

# CHAPTER 14

## DISPOSITION AND RENOVATION OF INCOME PROPERTIES

### What are my options?

If you own a property, you have three options available to you.

- Dispose or Hold
- If hold, refinance, renovate?
- If I renovate NPV is zero should I do nothing?

### Disposition Decisions

- Anticipated holding period
- Periodically evaluate disposition
- Equity buildup
  - Over time, the loan is repaid, and that capital is not being put to use
- Opportunity cost of not selling
  - A higher yield elsewhere?

### Cash Flow Summary:

Assuming Sale Today... this is what we have earned to date (assume that "now" is year 5)

	0	1	2	3	4	5
<b>BTCF</b>	-50,000	1,858	2,638	3,449	4,293	97,738
<b>ATCF</b>	-50,000	4,539	4,859	5,187	5,523	76,842
<b>BTIRR</b>	18.26%					
<b>ATIRR</b>	14.83%					

### So, does the past instruct the future?

- Are those rates of return adequate?
- Can it guide us for the future?
- The past can help us estimate the future, but it does not necessarily have a correlation with future returns.

### ATCF From Sale After Five Additional Years

	5	6	7	8	9	10
<b>ATCF</b>	-\$70,978	\$6,156	\$6,601	\$7,054	\$7,514	\$107,202
<b>ATIRR</b>	15.6%					

**Where did year 5's ATCF come from? It's the sale proceeds we would have realized if we sold today.**

### So, now what?

- To justify a sale the investor must earn more than **15.6%** on a comparable investment
- In other words, the same level of risk.

### Marginal Rate of Return

- The return that would result from holding property one additional year

$$MRR = \frac{ATCF_s(yr\ t+1) + ATCF_o(yr\ t+1) - ATCF_s(yr\ t)}{ATCF_s(yr\ t)}$$

- Property should be sold when the “MRR” falls below the rate at which funds can be reinvested

### Ideal vs. reality

- In the ideal world, this sort of analysis would be done on an on-going basis.
- In reality (and in a healthy market), most companies are too busy with live projects to analyze every property, every year.

### Refinancing as an Alternative

- Over time a property builds equity
  - Refinancing allows an investor to increase financial leverage and invest in other opportunities.
- Incremental cost of refinancing
- Refinancing at a lower interest rate

### Refinancing as an Alternative

Incremental Cost of Refinancing			
	Current balance	Monthly payment	Balance after five years
New loan	187,500	1,975	179,350
Existing loan	142,432	1,470	129,348
Difference	45,068	505	50,002
<b>Incremental cost of refinancing is 14.93%</b>			
<b>Can the investor reinvest the proceeds and earn more than 14.93%?</b>			

### Renovation as an Alternative

- Major CAPX improvements
- Convert to a different use
- Rezone because of Economic  $\Delta$  in the geographic area

## Renovation as an Alternative

### Incremental analysis

	5	6	7	8	9	10
ATCF <sub>R</sub>		5545	6578	7632	8707	218,585
ATCF		6156	6601	7054	7514	107,202
ICF	-50,000	-611	-23	578	1193	111,382
IRR	17.58%					

## Rehabilitation Investment to Tax Credit

Category	Credit
Before 1936 and non-residential	10%
Certified historic structures, residential or non-residential	20%
o Dollar for dollar reduction in taxes	
o Paid out over 5 years, and subject to recapture	
o <a href="http://www.kahrrealestate.com/KahrNotesvolume3issue2.shtml">http://www.kahrrealestate.com/KahrNotesvolume3issue2.shtml</a>	

## Low Income Housing Tax Credit

- o This is a primary Federal tool for the construction of housing for low income populations.
- o Essentially, if you build housing for low income, you receive a tax credit that is paid out over 10 years. This credit may also be sold to investors to raise equity.
- o See: LISC and Enterprise Foundation for more information.

## State and Local

- o As a general rule, states and municipalities do not give tax credits to encourage construction. For housing, they give:
  - Real estate tax abatements
  - Zoning bonuses
  - Low interest rate financing (NYC HDC)
- For housing, see NYC HPD and NYC HDC for more information. For everything else, NYC EDC.