Prologue

The following article describes how the Homer Hoyt Institute has been privileged over the years to receive donations of real property, either as gifts or through “bargain sales.” Also explained are creative solutions for problem properties that have benefited both donors and recipients.

The vignettes are mini-case studies that demonstrate how an understanding of real estate economics, environmental concerns, tax laws and politics is necessary to affect solutions to complex real estate problems. As Dr. Seldin would put it: “One must understand the system.”

Unstated in this article are the amounts of time spent in formulating detailed strategies for possible alternative outcomes at each step from the donation to disposition of a property, and the negotiations that produced, step-by-step, an outcome beneficial to all parties involved. Dr Seldin lived every detail of these strategies and negotiations. The Homer Hoyt Institute as we know it today owes its existence to his perspicuity and the generosity of its donors.

HHI actively solicits gifts of real property. The administration of HHI would be pleased to discuss the financial and non-financial benefits of a donation with any interested individuals or organization. Such gifts support real estate education and research through the Homer Hoyt Institute and the Advanced Studies Institute, sponsor of the Weimer School, and may include naming opportunities. Interested persons may call (561) 694-762 or toll free (888) 829-3501, or e-mail weimer@hoyt.org.

Ronald L. Racster
President, Homer Hoyt Institute

The Institute’s Real Estate Investment Strategy*

By Dr. Maury Seldin**

The Homer Hoyt Institute is a small foundation serving as the support organization of the Advanced Studies Institute (ASI). Its investment objectives call for sufficient income to continue to support the ASI within a set of risk constraints intended to preserve capital and provide sufficient liquidity for acquisition of problem properties as part-gift and part-sale, commonly known as bargain sales.

This discussion will focus on the real estate investment strategy over the past quarter of a century. It is important to deal with such a time span because conditions change and strategy and portfolios may change as an adjustment to conditions.

* This insert is adapted from a book in progress, Improving Decisions: Toward a New Age of Enlightenment. It tells the story of the major gift of problem property that transformed the Institute from a grant-receiving organization into a grant-giving organization. The story is used in the context of developing ideas of interdisciplinary approaches to interdisciplinary problems and of application of principles identified in one discipline to situations dealt with by use of other disciplines.

** Dr. Seldin is Chairman of the Board of Directors of each of the three organizations that comprise the Hoyt Group. His gratitude is expressed to his good friend and colleague Dr. Racster for adapting and editing the excerpts from the book to become suitable for publication as an insert to ASI News.
The Mile of Ocean Front Land

Acquiring the First Investment: Green Turtle Beach

The Homer Hoyt Institute, founded in 1967 as the research and development (R&D) arm of the then-Real Estate and Land Planning and Use Program at The American University School of Business Administration in Washington, D.C., functioned as a grant-receiving institution until late 1979 when it received a gift of a mile of ocean front land from Dr. Hoyt, for whom the Institute had been named since its inception. Until that time, there were no assets that could be identified as investment assets. There was no real estate for which to have an investment strategy.

When Dr. Hoyt assembled the parcel, he did so with the understanding that growth along the east coast of Florida would proceed in a northerly direction from the heavily urbanized areas of South Florida. The coastal area is warmed by the Gulf Stream, which turns away from the east coast of Florida just above St. Lucie County, in which the land is situated.

Among Dr. Hoyt's theoretical contributions was his sector theory of city growth and structure. He simply applied the theory to the coastal area and it was obvious to him that the time would come when the market for land would be so strong that it could support a high density development. His early promotion of the land showed that vision.

In fact, he initially sold the land to a developer who started development but went bankrupt. The timing was a little early and the developer got caught in the downstroke of the cycle. When Dr. Hoyt got the land back after the first sale, he started with an asking price of $3,000,000, but as growth in tropical Florida moved towards the property he raised the asking price to $6,000,000, and then again over time to $9,000,000.

The developability risk accounted for the great difficulty Dr. Hoyt had in finding a buyer for this environmentally sensitive land on acceptable terms using standard terms for a down payment with normal contingencies. Such a conventional sale would not work, and Dr. Hoyt recognized the possibility that he might die with the land in his estate. If that occurred, the government would want the estate taxes in cash, but the only liquidity in the land was the ocean, the intercoastal waterway, an interior lake, and the swamp. Dr. Hoyt had just sold a major tract of land in Fairfax County, Virginia, and the timing was right for a tax deduction for an "in-kind" contribution to the Institute.

When acquired by the Institute, the land was appraised for $9,500,000, including some additional frontage of about 1,000 feet owned with some minority interest holders whose interests were valued at 10% of the total value. At that time, the objective was to convert the asset (with the Institute's interest valued at $8,550,000) to cash so that it could be invested to produce income for a grant-giving program.
Disposing of the First Investment

Selling the land was a great problem because there was great uncertainty about its potential use. The land area totaled 387 acres, including 60 acres of submerged land. The remaining 327 acres included a 5-acre lake and 196 acres of swampland that contained mangroves. Thus, there were 126 acres of dry land, but much of that was not buildable because of the coastal setback requirements.

