



REAL ESTATE FINANCE AND  
SYNDICATION

R E 378K – UNIQUE 04225

T TH 12:30 – 1:45

ZOOM THROUGH CANVAS

SPRING 2021

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<b>Office Hours</b>	Thurs 2:30 – 4:00
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### Course Objectives

This course's primary objective is to examine real estate securities and real estate private equity investing. Students will learn about the various debt and equity securities available to investors, and will also learn about real estate private equity investing. Through lectures, readings, cases, and guest speakers, students will learn the benefits and risk of the various forms of investing in real estate securities and real estate private equity funds.

The course begins with a study of real estate debt markets and real estate debt securities, MBS (mortgage backed securities) and CMBS (commercial mortgage backed securities). The primary focus is on the structure and cash flow characteristics of real estate debt instruments. We start by studying the primary residential mortgage market and the mathematics and finance of residential mortgage cash flows and pricing. We then move into the secondary market for mortgage funds with a study of simple pass-through residential mortgage pass-through securities. The problems of prepayment and default and the complications that prepayment and default introduce to the valuation of mortgage backed securities is analyzed. The prepayment problem in simple residential mortgage pass-through securities drove structuring innovation in the early days of the market and the creation of Collateralized Mortgage Obligations (CMOs). Following our study of the prepayment problem we go directly to a study of the creation, structure, and pricing of CMOs, including a discussion of mortgage strip securities (IOs and POs), simple sequential tranching, and specialized CMO tranches including PACs and Zs. Students will analyze and model the tranches of an actual \$250 million Fannie Mae CMO (REMIC) as a case assignment. After our study of prepayment structuring in agency MBS, we will study tranching and securitization structures used in non-agency private

label MBS. Private label MBS came to be dominated by subprime MBS, and we will spend considerable time studying the creation of subprime MBS, CDOs, and CDS, and the causes and catastrophes related to the subprime crisis. After working through the residential mortgage instruments, we will go directly into our study of Commercial Mortgage Backed Securities (CMBS). CMBS are very similar in spirit and structure to MBS, but significant differences in both prepayment and default characteristics make CMBS an interesting twist on the original MBS model.

The second half of the course is dedicated to the study of real estate equity markets and securities, both public and private. We will study how real estate fits within a diversified investor's portfolio, and the various alternatives an institutional investor has to invest in commercial real estate. We will spend several meetings discussing Real Estate Investment Trusts (REITs), including their structure, corporate governance, and valuation. We will also analyze alternative ways to invest in private equity in the real estate sector, such as commingled real estate funds and limited partnerships, and we will also study various risk-return trade-offs available across the real estate capital stack.

### **Materials - books**

Required:

Mortgage-Backed Securities: Products, Structuring, and Analytical Techniques, Second Edition, Fabozzi, Bhattacharya, and Berliner, 2011, Wiley.

Liar's Poker, by Michael Lewis, 1989 Penguin Books – *required reading for the quiz is chapters 5, 6, and 7. It's best to start with the last 6 paragraphs of chapter 4, when the mortgage desk is introduced during the newbie training.*

### Course Requirements and Grading

Grades will be based on the student's performance on one quiz (on Liar's Poker), two tests (debt test and equity test), and cases. The weights on each component of the overall course grade are as follows:

Class Participation	ongoing	5%
Liar's Poker Quiz	Tues, Feb 2	5%
CMO Case DUE	Tues, Feb 18	20%
First half Debt test	Tues or Thurs, March 9 or 11	30%
Lions Industrial Case	Tues, April 28	10%
Second half Equity test	Thurs, May 7	30%

Make-up and extra-credit assignments are not possible. Your grade will be determined solely by the components listed above. If you fail to turn in the assignments when they are due you will lose points for a late submission. If your excel skills are not sufficient for the MBS cash flow work in the CMO case, please talk to me about getting various degrees of help with the excel modeling up to and including a working excel model you can use to make the required WAL measurements and answer the questions in the problem set. Please don't miss the Liar's Poker quiz or the tests. If you're falling behind and these dates become difficult, send me an email to set up a time to talk to me.

### McCombs Classroom Professionalism Policy

The highest professional standards are expected of all members of the McCombs community. The collective class reputation and the value of the Texas MBA experience hinges on this.

#### **You should treat the Texas classroom with respect.**

Faculty are expected to be professional and prepared to deliver value for each and every class session. Students are expected to be professional in all respects.

