Chapter 6

How to Get a $250,000 Donation

Bargain Sale Strategy Number 1: Stretch your resources.

A BARGAIN SALE IS PART GIFT AND PART SALE UNDER SECtion 170 of the Internal Revenue Code. The reduced price is the bargain sale price and the remainder is a gift, which must be validated by a determination of the property's fair market value by an independent, qualified appraiser.

For the sake of illustration, consider the case of a church that wants to buy a property valued at $1,000,000 from a Mr. Baker. Step one of the journey is developing the relationship with the property owner. The church representative should provide Mr. Baker with a complete update about the church, reviewing in detail its history, its current operations and its plans for the future, no matter how long (or recently) Mr. Baker has known of the church's ministry.

> Why would you put your congregation through the agony of an extended capital fund raising campaign, when you can reach $250,000 of the total with the swish of a pen by a generous donor?

After the relationship is well established and donative intent is perceived, the donative proposal would be presented providing for a bargain sale price of $750,000 to be paid in cash to the seller-donor which you the church will either raise through pledges or through conventional financing, plus his gift of $250,000. The seller-donor would benefit from the tax savings generated by the $250,000 donation deduction.

For the sake of this example we will say his federal income tax rate is 35%, which would yield an actual cash savings of $87,500. Adding the tax savings to the $750,000 provides $837,500 for the seller-donor. Moreover, many states allow state income tax charitable deductions that follow federal charitable deducibility guidelines, if itemized.

Check with your C.P.A. first. He will have a capital gains tax to pay, equal to 15% of the difference between his adjusted basis (discussed in Chapter 10) and the bargain sale price, but he still will have a very nice total package when the seller-donor considers the following factors:

1. The immeasurable benefit his gift will be to the community;
2. Otherwise continuing the property costs: taxes, depreciation, maintenance, utilities, and insurance;
3. The opportunity cost because of what else he could be doing profitably and immediately with the funds, while waiting perhaps many months for a sale.

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Considering the above bundle of benefits, the immediacy of this transaction, and most importantly, the good it will do for the community, it adds up to a very handsome package for the seller. As it has been proven, there is no need for a church to struggle for a huge down payment for its next large property purchase. Why put the congregation through the agony of an extended capital fund raising campaign, when you can reach $250,000 of the total with the swish of a pen by a generous donor.

Bargain Sale Strategy Number 2: We can use our cash better for ministry.

Consider the case of a financially healthy church in exurbia with a strong aversion to debt of any kind (for inspiration read *Good Debt Bad Debt* by Jon Hanson, Portfolio 2005). Before acquiring a $1 million property they had already raised $1 million in cash, which was drawing interest in a bank. If they made exactly the same donative proposal to Mr. Baker to pay the donor $750,000.00 of the church's cash by a using the bargain sale tool, there would be $250,000.00 extra cash remaining in the bank. This might pay for renovation, furniture, ministry programs, staff and it could fulfill the great commission by enabling missionaries to be witnesses "unto the uttermost part of the earth." (Acts 1:8 — (KJV)

Bargain Sale Strategy Number 3: Leveraged Liturgists

Here is an example of the strategy that says, "Never make another down payment for property again." This church loves leverage. They need a continuous stream of income to increase charitable programs or to pay the payments on their existing debt. They have an annual budget of $2 million including their elementary school and other charitable programs. The planned-giving officer develops a rapport with Mr. Caldwell, the owner of a shopping center, valued at $4 million.

Using the shopping center as the sole collateral, the church obtains a $3 million mortgage loan from a life insurance company to pay to the seller-donor Mr. Caldwell. The remaining equity of $1 million becomes a donation deduction for Mr. Caldwell.

Using a 10% capitalization rate the net operating income would be $400,000.00 per year. Of this, about $300,000.00 per year would be used for debt service on the $3 million loan, and $100,000.00 would be available each year for the church to use for its programs or to pay down its other debt. Someone may ask, "Isn't this just another nothing-down real estate program?" No, because those programs leave you owing 100% of the property's value and having no equity.

