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Commercial Lease Tenant Cash Outflow Forecasting Using Multiple Methodologies - Abstract

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CASE DESCRIPTION

The primary subject matter of this case is cash flow forecasting in the context of commercial real estate finance decision-making. Secondary issues examined include the financial analysis necessary when deciding on the appropriate lease type among Gross, Modified Gross, and Net commercial lease choices, the use of consumer and producer price indexes in generating tenant lease-based cash outflow forecasts, forecasting using the linear regression, historical mean, and Monte Carlo simulation methodologies, and the role of risk aversion in decision-making under uncertainty. The case has a difficulty level of four, appropriate for senior level courses, and five, appropriate for first year graduate students. The case is designed to be taught in either an entrepreneurial finance course, a real estate finance or commercial property management course, or an introductory forecasting course. The case can be taught in one class hour with two hours of outside preparation using an exclusively class discussion approach with forecasting results provided to the student or three class hours with five hours of outside preparation with students collecting data and forecasting tenant lease cash outflows. In addition to instructor notes, two versions of a financial model are available on request of the author as case supplements for instructors: a Master version, which provides completed forecast setups, recent data, and forecast results, and a Data-Entry version which is the Master version without the data and forecast results.

CASE SYNOPSIS

A young, recently-graduated financial analyst receives her first assignment from her startup company's CFO: develop a recommendation, with justification, on the appropriate lease type—Gross Lease, Modified Gross Lease, or Net Lease—that the company should accept in signing a new five-year lease for office space. The space location and size have already been decided. The only decision left is which lease type to accept. The analyst takes a tenant cash outflow forecasting approach to her assignment and uses three methodologies—linear regression, historical mean, and Monte Carlo simulation—to forecast the projected future cash outflows associated with each lease type. The analyst's plan is to use the appropriate ex-ante lease-related expense data to develop forecasts of the cash outflow for each lease type under each forecasting methodology, analyze her company's forecasted cash outflows in both current and present value dollars, and then make her lease type recommendation based upon her analysis.

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