Most potential buyers for the land were interested in a deal contingent on developability, so that if the purchaser was not able to obtain the permits, the sale could be cancelled. Others were interested in joint ventures that would have required the Institute to put up the land as security while the developer financed the development. Neither of these arrangements was attractive to the Institute because the purchaser/developer could opt out if the property was found to be not sufficiently developable, leaving the Institute with tainted land, i.e., land already demonstrated as not developable.

The solution was to design a sale that could balance the risks between seller and buyer by scaling risk and reward with a change in price dependent upon the permissible number of units for development. When the Institute offered the land for sale, the asking price was $12,000,000. Growth was moving up the coast in spurts of momentum. Nodes of development were being added to the network of ocean front communities, so the land was becoming more attractive for development.

A sale was designed with Campeau of Florida, a subsidiary of a Campeau of Canada, for a contract price of $10,000,000. The price was, however, adjustable. If more than the stipulated number of units were permitted, the price could rise to as much as $12,000,000. If less than the stipulated number of units were permitted, the price could fall to as little as $8,000,000. But, in any event, the down payment was $1,000,000 and semi-annual interest payments were $375,000. The developer was obligated to proceed with efforts for development at the developer's expense and to turn over permits and associated documents relating to the efforts if the project were abandoned. The developer was seeking the ability to withdraw if the project was not feasible and at least get back the money paid to the Institute.¹

The solution was to promise to return the down payment and the semi-annual payments if the developer chose to withdraw. The disadvantage of the promise was that the Institute immediately began a substantial grant-giving program upon closing the sale and was using the down payment and then the interest payments to award the grants. The grant program was quickly rising towards the planned level of $500,000 per year. Florida State University was to receive $100,000 per year; the University of Florida would

¹One of the minority interest holders, when offered the deal designed for the sale to Campeau of Florida, responded that it was so convoluted and not really a sale that he would sooner give the land away than consent to the sale. He donated his interest to the Institute, and took a $225,000 tax deduction (with no capital gains tax to pay on the substantial appreciated value of his interest). It turns out that he was audited by IRS, but, there was no problem. The value was reasonable. His counterparts with the other 5% minority interest went along with the sale. When the time came for the Homer Hoyt Institute to rework something with Campeau of Florida, it made sense to buy out the other minority interest holders, which the Institute did for $250,000.
receive $50,000 per year, and an array of other universities would share the balance. We believe that the developer was able to make better progress with the permitting process under this arrangement than if the seller had been a private person who kept the proceeds for his or her own personal purposes.

The plan, in the event permits were not obtained, was to pledge land in proportion to the cash paid to the Institute with a stipulated front foot valuation and to use a two-to-one ratio. Thus, if the Institute took the land back with the obligation to repay, the security would be a portion of the land sufficient to give the developer an asset to donate to the State of Florida or to a tax-exempt environmental group and take a tax deduction.  

The environmentally sensitive land had a tremendous permitting problem. The network of agencies was awesome. Yet, a program was built that was respectful of the environment. A level of permits acceptable to Campeau was obtained, and the price was fixed at $8,000,000. Fortunately, Campeau got the permits and did not have the right to terminate the process with a return of funds.

Unfortunately for Campeau of Florida, the market deteriorated during the time it took to get the permits and Campeau decided that it was in their best interest to transfer the property back to the Institute with a deed-in-lieu-of-foreclosure.

**Institute’s Development Strategy**

The grant program was progressing, and the Institute now had land that was developable. It needed a new strategy. At this time, the Institute could assume the role of the developer, which it did by hiring two of the key executives who had worked with Campeau of Florida, the company that returned the land.

The momentum for development was rolling along, so the opportunity to develop was worth exploring. As believers in understanding the system, the Institute studied the composition of the market to find the niche that was underserved. New methodology was developed to identify the best segments to serve. Based upon identifying that segment, the Institute, through its subsidiary, Treasure Beach Corporation

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2The fall back position for Campeau, if the land were not developable, was to return the land to the Institute in exchange for a promissory note with land as sole security for refund of the down payment and interest payments made up to the time of return. The land was to be sole security for the note created and would be valued at $1,500 per front foot and the loan-to-value ratio would be 50%. So, in the event of the return of the land for non-developability of the land in accordance with the terms of the contract, the down payment and interest payments could be recovered to the extent that there were tax savings from the subsequent contribution of land. The quantity of land to be returned to Campeau would be calculated at $750 per front foot (50% of the stipulated value of $1500 per front foot for the purpose of securing the note) and the tax deduction if Campeau chose to donate the land to an environmental conservation non-profit organization, or the state, would then be based upon whatever the fair market value of the land would be, presumably around $1,500 per front foot, and the tax benefit would be dependent on the marginal tax bracket of the donor.
(now known as Hoyt Advisory Services), started the development process. (Finding the niche required advancing the state of the art. The methodology and example is reported in the literature [Real Estate Market Analysis: Methods and Applications, edited by John M. Clapp and Stephen D. Messner, Chapter 9, “Absorption Analysis” by Maury Seldin and R. Thomas Powers].)