This bargain sale strategy leaves you owing only 75% of the property's value, and having a solid equity equal to 25% of the total property value.

A properly funded large building program should not be paid for by an over reliance on any one financing mechanism. Having a 100% bank debt would leave the church strapped financially, unable to budget for ministries and programs for many years into the future.

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Likewise, asking the congregation to completely pay in cash 100% for a large expansion over the relatively short span of say, a three year capital campaign, is very difficult for most churches. By adding the third component of a major real estate gift via any of the four bargain-sale strategies explained above, the burden will be shared among three resources, establishing a balanced funding program.

Note however, that it may be necessary for the buyer to add a component of cash towards the down payment, perhaps an additional ten percent, even if the Seller has agreed to donate 25%. Unless the lender is satisfied with the borrowers other financial resources, property, liquidity and history of growth, it may be reluctant to loan even 75%, when the buyer has absolutely nothing at stake.

Non-profit organizations need to be aware that if they borrow money to buy income producing rental property, then the Internal Revenue Code requires that the rental income be taxed, as Unrelated Business Income. The tax due is called Unrelated Business Income Tax (UBIT).

However there is an exemption from the UBIT for non profit organizations which acquire rental income property in the neighborhood of their existing tax exempt operations, with the intention to convert the property acquired to their exempt purpose within 10 years (15 years for churches). Therefore in the above example, if the church were to acquire the above shopping center from Mr. Caldwell, and use one large vacancy (which is why Mr. Caldwell put the property on the market) for an immediate ministry, with the intention of using the entire balance of the space for expanded ministry programs, gradually over a 15 years time span, as the other commercial tenants' leases expire, then the rental income would not be subject to UBIT even if part of the acquisition cost is borrowed, under the *neighborhood land* exemption.

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Retail properties with a single large vacancy will more likely have real estate broker's signage which says "Available", not necessarily "For Lease" or "For Sale." This is your invitation to start the process to obtain the bargain-sale real estate gift. The huge equity that is possible with the bargain-sale donation, in fact provides you the almost free space ready to improve for ministry, while the rental income from the remaining commercial tenants can pay for the bulk of the mortgage required to complete the purchase.

Bargain Sale Strategy Number 4: Cash out the gift, and repeat.

Perhaps your church would just like to have the $250,000 in cash. Then cash out the gift. But you will process the gift in phases. The money comes at the end. The rewards are great for both for the church and the donor. Greatly over-simplified, it works like this:

1. Develop a rapport with the seller-donor.
2. Evaluate the property and obtain a preliminary title report to estimate indebtedness.
3. Create the proposal and close the transaction to acquire the property.
4. Put the property on the market and sell it for cash. Pick up your $250,000.

By the time you re-sell it in 3 or 4 years, the property might be worth an extra 10-12%. Not on the $250,000, but the entire $1,000,000. If the property was properly selected for value from the beginning, and then it grows in value at the rate of inflation, say 3% per year. That would be about 12% in 4 years, or an extra $120,000; so you get $370,000 (less costs), not $250,000. Of course there will be some holding costs, real estate commissions and other closing costs. However, in that price range, the fees, always negotiable, are usually a lower percentage than with the sale of a typical house.

A few words of caution: Some charities have reported that properties donated by say, an alumnus who could not dump the property any other way, could only obtain 70 to 80 % of the original donation amount, as appraised by the donor's appraiser. By carefully screening acceptable donations, the goal is for that not to be the case.

The resale date cannot be specified by the donor. Any resale must be in the donee organization's sole discretion.

If the property is resold in less than 2 years, the donee organization must report the sale to IRS on Form 8282. If the resale price within 2 years is lower than the fair market appraised value originally claimed on form 8283, IRS could possibly challenge the donor's deduction that had been claimed on Form 8283. However, there must not be any agreement with the donor for the donee organization to hold the property beyond the 2 years before selling it. The resale date cannot be specified by the donor. Any resale must be in the donee organization's sole discretion.