.
3. Introduce Group Project to find/value a distressed real estate investment, with discussion of possible ideas and topics.
4. Guest Speaker: Extracting value from retail investments.
5. Review of risk and conducting due diligence including importance of alignment of interest, covenants, bankruptcy constraints, and capital market/liquidity risk.
6. Discussion, questions and key take aways

*Individual Homework Assignment:* Examine a partially vacant property (provided). Do proforma projections for recovery.

**January 26: Session 3- Unlocking Value – Structure, Control and Strategy**

Themes: Deep dive on debt structure and the balance sheet, including legal structures, parties involved, and the nature of the discussion/negotiation between parties. How to source distressed debt opportunities and strategies for unlocking value once you have made the investment.

* Review of real estate debt and balance sheet structure, including various forms of debt such as CMBS, traditional bank or insurance company whole loan, and senior/mezz structures.
* Guest lecturer: Lender’s perspective on borrower/lender discussions, risk, and workouts,
* Guest lecturer: Unlocking value in a distressed situation, including how to source deals, working with servicers, and navigating bankruptcy and foreclosure.
* Introduce and initial discussion of the Extended Stay Case.

*Individual Homework Assignment*:Answer questions on readings

**February 2: Session 4- Distressed Investing Beyond the Basics**

Themes: Focus on Extended Stay case as a review of the principles learned to date. Understand how to maximize value for distressed public companies and manage through bankruptcy.

1. Introduction: Key facts (situation, players, numbers) in the Extended Stay case.
2. Student groups take turns presenting their analysis and conclusions on the case.
3. Guest lecturer: Extracting value in a public company – shareholder activism.
4. Guest lecturer: Managing a public real estate company through bankruptcy.
5. Check in on case preparation for final class.

*Group Case Study Due: Extended Stay of America*

**February 9: Session 5- Real Estate Distress In Global Markets**

Themes: Examine three mini cases of opportunities around the world. Gain exposure to distressed investing in non-US markets and how concepts change when investing globally.

1. Introduction to distressed investing in Europe.
2. Mini Case 1: Distressed investing in Europe with Guest Lecturer describing investment.
3. Introduction to distressed investing in Latin America.
4. Mini Case 2: Distressed investing in Brazil with Guest Lecturer describing investment.
5. Introduction to distressed real estate investing in Asia.
6. Mini Case 3: Distressed investing in in Japan with Guest Lecturer describing investment.
7. Review themes from global distressed investing

*Individual Homework assignment: Pre-Readings on Courseworks*

**February 16: Session 6- Final Class/Case Presentations**

What can you invest in going forward? Where are the best opportunities today? The class will involve a presentation/discussion of group projects. Review of class material and applications going forward including COVID and climate change.

* 1. Group presentations.
  2. Review of the course including themes and topics. Summarize key takeaways from the class*.*
  3. Applications to Covid investing and climate change.

*Group Final Project due*- Groups will create their own investment thesis/opportunity to present to the class. Will provide support as possible to source a deal and evaluate economics. Could be investing in a distressed hotel, retail or other property on the market, buying shres or bonds in a distressed/bankrupt REIT, purchasing CMBS tranches, or any other distressed real estate opportunity.