That process of moving ahead involved preliminary design of the first building, a 60-unit condominium, and the land development necessary to support the building, its service areas, and access.

The key to the land development was the fill permits and the fill itself. The permits called for approximately 249,182 cubic yards. Obviously, not all of this was needed for the first phase, but a start was needed. The new staff was told to start the fill process, and the question asked was, “how many trucks?” Having been informed that a truck would handle 18 to 20 cubic yards and eight or nine trips per day depending on whether they are hired by the day or the trip, my response was, “One truck, but I want it every day.”

Disposition of the Land

At the same time that the former vice president of Campeau of Florida (one of the two staffers hired) was working on the development, he also was working on a sale of the land to the State of Florida under its preservation program. The one truck a day with its eight or nine trips was enough to spark 3,000 letters to Tallahassee from the Turtle Mothers, who were concerned about the impact on this prime turtle restoration beach. The land got on the list for state acquisition in record time. Ultimately, the land was sold for cash to the State of Florida and the Institute continued its grant-giving program.

The sale was politically sensitive. After the land was placed on the list for the Save Our Coasts program, the Institute was informed that the Institute’s priority listing was such that the state only had enough money to buy one-half of the land at that time, but it would give the Institute first consideration in the ensuing bond issue. The option was to sell one-half or take the chance waiting for a sale of all of the interest in the next round.

As it happens, the parcel ahead of the Institute’s was in the county of one of the state’s leading politicians. The Institute decided to sell a one-half interest in the property. So the Institute became partners with the state until after the next bond offering, and leased the land to the State of Florida for a dollar a year.

Investment of Proceeds of Sale

The proceeds of the sale were invested in laddered treasuries. That was a continuation of the policy pursued while the Institute had the potential obligation to accept a return of the land from the developer/purchaser and repay the funds provided to the Institute. Laddered treasuries refer to staggered maturity dates, so that the Institute faced an interest rate risk for reinvestment, but no liquidity risk in terms of having cash available for operations and minimal liquidity risk in getting cash for investments.
The price level risk was offset to some degree by the high level of prevailing interest rates that served as compensation. There was still some exposure from changing rates of inflation, but the Institute could live with that. Of course, with U.S. Treasuries there is no business risk. This investment strategy served the Institute well for its time, especially since funds were available for acquisitions of real estate that were part-gift and part-sale, commonly called “bargain purchases.”

**Two Office Buildings**

**A Maryland Office Building**

While the Institute was comfortable with the laddered treasuries resulting from the sale of Green Turtle Beach, an opportunity arose for an investment in a small office building in Prince George’s County, Maryland. The building was a two-story structure without elevators. Access from the street level was up a half flight of stairs or down a half flight of stairs.

Under newly adopted federal government guidelines, the building’s prime tenant, the National Park Service, was required to vacate unless handicap access was provided. Adding elevators was not economically feasible. The result was that the building lost its main tenant and tenants satisfactory to the owner were not found.

The owner, having built the structure almost twenty years earlier, had taken most of the depreciation, but still owed about $100,000 on a mortgage. The property was valued under an MAI appraisal at $400,000. The county assessor assessed it for $400,000. The owner thought it was worth $400,000. Everyone thought it was worth $400,000 — except prospective buyers that had been contacted.

The owners offered to give the property to a hospital as a gift, but the hospital would have sold it for quick cash and possibly jeopardized the amount of the tax deduction. Also, it wasn’t clear that the hospital would take it subject to the existing mortgage.

The owner then offered the property to the Homer Hoyt Institute. The Institute gratefully accepted the gift, subject to the mortgage, which was paid off at closing. The Institute looked at the building differently than the previous owner. The building was in transition from a maturing stage to an aging stage and had become more suitable to a tenancy expecting a less desirable quality of space. The result was a standard for tenants lower than the previous owner had envisioned, and a rent-up of the building that initially produced an annual cash flow of more than $20,000 per year and, later, more than $30,000 per year. After about a decade the building was sold to a tenant for $425,000.
Another opportunity arose for an office building investment when the Institute was in the market for expanded office space in the North Palm Beach, Florida, area. A well located, but very troubled building was available for lease or purchase. The building was half empty and half of the tenants that occupied the leased space were in arrears in their rent. Thus, the rental income was about a quarter of what the building would produce if well tenanted. The owner wanted $1,750,000 as a purchase price.