The Texas classroom experience is enhanced when:

- **Students arrive on time.** On time arrival ensures that classes are able to start and finish at the scheduled time. On time arrival shows respect for both fellow students and faculty and it enhances learning by reducing avoidable distractions.
- **Students are fully prepared for each class.** Much of the learning in the Texas program takes place during classroom discussions. When students are not prepared, they cannot contribute to the overall learning process. This affects not only the individual, but their peers who count on them, as well.
- **Students respect the views and opinions of their colleagues.** Disagreement and debate are encouraged. Intolerance for the views of others is unacceptable.
- **Students do not confuse the classroom for the cafeteria.** The classroom (boardroom) is not the place to eat your breakfast tacos, wraps, sweet potato fries, or otherwise set up for a picnic. Please plan accordingly. Recognizing that back-to-back classes sometimes take place over the lunch hour, energy bars and similar snacks are permitted. Please be respectful of your fellow students and faculty in your choices.
- **Technology is used to enhance the class experience.** When students are surfing the web, responding to e-mail, instant messaging each other, and otherwise not devoting their full attention to the topic at hand they are doing themselves and their peers a major disservice. Those around them face additional distraction. Fellow students cannot benefit from the insights of the students who are not engaged. There are often cases where learning is enhanced by the use of technology in class. Faculty will let you know when it is appropriate.
- **Phones and wireless devices are turned off.** When a need to communicate with someone outside of class exists (e.g., for some medical need, or a phone interview that could not be re-scheduled) please inform the professor prior to class.

## Academic Dishonesty

I have no tolerance for acts of academic dishonesty. Such acts damage the reputation of the school and the degree and demean the honest efforts of the majority of students. The minimum penalty for an act of academic dishonesty will be a zero for that assignment or exam.

The responsibilities for both students and faculty with regard to the Honor System are described on the final pages of this syllabus. As the instructor for this course, I agree to observe all the faculty responsibilities described therein. As a University of Texas student, you agree to observe all of the student responsibilities of the Honor Code. If the application of the Honor System to this class and its assignments is unclear in any way, it is your responsibility to ask me for clarification.

## Students with Disabilities

Upon request, the University of Texas at Austin provides appropriate academic accommodations for qualified students with disabilities. Services for Students with Disabilities (SSD) is housed in the Office of the Dean of Students, located on the fourth floor of the Student Services Building. Information on how to register, downloadable forms, including guidelines for documentation, accommodation request letters, and releases of information are available online at <http://diversity.utexas.edu/disability/how-to-register-with-ssd/>. Please do not hesitate to contact SSD if you qualify for accommodations, and please send me a note re: accommodations at least a couple of weeks before the tests so that I can get you a spot in the testing center. This is not at all a burden to me and don't hesitate to contact me about testing accommodations.

## Schedule and Topics

MEETING	DAY	DATE	TOPIC	READING
1	Tues	Jan 19	Syllabus and course overview	
2	Thurs	Jan 21	The Primary Mortgage Market – Players and Products, Mortgage Math (amortization)	Fabozzi C1
3	Tues	Jan 26	RMBS construction, pooling mechanics, basic Ginnie pass-throughs; <b>Fixed income (FI) primer</b> concentrating on the calculation and idea of duration and convexity in basic FI and in MBS	Fabozzi C2
5	Tues	Feb 2	<b><i>Liar's Poker quiz at beginning of class</i></b> Structuring around prepayment risk with IOs, POs, and basic sequential tranching in Agency RMBS.	Fabozzi Cs 5, 6, & 7

6	Thurs	Feb 4	Finish RMBS Agency prepayment structuring with more advanced structuring including PACs and Zs. <b>Assign and discuss CMO structuring case</b>	Fabozzi Cs 5, 6, & 7
7	Tues	Feb 9	Structuring Credit Risk in Private Label MBS – Subprime mortgages, ABS, and CDOs	Fabozzi C8
8	Thurs	Feb 11	Structuring Mortgage ABS (subprime credits), overview and history of subprime crisis and update on casualties (almost over, but not quite), post-crisis structures: CRT, SFR, and RPL/NPL bonds	Fabozzi C9
9	Tues	Feb 16	<b>Speaker</b> – Amherst Securities speaking on securitization and the single-family home business	
10	Thurs	Feb 18	<b>CMO Structuring case DUE</b>  CMBS1 – Intro, structure, market history and performance, call protection and calculations	
11	Tues	Feb 23	CMBS2 – current market, a defeasance trading strategy	
12	Thurs	Feb 25	<b>Speaker</b> – Chris Garza of Wells Fargo will be speaking to the class re: commercial bank direct lending, and differences between on-book commercial mortgages and securitized (CMBS) commercial mortgages	
13	Tues	Mar 2	Valuation and Analysis of MBS and CMBS - Yield Measures, Z-spreads, OAS analysis	Fabozzi Cs 10 & 11
14	Thurs	Mar 4	Review debt material	
15	Tues	Mar 9	<b>Midterm – Debt Test</b> (you can take the midterm on Mar 9 or Mar 11)	
16	Thurs	Mar 11	<b>Midterm – Debt Test</b> (you can take the midterm on Mar 9 or Mar 11)	
<b><i>Spring Break: March 15-19</i></b>				
15	Tues	Mar 23	Return and review debt test – written re-grade appeals due immediately after class after we review test key in class and discuss answers and points	

