

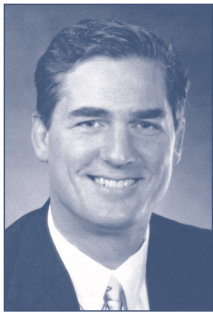
# BANKER & TRADESMAN

ESTABLISHED 1872

THE REAL ESTATE, BANKING AND COMMERCIAL WEEKLY FOR MASSACHUSETTS

## Proper Decision-Making Tools Crucial in a Difficult Market

by John P. Ciccone, ChFC, CFS



The overall economic downturn and the events of September 11th have created a cloud of uncertainty in the real estate market. This is a time of significant transition and no one knows how long it will last. As a result, commercial real estate developers are pondering how to both protect themselves

and take advantage of potential opportunities in this difficult market. In these times of change, how can real estate developers be assured they are making the right decisions and avoid costly mistakes? How does the developer determine whether or not to expand his holdings? What is the best way to determine whether or not to re-finance in this low interest rate environment?

To address the above questions, real estate developers will no doubt turn to their instinctive entrepreneurial skills and their hard earned wisdom, thus using qualitative analysis. They will further benefit by applying the discipline of financial modeling to their decision making process. Financial modeling is a dynamic tool that projects the results of alternative financial scenarios based on actions taken today. Each financial model is a completely unique document customized with detailed information provided for a specific situation. Its versatility makes it applicable to a wide variety of situations. The three main components of the model are annual income, annual expenses and annual asset values. Together they constitute a combined cash flow and net worth statement with projections over a period of time.

The financial model can be used in a variety of ways. Commercial real estate developers may want to project the benefits of owning a specific property over a 15 year timeframe versus selling it and buying another property. Alternatively, a developer can compare the financial viability of re-financing in this low interest rate environment. "Commercial and community banks are experiencing a high volume of real estate developers looking to refinance existing properties and take advantage of the low interest rates now occurring in the marketplace," said Don Queenin, executive vice president of Northern Bank and Trust Co.

"Given the numerous variables confronting developers when making financial decisions, financial modeling can be an invaluable tool," says commercial real estate development attorney, Henry G. Kara. First, utilizing a given set of assumptions, a "base model" is created that serves to project one particular financial scenario. Then the base model can be modified to illustrate the result of alternative financial scenarios. As a result, developers are able to quantify the relative differences of one strategy versus another to determine which approach best meets their goals.

Bill, a real estate developer, stated that he wanted to work less and take at least six months off a year to travel. He had been working for over 25 years building up a number of substantial real estate holdings. His goal was to receive a predictable income stream from his assets to maintain his financial independence for life. Understandably, Bill was uncomfortable relying solely on his real estate assets to maintain his needed income.

*continued*

# BANKER & TRADESMAN

ARTICLE REPRINT • MONDAY, OCTOBER 29, 2001

He further stated, "I do not want to continue taking the same amount of risk as I have in the past. I realize that putting all my eggs in one basket could eat me up. I have seen a lot of my friends back in the late 1980's and early 1990's lose it all."

While Bill's goal was clear, he was uncertain how he should position his assets to achieve the optimal income and level of diversification to satisfy his risk tolerance. In this particular case, Bill owned five properties of which two represented 80 percent of the overall holdings. Through the use of financial modeling, he was able to review and evaluate multiple scenarios and determine the optimal choice for his personal objectives. As a result, he decided to sell one of the larger properties and use the proceeds to pay off the mortgage on the other while also refinancing two of his smaller properties. The financial model quantified that this combined approach would maximize his cash flow significantly versus the other alternatives. Furthermore, this approach reduced Bill's income tax burden significantly while creating sufficient liquidity to diversify his overall assets.

In another example, a multi-generational family business owned several properties, including a substantial shopping mall. As with other family business owners, unless they took part in proactive planning, they were confronted with the threat of losing half of all they had accumulated to the IRS in the form of estate taxes. They were all too aware of other family businesses that had to be liquidated to pay the estate tax bill, including the owners of the Miami Dolphins and Prince Spaghetti.

## Compare & Contrast

Through the use of financial modeling, however, they were able to compare and contrast many estate planning tools and select the one that allowed them to transfer the future appreciation of the business to the next generation and avoid significant taxes. The

financial model determined the amount of income and assets the senior generation could afford to transfer out of their taxable estate to their children during their lifetime without jeopardizing their lifestyle. As a result of completing this planning in 1994, the portion of assets included in the senior generation's taxable estate was capped at \$10 million.

Consequently, \$20 million was successfully transferred to the children, deferring estate taxes for another generation and avoiding a forced sale of this family business.

Financial modeling can be a powerful tool for assisting real estate developers in the strategic management of their business and personal financial life. It simplifies the decision-making process by making alternatives clear and specific. It enables developers to make better decisions, efficiently and with confidence, knowing they have weighed each alternative deliberately and in detail. If you do not have the internal capabilities to create a financial model, you may want to speak to your banker, CPA or financial advisor to create one for you.

*John P. Ciccone, ChFC, CFS, Financial Consultant and founder of The Capital Navigation Group, has specialized in comprehensive financial consulting for over 20 years.*

*John developed The Capital Navigation Plan™ in response to the unique dangers and opportunities his clients face. He works exclusively with closely held business owners and high net worth individuals. He can be reached at 800.542.1545, Ten Post Office Square, 5th Floor, Boston, MA 02109.*