A check of the records showed that there had been a recent recorded sale of the property at a valuation of $2,000,000. But that was as part of a trade ("two one-million dollar cats" for "one two-million dollar dog"). The tax basis of the new owner was transferred to the subject building from a previous investment. He wanted to get out of this property into something more suitable for his purposes, including further deferring the tax liability associated with the low cost basis that reflected substantial depreciation previously taken.

The Institute acquired the building as a part-gift and part-sale at the valuation of $1,750,000, but in this case the Institute had to pay more than half of the purchase price in cash, with the gift portion being valued at less than one-half of the property's value. The Institute immediately spent $100,000 to renovate the building and rented up the space at what may have been below-market rents. It worked well for the Institute, because it provided home office space and enough of a cash flow to justify the investment.

Again, the aging process and weak market had snowballed and the owners did not grasp the reality of what needed to be done. The reality was a renovation with a new look and strong management. The cash flows became attractive and the building has now been held for over ten years. The book value keeps declining, which doesn't make the financial statement attractive, so a sale is being considered.

The Institute has negotiated with some potential purchasers at around $2,000,000, but hasn't closed on a sale because the Institute would remain as a tenant subject to new management, the selection of which is important to the Institute. Finding an appropriate buyer/landlord at an acceptable price has not, as yet, worked out. At this writing the rental market is weak, but the space is fully occupied. The location is getting better because of the surrounding development, and time is on the side of the Institute. The Institute will probably wait for a better balance in the market and sell when the buyers see an upward momentum in the rental rates. The biggest advantage to selling is that it would free up cash for another bargain purchase of larger size. Cash is available for the acquisition of a comparably sized or smaller property. [One of the reasons for telling this story as an insert to the ASI Newsletter is the hope of finding such opportunities.]

A Real Estate Investment Strategy for Today

The Institute's real estate investment strategy has evolved over time. In 1979, the Institute was prepared to close its doors if Green Turtle Beach could not be converted into the spendable funds that would enable the Institute to become a grant-giving organization. If the Institute were offered Green Turtle Beach today, the gift might be refused because the risk of converting to cash in a reasonable period of time would be very high and a cash drain from property taxes and other expenses would use a disproportionate amount of the Institute's income. Such a large gift could take the investment portfolio out-of-balance.
The Institute has a momentum today that could be disrupted by the cost of carrying a property such as Green Turtle Beach. The Institute now has on-going responsibilities as the support organization for the Advanced Studies Institute. It requires a certain level and stability of income for that purpose. Financing Green Turtle Beach, if financable, would increase the risk to the Institute and would not be appropriate. Only a very positive risk assessment of developability and disposition would make Green Turtle Beach a viable acquisition for the Institute. Board policy for the Institute today indicates that a smaller project than Green Turtle Beach would be acceptable. Perhaps such a property will become available through the Hoyt Fellows or other sources.

Regardless of issues of magnitude, all real estate investments require an understanding of an integrated system of economics, legal and political elements. Green Turtle Beach was re-acquired by the Institute at a time when the South Florida market was overdeveloped but the property could still be developed to serve a market niche. Understanding the system made the difference. We support research that aids understanding the system.

At the same time, the Hoyt Institute understood the environmental sensitivity of the land and the State of Florida’s interest in preservation. Understanding how to deal with the environmental sensitivity, accompanied by massive regulation, was the most difficult part of the development process. The Canadian developers were far better suited to dealing with the regulatory authorities than those who had the schemas in their minds in the United States. The Canadians understood the system better because Canada is even tougher in its regulations than the United States.

Because of the developability risk for Green Turtle Beach, as discussed earlier, it was essential to understand the income tax system in order to be able to strike a deal that had acceptable risks to both buyer and seller. The benefits to the initial donor, the ultimate purchaser, and the initial donor’s tax deduction had to be protected. The other real property donations accepted by the Institute incorporated these factors in varying ways. The Institute’s counsel, Thomas L. Howard, Esq., understands the taxation system. Finally, getting Green Turtle Beach on the list of properties to be acquired by the State of Florida required lobbying and an understanding of the political system.

**REIT Investment Strategy**

For the last decade, the Institute has focused on REIT investments, and has done exceptionally well. That is another aspect of investment strategy, which perhaps is better told at another time. But, it does relate to the development of the proprietary model for REIT valuation and risk assessment, and has led to the current flow of funds / capital market research program for which specific additional support is currently sought.

As noted, the Institute seeks to acquire other problem properties as gifts or part-gift and part-sale. We have research projects to support in addition to those dealing with capital markets and are engaged in a fundraising campaign. Donors of property interests have found it especially beneficial to provide “in-kind” contributions.