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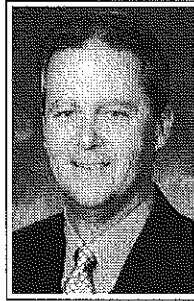
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Tax Free Exchange – The Improvement Exchange

Here is an interesting situation. A seller seeking to enter into a tax-deferred exchange of real estate finds a buyer with cash willing to purchase the property for \$1 million. To protect the right to defer any taxes on the transaction, the investor transfers the property to a Qualified Intermediary (QI) who completes the sale and will hold the cash proceeds during the period in which the seller must obtain title to a replacement property.

The seller has an initial period of up to 45 days in which to identify the replacement property, followed by 180 days in which to obtain title.

The Improvement Exchange

Suppose the seller immediately identifies the property valued at \$500,000 to be received in the exchange and wishes to make improvements to it. If he immediately concludes the exchange, the maximum tax deferral will be \$500,000, and the gain in excess of that amount will be taxable.

However, any improvements made prior to the expiration of the 180 days can be added to the value of the seller's property and to that extent can defer additional taxes. This is known as an "improvement exchange".

An alternative would be to have the seller of the replacement property make the improvements prior to the exchange and so increase the value of the property to be given up. However, this has obvious difficulties. A further alternative is to perform a "safe harbor improvement exchange" as permitted by revenue Procedure 2000-37. To achieve this, however, the investor needs to take certain steps prior to acquiring the replacement property, in many instances prior to selling the relinquished property.

Additional Requirements

The selling party cannot obtain any credit for prepayment to contractors for improvements not yet completed or for the cost of materials purchased and placed at the site but not yet incorporated into the real estate. On the other hand, the rules do not require that the improvements be completed within the 180-day exchange period or that a certificate of occupancy be issued for the project. The seller is entitled to receive credit for the cost of whatever improvements actually have been made regardless of the stage of completion of the overall project. ■

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This publication is not a solicitation but is an information service from this office.

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When ideas in tax and other legal areas in this publication seem to fit your situation, it is recommended that you discuss them with your professional advisor before taking action.

Conversions Of Older Buildings For Big Profits

By putting some imagination and cash into an old, deteriorating property, that building might be converted into a profit-making investment. Sometimes you can turn things around and make a moneymaker out of an otherwise wasted property. Here are some ideas on how various types of properties can be rejuvenated.

Lofts

Office or Residential Space: A loft building that is located in or near a downtown business district can be adapted for use as office or residential space. This type of space appeals to businesses that don't ordinarily have visitors but need extensive floor space for their

into elaborate artist-in-residence studios that can be rented to high-paying tenants. Such conversions have changed Manhattan's once deteriorating lower West Side into a fashionable Soho area.

Old Theaters

Many old movie theaters have excellent locations and are still structurally sound and offer a number of conversion possibilities.

Catering Facilities: A theater building can be gutted and refinished to house a catering business. The wide-open area can be easily converted to include a dance floor and dining area.

Sometimes you can turn things around and make a moneymaker out of an otherwise wasted property.

operations. Thus, prospective tenants for this type of building would be businesses that require facilities for many employees or for storage of continually used materials. Possible tenants include government agencies, insurance companies, manufacturers' representatives, architectural firms, and trade associations.

One popular way to go about converting a loft building to office or residential space is to drop the ceilings a few inches and then put up dividing walls. Allow enough space between the original ceiling and your new one for heat and air-conditioning ducts and new wiring. In most instances, old loft buildings will need extensive electrical and plumbing work. These improvements and modifications can transform a rundown loft into a modern office complex that will substantially increase the building's value and financial return.

Art Studios: Lofts are also sought after by artists who need large, open spaces for their work. Suitable buildings can offer low-rent accommodations in the form of bare loft space. For a larger investment, lofts can be converted

Commercial Buildings: Theaters can be converted into multistory commercial buildings. In one instance, a theater was converted to house a supermarket on its main floor, offices on the second, and a billiard parlor in the basement.

Factories: In one theater, the floor was leveled and air-conditioning was installed to accommodate a candy factory.

Distribution Depots: In another conversion, a theater was turned into a distribution depot for newspapers and magazines. The high ceilings were lowered and the upper portion of the building was used for storage.

Parking Facilities: An old theater located in an active business section of a heavily populated area can be razed and the land converted to a parking facility. However, it's especially important to closely calculate your costs. Keep in mind that these structures are made of heavy steel and masonry, do not have much salvageable material, and will entail substantial wrecking costs.

Gas Stations

Many gas stations have been abandoned in

Apartments — Cash Flow And Appreciation

Apartments continue to be the most popular investment among a cross section of investors. When owners are surveyed the results show that most buyers put cash flow as their number one reason for the purchase, while the next reason is appreciation potential. A few years ago it was the other way around, with appreciation being the number one goal.

Cash Flow

Cash flow has now surpassed appreciation and tax shelter as the reason for buying apartments. Last year approximately 40% of buyers surveyed held this opinion. This was down from 55% in 1999, but still was ahead of appreciation in the survey.

The owners and recent buyers stated they expected or hoped for a cash flow of about 7.5%. Most were also confident that they could increase net operating income shortly after buying the property, expecting a cash flow of about 9% by 2008 and after.

