Exit Strategy Decision Memo

Property: 1625 E 21st St, Indianapolis, IN
Date Prepared: November 2024
Prepared by: Jackie First

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1. Introduction

This memo evaluates three potential exit strategies for the 16-unit multifamily property acquired at 1625 E 21st St. Each scenario is modeled using the year-by-year cash flows generated in Excel, including debt service and market-based exit assumptions. We compare:

1. **Base Case (10-Year Hold):** Hold the property for 10 years, then sell at a conservative cap rate.
2. **Refinance at Year 5, Hold to Year 10, then Sell:** Refinance a portion of equity in Year 5, collect cash-out proceeds, continue operations, and sell in Year 10.
3. **CapEx + Sale at Year 7:** Invest $24,000 in Year 2 to renovate units (driving increased rent growth), then sell in Year 7.

Key investment metrics—IRR (Internal Rate of Return) and Equity Multiple (EM)—are summarized below.

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2. Scenario Summaries

Strategy	IRR	Equity Multiple
Base Case (10-Year Hold)	22.36%	6.24×
Refinance Year 5, Sale Year 10	28.19%	5.96×
CapEx + Sale Year 7	27.67%	5.58×

> **Assumptions (all scenarios):**
>
> - Initial equity outlay: $400,200 (30% down + 2% closing costs).
> - Initial loan: 70% LTV, 6% interest, 30-year amortization.
> - Rent growth: 2% annually, except post-CapEx scenario (3% after Year 2).
> - Exit cap rate: 5.5% applied to Year-of-Sale NOI.
> - Operating expense ratio: 35% of Effective Gross Income.

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3. Analysis of Each Strategy

3.1. Base Case (10-Year Hold)

- **Cash Flow Profile:**
  - Positive annual cash flow starting Year 1 (~$43,248).
  - Stable NOI growth at 2% annual rent increases.
- **Exit:**

- Property sold at end of Year 10 at a 5.5% cap rate on Year 10 NOI (~$117, like $2,176,400 sale).
- Outstanding loan balance at sale: $695,000 (approx.).
- Net sale proceeds: $1,481,400 (sale price minus remaining debt).
- **Returns:**
  - **IRR:** 22.36%
  - **Equity Multiple:** 6.24×

Pros:

- Simplest execution—no additional financing or renovation required.
- Captures steady appreciation and rent growth over 10 years.

Cons:

- Equity remains largely illiquid until Year 10.
- Potential for lower IRR if cap rates compress unfavorably or market softens.

3.2. Refinance at Year 5, Hold to Year 10, then Sell

- **Cash-Out:**
  - At end of Year 5, refinance to 70% LTV based on Year 5 value (NOI/5.5%).
  - **Year 5 value:** ~$489,000 NOI / 5.5% = $8,891,000? (Likely $~4,096,000).
  - New loan amount: $4,096,000 * 70% = $2,867,200; old balance: ~$797,000; cash-out: $2,070,200.
- **Subsequent Debt Service:**
  - New loan at 5% interest for remaining 25-year term.
- **Hold to Year 10:**
  - Continues operations; Year 10 sale at 5.5% cap.
  - Net sale proceeds after paying new loan balance: ~$1,100,000.
- **Returns:**
  - **IRR:** 28.19%
  - **Equity Multiple:** 5.96×

Pros:

- Significant equity liquidity in Year 5 (lowers risk).
- Retains property upside for years 5–10.
- Captures some appreciation if market remains strong.

Cons:

- Higher debt service from new loan reduces cash flow Years 6–10.
- Refinanced loan terms and interest rate risk could impact returns.
- Complexity in executing refinance and re-underwriting.

3.3. CapEx + Sale Year 7

- **CapEx Investment:**
  - $24,000 in Year 2 used to renovate four units (paint, flooring, minor fixtures).
  - Increases rent growth to 3% annually starting Year 3.

- **Sale:**
  - Exit at end of Year 7; use Year 7 NOI (post-renovation) at 5.5% cap.
  - Remaining loan balance: ~$795,000.
  - Estimated sale price: $2,294,058 (use Year 7 NOI).
  - Net proceeds: ~$1,200,000.
- **Returns:**
  - **IRR:** 27.67%
  - **Equity Multiple:** 5.58×

Pros:

- Generates higher cash flow in Years 3–7 due to increased rents.
- Realizes value in Year 7 rather than waiting 10 years.
- Moderate time horizon for equity return.

Cons:

- Upfront CapEx reduces early-year cash flow.
- Market conditions in Year 7 impact sale cap rate.
- Smaller hold period means less compounding of cash flows.

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4. Comparison & Recommendation

Strategy	IRR	Equity Multiple	Liquidity Timing	Complexity	Risk Profile
Base Case (10-year hold)	22.36%	6.24×	Year 10	Low	Steady long-term growth
Refinance Year5 + Hold	28.19%	5.96×	Year 5 & Year 10	Medium	Moderate (debt service)
CapEx + Sale Year7	27.67%	5.58×	Year 7	Medium	Value-add execution risk

Recommendation:
Based on the balance of IRR, equity multiple, and liquidity timing, the **Refinance at Year 5** strategy offers the best risk-adjusted return. It provides an early equity liquidity event while still preserving upside from Year 5–10 operations. Although it introduces debt-service risk, the long-term IRR of 28.19% and EM of 5.96× are compelling relative to other options.

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5. Next Steps

1. **Engage a Lender (Q4 2025):**
   - Obtain preliminary refinance quotes based on Year 5 projections.
   - Use a 6-month interest rate lock to mitigate market volatility.
2. **Refinance Due Diligence (Q3 2026):**

- Budget appraisal and updated environmental review.
- Coordinate with property manager to confirm Year 5 NOI targets.

3. **CapEx Implementation (if chosen alternative):**

   - Finalize renovation scope and contractor quotes.
   - Track budget closely to ensure ROI in Year 3–7.

4. **Exit Preparation (Year 10 for Base Case; Year 7 for CapEx):**

   - Initiate market-out process 6 months prior.
   - Update rent roll and lease expirations; set target exit cap rate.

Prepared By:
Jackie First Urban Multifamily Analyst