

Real Estate Accounting: Fundamentals, Organizations, and Revenue

New to real estate accounting? Start here. This course introduces the foundational concepts of real estate, explores the various organizational structures used in the industry, and covers how to properly account for revenues generated by operating properties. Whether you work with individual investors or complex entities, understanding these basics is essential for providing accurate, informed guidance to clients in the real estate sector.

CREDIT HOURS 2 | FIELD OF STUDY ACCOUNTING | EXAM QUESTIONS 10

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LEARNING ASSIGNMENTS AND OBJECTIVES

Assignment

- Study the full course materials included here.
- Complete the review questions after each chapter.
- Answer 10 final exam questions.
- Final exam is scored immediately, 70% or better passes.
- Certificate of completion is available in your account.
- Failed exams can be retaken free of charge.

Course Objectives

- Identify characteristics of various real estate assets.
- Recognize characteristics of various forms of real estate ownership.
- Identify differences between types of leases.

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Chapter 1: INTRODUCTION TO REAL ESTATE

Chapter Objective

After completing this chapter, you should be able to:

- Identify characteristics of various real estate assets.

Real estate is generally defined as land and all things that are permanently attached to it. These attachments include improvements made to add to the value of the land, such as irrigation systems, fence, roads, or buildings. When buyers purchase real estate, in addition to acquiring the physical land and its improvements, they acquire other specific rights related to that real estate. These rights include the right to control, exploit, develop, occupy, improve, pledge, lease, sell, or assign the real estate. These rights apply not only to the physical land and improvements but also to the ownership of all that exists above and below ground. These ownership rights can normally be separately leased or sold to interested parties; thus landowners can separately sell the space above a certain height on a particular piece of land. This space is usually called an air right. However, it is important to note that the use and transfer of air rights can be restricted or regulated by state and local laws.

TYPES OF REAL ESTATE ASSETS

Generally, a piece of land can be improved into different types of real estate assets. These improvements can be classified into seven different types of real estate:

1. Improved non-built land
2. Residential properties
3. Commercial office properties
4. Industrial properties
5. Retail properties
6. Hotels
7. Mixed use properties

Improved Nonbuilt Land

In economics and business, land is described as one of the four factors of production (the other three include labor, capital, and entrepreneurship). The value of land is derived from the demand for land for the production of goods, and also from the demand for goods and services created by improvements made to land. For example, the demand for rice requires the cultivation of farmland to grow the rice. Likewise, the demand for cars requires the construction of factories to produce the

cars: land is needed to build these factories. Therefore, even an empty lot is an asset with measurable, and in many cases, significant value. Thus, a vacant lot can be improved for farming through the installation of proper irrigation and access roads, or made suitable for the production of goods and services with the construction of infrastructure.

Residential Properties

Shelter is a basic necessity of life. In order to obtain it, residential properties must be constructed. The predominant type of residential properties in a particular area depends on factors such as the availability of developable land, population and population growth, zoning laws, local government policies, and access to transportation, among others.

There are four primary types of residential property:

1. Single-family and small multifamily properties
2. Garden apartment buildings
3. Mid-rise apartment buildings
4. High-rise apartment buildings

Single-Family and Small Multifamily Properties. Single-family residential properties are mostly found in suburban areas and are usually occupied by one family. Such houses normally have a living room, bedrooms, kitchen, bathroom(s), and maybe a family room. They tend to be either occupied by the property's owner or rented out to a tenant. This type of residential property is not usually found in a central business district (CBD) because it requires more land space per family living unit than other types of residential properties. They are thus usually more affordable in a suburban area.

A small multifamily residential property is similar to a single-family residential property but with more than one unit. Because of the multiple-unit structure, each unit is rented out to different individuals or families. These small multifamily properties can be between two and four separate units. In some cases the owner occupies one of the units and rents the other units to tenants. This type of residential property is also predominant in suburban areas and sometimes is also found in urban areas. In some cases it can be found near CBDs.