Appreciation And Tax Shelter

In the early 1980s, before the tax law changes in 1986, all kinds of income real estate were

booming. At that time, less than 10% of buyers considered cash flow the most important. The buyers then wanted tax shelter or inflation-driven appreciation as prime considerations. This was the goal of over 40% of all buyers through the mid-1980s. However, when the real estate recession began, and it was realized that apartments do not always increase in value, buyers quickly shifted their attention to cash flow. By 1998, fewer than 20% of buyers were primarily looking for appreciation, but now that percentage has risen to just below 40%.

Upgrading For Cash Profits

About 20% of new investors are trying to generate both cash flow and appreciation by renovating the purchased property. When the cash flow increases, the value goes up also. Among these 20% of buyers, the renovation budgets averaged over \$3,000 per unit. These owners expected increased cash flow of about \$700 per unit per year. With most of the increased rent going to the bottom line, this will increase the value of the property by \$7,000 per unit. ■

Conversions...(Continued)

recent years. For a creative investor, these properties offer opportunities to convert good locations to moneymaking uses.

Restaurants: Many entrepreneurs have successfully converted abandoned service stations to drive-in, fast food restaurants. A well-located station with adequate on-site parking space is ideal for this use.

Offices: A converted gas station can provide ample office space with on-site parking in a good location for a doctor, dentist, lawyer, accountant, insurance agent, or real estate broker.

Grocery Stores: Drive-in grocery stores, where the customers drive up to the purchasing window and buy small quantities of groceries, have become very popular in some parts of the country. Small service stations are ideal for this type of conversion. The station's garage space, with its large doors, is a perfect receiving area.

Shops: An abandoned service station in an affluent suburban community can be converted to a moneymaking shop for a florist or hair-stylist, or for use as a boutique or other specialty shop.

Recreation: Abandoned gas stations can be used for miniature golf courses. The minimum space requirements are 1,400 square feet for a 9-hole miniature golf course and 2,800 square feet for an 18-hole course.

Suburban Conversions Buildings located away from central cities cannot, as a rule, be profitably converted to office uses, nor does it pay to level the buildings and use the properties for parking facilities. But these buildings can be renovated and recycled for warehouse or mini-warehouse use if the locations allow easy access to major highways. The fact that a structure is situated away from a city means that the area is probably not congested and merchandise can be handled expeditiously. ■

Solving Problems In Apartments And Other Income Units

In spite of the loan problems caused by the sub-prime lending, the timing now seems increasingly right for investors and developers to obtain troubled property at bargain prices. There are two reasons for this: (1) the supply of money for real estate loans on good projects is still available, and (2) the pressure on owners and lenders with troubled property to get out from under the on-going burden is also high. The result is that syndicates are rapidly being formed to seek out and buy up troubled properties.

A remodeled apartment house. An empty new office building or hotel that has an excessively high level of vacancy. A large tract of undeveloped land that no developer has become serious about wanting to develop. These are examples of troubled property — property that is a definite financial burden to continue to hold but which also is unattractive property to most prospective buyers. Unattractive, that is, until very recently.

High Risks

Knowledgeable property developers and managers (especially those familiar with empty or near-empty office, hotel, and apartment buildings) caution that buying troubled property requires taking a very high risk. The financial returns are uncertain and

may be a long time in coming, if they come at all. This type of investment is not for everyone; it's for those who can afford high-risk situations.

The profits can come from any one or a combination of circumstances.

- A market turnaround caused by a boom in the local and/or national economy.
- An improved system for promoting and operating the property. Some syndicates are being formed solely to manage the troubled property with an option to buy when and if it hits a specified profit level.
- Purchase of the property at an almost give-away price, often combined with imaginative and untraditional financing techniques. Some lenders are asked to share the financial risks by accepting a low initial interest rate in return for a big share of the profits later on. Sometimes the seller of the *troubled property* is asked to retain a financial stake in the *property* and to help turn it around. The seller's experience and involvement in the project from the start can be valuable.
- Including the troubled property in a larger development plan. An office building that sits empty might become part of a new industrial park with hotels, conference facilities, and residential apartments, all of which are successful.

Take another look at troubled properties in your area. With fresh new ideas and a re-structuring of the mortgages, the troubles may go away, leaving a profitable investment for you. ■

Real Estate Investment Consultants

When you need professional advice and help in commercial real estate you must come to our office. We are experts in values and knowledge of the entire market in this area. If you have been looking for a certain type of property we probably have the full information on several like it already.

Today's investor in real estate must have a grasp of market conditions and potential that is usually beyond their own available time to attain. Investors need assurance about the true condition of the market. With increased competition, the market place is becoming more complicated. As your professional commercial real estate advisors, we are in the position to represent you in real estate

transactions by setting up sales, exchanges, leases, purchase and sales of options, and management of real estate.

More investors are turning to real estate consultants as a means of providing a sounding board for their ideas as well as expertise in the planning and construction stages for their projects.

Feasibility studies are essential for commercial office, industrial, resort and hotel investors. With this kind of information, planning is better and there is less chance for error.

Real estate investing is not just the structure and the land. It is investing in the type of property that you want at the price and terms that suit you at the time you want to make the purchase.

We can be your consultants. ■



A CCIM is a professional real estate practitioner with proven technical expertise in commercial property. A CCIM is a person truly committed to the fundamentals of effective commercial-investment brokerage. The CCIM has completed a full schedule of Post Graduate Level Courses in investments, taxation, development and marketing all types of commercial-investment properties. The designation of Certified Commercial-Investment Member is unquestionably the highest degree awarded in the commercial-investment real estate practice.

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