

Q & A: KOG RENTAL PROPERTIES

BRIEF HISTORY

During 2010 through 2012, KOG purchased six houses (W2-W7) to the west of KOG in order to build a parking lot to replace the parking spaces lost between KOG and the frontage road during the widening of IH-635. These houses were purchased with proceeds from the condemnation of KOG's frontage property. During 2014, houses W2-W5 were demolished and the parking lot expansion was completed. Houses W6 and W7 were retained as rental properties (6406 and 6410 Clubhouse Circle, respectively). We also own the house at E1 (also a rental property) and the lot at E3.



Why did we purchase W6 and W7 if we did not convert them into a parking lot?

We owned W4 and W5 when W6 and W7 came available. At that time, the owners of W2 and W3 had overpriced their houses. We considered using W4-W7 for our parking lot but this required rezoning and the neighborhood was very resistant to this action. When the prices for W2 and W3 came down, the neighborhood was more amenable to our expanding out W2-W5.

How much rental income do the houses generate?

The three rental properties generated net income of \$25,000 in 2015 and 2016 but KOG spent virtually nothing on maintenance or improvements. In 2017, the rental properties generated net income of \$13,000 due to increased maintenance, repairs and taxes. In 2018, we lost two tenants and used the vacancies to institute major repairs to all three rent houses; the net income (amount to be determined) funded the repairs.

In 2019 without regard for maintenance and repairs, W6, W7 and E1 are expected to net \$15,000, \$12,000 and \$5,000, respectively. This is a yield of less than 4% on estimated market value. This level of income is the "best case:" 100% occupied and no repairs.

What have we done with the rental income?

Prior to 2015, the rental income went into the Right-of-Way fund to offset the cost of the parking lot, which eventually cost \$100,000 in excess of available funds. This debt was shifted to the rental properties for payment. In 2015, the \$25,000 net income was used to reduce the parking lot debt to \$75,000. In 2016, \$10,000 was used to reduce the parking lot debt to \$65,000 and \$15,000 was used for 2016 operations. In 2017, the \$13,000 was used for 2017 operations. In 2018, we used 2018's net income and borrowed fund of \$35,000 for the repairs. The rent houses now have debt of \$100,000 (\$65K + \$35K) borrowed from our Designated Funds.

How much is W7 worth?

Based on a local real estate agent's opinion of value, W7 should retail for \$342,500. We would list the house for \$350,000 to \$390,000. (We purchased the house for approximately \$320,000 in July 2011. This implies an appreciation rate of less than 1 percent per annum from our initial purchase.)

Who handles the rental operations?

One year ago we retained a property management company for leasing the property. This company handles the general rental and billing for W6 and W7 for 8% of the rental fees. Any basic repairs that need to be made to the house are billed at a markup to the cost of materials. So, while this company can handle repairs and call-outs, KOG saves money by having Kim Widlund, Director of Administration, and KOG members address these matters.

Why should we sell W7?

We have already satisfied the original objectives for parking expansion that were envisioned through the purchase and conversion of lots W1-W4. These lots continue to offer capacity of up to 100 vehicles, and are typically less than 20% utilized on any given Sunday.

Lots W6-W7 are not needed for the continuing mission of KOG and tie up resources that are better applied to the long-term maintenance and upkeep of our core congregational facilities. Lots W6-W7 do not offer potential use for anything other than residential units. KOG cannot change the use of the property from residential without rezoning, which the neighborhood would be expected to resist. Maintaining the houses as rental properties does not appear to advance our mission "to be and to make followers of Christ who boldly share the grace of God with the world." While it is possible that KOG could use these units in some form of residential ministry, no one has advanced such a use, and the cost of maintaining these units in this capacity would only increase in the absence of additional rental income. We cannot use them for our refugee families as our houses are outside the program's parameters.

We believe there are more important and immediate applications of staff time and capital resources to improve and preserve the primary operating assets of KOG. To

date, the houses have not represented an attractive investment of capital proceeds. Based on the modest property appreciation and the limited cash flow they have generated after taxes, management fees and maintenance, they do not represent the highest and best use of KOG's resources.

Won't selling these homes preclude KOG from expanding in the future?

Currently KOG has ample capacity for growth, both in terms of accommodating Sunday worship and related parking. KOG's current footprint is well positioned for a meaningful increase in worship attendance and event-related activities. We currently maintain a meaningful presence on the East side of the property and are well positioned to act on this when KOG reaches a point that merits an increase in our physical location. As it stands, zoning restrictions and likely neighborhood resistance limits the value that lots W6-W7 offer in this capacity. Selling W7 is not being proposed out of expediency. Rather, selling W7 is in keeping with our efforts to ensure that God's resources are supporting our core mission, as well as maintaining congregational assets that are used in that mission.

What would we do with the proceeds of the sales?

Based on a conservative list price of \$350,000, we would expect to realize \$310,000 from the sale of W7. We would envision using approximately \$100,000 to pay off the overage balance and \$150,000 to pay off the chiller note. (Recall, KOG just invested \$200,000 to purchase and replace the existing HVAC system after 18 years of use.) We would establish a capital reserve fund of the \$60,000 balance for future capital items. In order to ensure that we are using our proceeds wisely and efficiently, we have established a KOG - Facilities Committee that is working to develop a full inventory of KOG's core operating assets and a long-term maintenance plan to ensure that we are properly addressing our maintenance needs on an annual basis.

Why don't we sell W6 too?

We retain this as an option, but concern was expressed last year that KOG did not have an expressed and clear action plan for the application of proceeds from these sales. While, keeping one house provides KOG with reserves by preserving the option of selling that house in the future, the reality is that given that the use of these homes is zoning restricted, it is highly likely that KOG will eventually move to sell this home as well. Before we do so, it is our goal to ensure that we have an identified need and a plan for the proceeds to be efficiently applied in support of our ongoing mission as a church.

Of the two houses, W6 is in better physical shape and rents more easily than W7. W6 is currently rented through May 2019. W6 is a more valuable property than W7. W6 is generally contiguous to KOG property on two sides. W7 is only contiguous on one side. Of the two properties, W7 has been identified as the one to sell.