Garden Apartment Buildings. Garden apartment buildings usually are located in suburban areas and contain individual attached apartment units. They are usually built horizontally and are three to four stories tall. In suburban areas, retirement homes and some condominiums and cooperative houses are built in this style. A typical garden apartment complex can have between 40 and 400 units. This type of residential property is more common in the suburbs because it requires significant land space due to the horizontal nature of the structures.

Mid-Rise Apartment Buildings. Mid-rise apartment buildings are more commonly found in urban areas. They are usually higher than five stories, but can rise up to ten stories. In cities, mid-rise apartment buildings can be structured as condominiums and cooperative properties. Unlike garden

apartment complexes, but similar to high-rise apartment buildings, mid-rise apartment buildings require relatively small land space. But the cost of land, even relatively small parcels, is often very expensive.

High-Rise Apartment Buildings. High-rise apartment buildings are usually towers built in urban areas. High-rise apartment buildings make effective use of the high cost of land in cities. High-rise buildings are usually taller than 11 stories. In major cities, such as London, New York, Tokyo, and Toronto, it is not uncommon to find 50-story high-rises. The construction costs of these towers are enormous. High-rises contain significant numbers of apartment units, certainly more than mid-rise apartment buildings.

Commercial Office Properties

Commercial office properties are properties constructed for commercial office activities. These properties can be found in both urban and suburban environments and are occupied by businesses for conducting business activities; however, they are predominantly found in CBDs. Office properties are usually classed either as A, B, or C. These classifications have no specific rules or criteria, and classifications in different cities vary; thus, what is classed as a Class A building in Dallas might have a different classification in Washington, D.C. However, some of the factors that affect a building's classification include amenities, type and condition of the elevator, lobby finishing, electrical and mechanical engineering efficiencies, adoption of modern energy concepts, design of the building, age, proximity to transportation, and tenant mix.

Generally, a Class A building is better, in terms of the factors listed above, than a Class B building in the same market. Class A buildings tend to be close to major transportation hubs; are new, or relatively new, and have modern designs; have modern electrical and mechanical engineering systems; have modern heating, ventilation, and air-conditioning (HVAC) systems; and usually have major companies as tenants, among other attributes. Class B buildings tend to have fewer amenities than Class A buildings. They may have older electrical and mechanical systems and may be located farther away from main transportation hubs. Class B buildings also may have a mixture of major companies and lesser-known companies as tenants. Class C properties are much older buildings that have not undergone any major renovations for a long time. They also have older electrical and mechanical systems that lack current technological efficiencies. Most often Class C buildings are occupied by numerous, less-well-known companies with relatively small spaces rented to many tenants.

Industrial Properties

Industrial properties include manufacturing plants and warehouse facilities. These properties are usually built horizontally and are very large in size. Sometimes they are custom built to meet the specific needs of tenants due to the nature of the manufacturing process or the type of equipment used.

Industrial properties tend to have simple structural designs with open space and high ceilings. Some might have unique floor, wall, HVAC, or roofing specifications. The actual structure depends on the needs of the tenants. It is not unusual to find a manufacturing facility of up to 1 million square feet of horizontal space or a warehouse facility of the same size.

Industrial properties are usually located away from residential areas and urban cities. Due to the amount of land required to construct these structures, and also due to zoning restrictions, they are mostly located in areas in which land costs are relatively cheap. In some cases, the waste from these facilities can be unfit for normal living environments. In some areas, only certain locations far away from residential areas are zoned for industrial activities.

Retail Properties

Retail properties in general are built near residential neighborhoods and commercial districts. There are different types of retail properties; the most common types are:

- Convenience centers
- Neighborhood shopping centers
- Community shopping centers
- Regional shopping centers/malls
- Super-regional shopping centers/malls
- Specialty centers
- Lifestyle centers
- Power centers
- Off-price outlets and discount centers/malls
- Strip commercial
- Highway commercial

The main differences among these types of retail properties are the size of the buildings and the nature and type of tenants. On one extreme are the convenience centers, which usually span fewer than 30,000 square feet; on the other extreme are the regional and super-regional malls, which can contain over 1 million square feet of shopping space. Exhibit 1.1 summarizes the attributes of each of these types of retail properties.

EXHIBIT 1.1 TYPES OF RETAIL PROPERTIES