- 16      Thurs    Mar 25    Real Estate equity product overview –
- Real Estate Investment Trusts (REITs):  
Public Market investing
  - Real Estate Private Equity funds (REPE);  
Private Market Investing
- Start REITs – Industry overview
- 17      Tues      Mar 31    REIT analysis and valuation:
- valuing REITs as stock using FFO, AFFO,  
and DDM;
  - valuing REITs as real estate using NAV and  
implied cap rates;
  - the possibility and mechanics of public-  
private arbitrage with REIT stocks and  
underlying properties.
- 18      Thurs    Apr 2      Real Estate Private Equity (PE) – description,  
industry stats, performance, etc., example deal  
OMs; basic fund structure.
- 19      Tues      Apr 7      **Speaker** on PE funds (Pennybacker?)
- 20      Thurs    Apr 9      Public (REITs) vs. private (PE) real estate equity  
**returns** – are these things truly different or are the  
differences in returns driven by ‘measurement  
error’?

Readings (available on Canvas):

1. Cannon, S. E., & Cole, R. A. (2011). How accurate are commercial real estate appraisals? evidence from 25 years of NCREIF sales data. *Journal of Portfolio Management*, 37(5), 68-88,6.
2. Ang, Andrew, Neil Nabar, and Samuel J Wald. “Searching for a Common Factor in Public and Private Real Estate Returns.” *The Journal of Portfolio Management* 39.6 (2013): 120–133.
3. Chen, Bingxu, and David Greenberg, “Consistent Risk Modeling of Liquid and Illiquid Asset Returns”, *Journal of Portfolio Management, Special Real Estate Issue*, 2017.

21            Tues    Apr 14    Real Estate in a Mixed Asset Institutional Portfolio:  
The use and effectiveness of real estate as a means  
of diversification and Sharpe ratio enhancement

Reading (available on Canvas):

Pagliari, Joseph L. “Another Take on Real Estate’s Role in Mixed-Asset Portfolio Allocations.” *Real Estate Economics* 45.1 (2017): 75–132.

22            Thurs   Apr 16    Managing an Active Real Estate Portfolio Against  
a Benchmark –

- managing a REIT portfolio against a publicly traded benchmark,
- and an extension of the idea to managing a private real estate portfolio against a private NCREIF benchmark.

Reading (available on Canvas):

Plazzi, Alberto, Walter Torous, and Rossen Valkanov. “Exploiting Property Characteristics in Commercial Real Estate Portfolio Allocation.” *Journal of Portfolio Management* 37.5 (2011): 39–50,4

23            Tues    Apr 21    **Speaker** on real estate portfolio construction -  
Mark Roberts, Executive Director, Texas Real  
Estate Center

24            Thurs   Apr 23    Options in real estate, including the valuation of  
raw land as a call option on future development.

Reading (available on Canvas):

“Urban Land Prices Under Uncertainty”,  
Sheridan Titman, *The American Economic Review*, Volume 75, Issue 3 (June 1985), 505-514.

25            Tues    Apr 28    Logistics Industrial Partners case discussion with  
Prof. Joshua Brown

Reading: Lions Industrial Partners case

26	Thurs	Apr 30	Real estate and real estate investing post-pandemic: the repurposing of real estate in the post-pandemic world
27	Tues	May 5	Review equity material for test
27	Thurs	May 7	<b>Equity Test</b>

Notes on Fabozzi MBS textbook reading for first half of class, by chapter

The Fabozzi mortgage book can get technical. I have reviewed the book page-by-page, and below I have indicated required and optional or not-class-necessary topics covered in each chapter. I also indicate where my class notes will cover numerical examples presented in the book. By Chapter -

1. Read all of it.
2. Can leave out the structural detail in “MBS trading” pp 35-40.
3. Lots of numerical examples and industry terms that I will cover and include in the slides in class. Skim it but don’t have to study it; use the notes and class here.
4. Easy chapter; read all of it.
5. Intro chapter to structuring mechanics; read all of it.
6. Read through the first sentence on page 121; 121-129 is pretty complicated and generally beyond the scope of what I’m trying to accomplish in this class. Likewise the example starting at the bottom of 134 through the end of the chapter is difficult and unnecessary for this class.
7. Read through the first half of page 147, so about the first 6 pages or so. The rest of the chapter covers interest securities such as floaters and inverse floaters and TTIBs, and that’s a hard read that I can cover more easily in class, as time allows.
8. Read through the first half of page 176, ~ 10 pages. Beyond the heading “Private Label Senior Structuring Variations” is not necessary.
9. Read 193-202. The rest is honestly not bad, and discusses mortgage insurance and tranche-wrap products, but not necessary to read as I’ll discuss both those products in class.
10. I like it, good fixed income finance. I’ll do something very similar in class and you will be responsible for the classroom treatment, but not all the details contained in the textbook. Skim it but don’t get bogged down.

11. I like it, good fixed income finance. I'll do something very similar in class and you will be responsible for the classroom treatment, but not all the details contained in the textbook. Skim it but don't get bogged down.
12. Long, detailed, example – we will not cover in this class.
13. Long, detailed, example – we will not cover in this class.