

**Letters to Mycroft #57:  
Tell Me Again Why I Should Refinance Now?  
by Klarise Yahya**

My Dear Nephew Mycroft,

*“Aunt Mitochondria,” Dromedary said, “don’t you think it might be several years before interest rates rise enough to cause values to drop significantly? So, why should I refinance my little building now? Why wouldn’t it be better just to wait until values come down and I could refinance then?”*

“It seldom happens, dear, that both interest rates and values are low at the same time. It would be useful to us if it occasionally occurred, but it almost never does.”

*Dromedary interrupted. “But I remember you saying that when you started you bought at \$30,000 per unit or thereabouts. That was cheap!”*

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whatever loan its income will  
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That’s all there is to it.

Mitochondria looked at her niece as though she was yet another young relative with suspect DNA and spoke slowly. “First, that \$30,000 per unit was full market price at the time. Remember, economic activity occurs on the margins ... the only reason I could buy that little six unit building for \$180,000 was that nobody else offered to pay that much! It may look like a favorable purchase in retrospect, but at the time it was very dear.

“Try to ignore the bricks and mortar. When we buy a building, what we’re really buying is a stream of net income”.

*“I remember you told me once how to estimate what a building’s value might be, but I was thinking about Brandon – who has since dumped me – and didn’t pay as much attention as I probably should have”, Dromedary said.*

“A building’s value is the sum of whatever loan its income will support plus whatever down payment the buyer is willing to pay. That’s all there is to it.

“The mortgage amount is determined by the bank. Clearly, the higher the interest rate, the lower the loan.

“The down payment is a little more complicated. Basically, at the end of the year, after you (a) collect all the income and (b) pay all the expenses and then (c) pay the mortgage, what you have left is the annualized Net Cash Flow.

“Pretend the (annual) Net Cash Flow is the interest on a 90 day Certificate of Deposit. How much would you have to invest in a C.D. to receive that much interest over the year? Well, the easiest way to figure it out is to put the Net Cash Flow in your calculator and divide by whatever interest rate you would get on a 90 day C.D. Whatever the answer is, you add it to the bank loan and the total is a reasonable approximation of the building’s value.

“What makes that first building look amazing in retrospect is that I benefited from a double blessing. First, the net income went up from year to year as I increased my rents. That’s pretty much to be expected. It’s why you buy buildings.

“The second – and maybe more important blessing – is that interest rates immediately began to trend downwards for the next twenty-five years or thereabouts. So my building appreciated at an unusually rapid pace because ever-increasing rents were being capitalized at ever-decreasing rates. It made me look smarter than I am.

*\$1,000 capitalized at 10% = \$10,000*

*\$1,200 capitalized at 10% = \$12,000*

*\$1,450 capitalized at 10% = \$14,500*

**BUT**

*\$1,000 capitalized at 10% = \$10,000*  
*\$1,200 capitalized at 08% = \$15,000*  
*\$1,450 capitalized at 06% = \$24,000*

“That may not be the case over the next phase of the interest rate cycle. If, in a period of rising interest rates, you expect to improve your position in life, you have to plan ahead. You will have to make your own luck.

“What might be an example of steps you could take? Well you may wish to have as much money as you possibly could to buy when a favorable opportunity occurs. *“How could I do that?”*

“Let’s take your ten units as an example. You’ve told me you gross \$120,000 annually, and your Net Operating Income is \$85,000. Right now, with current 6% interest rates, your building will support a loan of \$985,000. The payments will be about \$5,900 monthly, leaving you a monthly cash flow a little under \$1,200.

“With current 90 day Certificate of Deposit rates at about 3%, your \$1,200 cash flow should be worth about \$480,000 (\$14,400 yearly divided by 3% = \$480,000). So the value of your current building is \$985,000 in bank loans plus \$480,000 down payment, or a total of \$1,465,000. That’s the approximate sales value as things are today. (Of course, you won’t put all that in your purse. You’ll have to deduct for costs of sale and to pay off your existing mortgage.)

“But we’re really interested in your building’s cash-out value. The maximum mortgage remains the same, you can still borrow \$985,000 (minus costs), and you’ll still have to pay off your existing loan of \$315,000. That will give you about \$650,000 in cash to tuck away while you wait for a building to be available at a favorable price.

“What you are doing is separating the time of refinance from the time of purchase. Although obvious when you think about it, it’s really pretty sophisticated investing.

“It’s important for you to think about this, dear. *Your refinance doesn’t have to occur at the same time as your purchase.*

“Timing your refinance when rates are low (values are high) maximizes the cash out. Timing your purchase when rates are high (values are low) results in your being able to buy a larger building.

“You remember how I benefited from the double-blessing of rising rents and lowering interest rates? It made me look so very clever, but it was just luck! Well, if you separate your refinance from your purchase – refinancing when rates are favorable, and buying when prices are favorable – you don’t have to hope for luck. You’ll be making your own.

Cordially,

Aunt Klarise

Klarise Yahya is a Commercial Loan Broker. If you are thinking of refinancing or purchasing five units or more anywhere in the U.S.A., **Klarise Yahya** can help. **Find out how much you can borrow!** For a complimentary mortgage analysis, please call her at **(818) 500-9966**.