Voyager Pacific High Yield Fund III, LLC

REPOSITIONING RENT REGULATED APARTMENTS

How to Succeed in Highly Regulated Markets

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In and around large urban centers such as New York, investment opportunities in rent regulated multi-family housing exist. Voyager understands that not every community is "*business friendly and or investment ready*" but that doesn't mean there are not untapped opportunities in rental housing. We continue to seek out investments in areas without rent controls, such as Tennasee, Ohio, and South Carolina where our family of Fund's already has made investments and already has an on the ground presence. In-depth knowledge and experience working with convoluted and complex rental regulations is essential for increased rent rolls, reduced costs and added value *regardless* of the macro state of the economy. However, not every rent regulated multi-family building presents an opportunity. An understanding of the local regulations, condition of the property and its core components is essential. Further, even in jurisdictions without explicit rental regulations, understanding the dynamics and priorities of communities and tenants is critically important.

Key factors include:

- ✓ The condition of boilers, roofs, and windows;
- ✓ Their "remaining useful life" of building components such as boilers and roofs, as defined by the IRS tax code;
- ✓ Current rental rates;
- ✓ Market rental rates in the competitive market (rent regulated and free market apartments);
- ✓ Vacancy levels;
- ✓ Market demand; and,
- ✓ Projected rental rates post project-wide and unit-based improvements.

To add further complexity, individual apartment rents are affected by variables that include how long the present tenant has occupied the unit and what renovation work the previous landlord has completed. The key to understanding whether or not any property presents an investment opportunity is *whether or not the rental rates of the prospective property are at or below comparative apartments, either free market or stabilized units*. The following property is an example rent regulated garden apartment complex, in one of the most bureaucratic, legislatively burdened business environments in the Country. For the example project hereinafter, planning, environmental, and architectural approvals from municipal boards was required prior to our ability to obtain a building permit. All on-site and in-unit work was subject to local building department permits, inspections and approvals. We choose this property as an example because we could think or no other region of the Country in which the ability to execute our team's vision is more highly regulated.

200 Beacon Hill Drive, Dobbs Ferry, NY

The property is a garden style apartment complex containing 262 units in fourteen two or two and one-half story buildings. The buildings are situated on approximately 15 acres. There are approximately 200 outdoor parking spaces and 96 garage spaces. The units are subject to the Emergency Tenant Protection Act of 1974 ("ETPA") regulations of the State of New York, as adopted by the Village of Dobbs Ferry. The property was constructed between 1957–1959, with original Certificate of Occupancy's dated May 6, 1959.

Financial highlights:

Purchase price & date:
$16,000,000 September 2006

Capital improvements:
$ 5,000,000

Sales price & date:
$28,000,000 November 2010

Subsequent sales price & date:
$50,375,000 May 2016

- ✓ At acquisition, the annual rent roll was $2.5 million.
- ✓ After the completion of the property-wide capital improvements and renovation of 93 individual units (35% of the total units), the annual rent roll was $4.1 million, an increase of 61% in just four years.
- ✓ ***All renovation work took place while the property remained occupied.***

Dobbs Ferry is located along the Hudson River in Westchester County. Its schools are considered excellent. The community's proximity to New York City, White Plains and employment hubs in Fairfield County, CT create demand for all types of housing. Significant barriers to entry exist for all housing types in this market, but especially for projects with this density.

At the time of our acquisition, there were thirteen individuals in the ownership entity. Upon the death of the family patriarch, this real estate asset was inherited by his wife and five children. Subsequent marriages, deaths and divorces created an ownership group of thirteen individuals. One adult child managed the property. Many of the other siblings had not visited the property in many years. The family's lack of interest was reflected in the rundown condition of the property.

Working the rent roll: Landlords are allowed increases in the base legal rent each year by the Rent Guidelines Board. The increases in 2008 were 4.50% for a one-year lease and 6.50% for a two-year lease. The increases in 2009 were 2.25% or $20, whichever is greater, for a one-year lease and 4.00% or $40, whichever is greater, for a two-year lease. In addition to the increases allowed at lease renewal, the Guideline Board provides for increases at vacancy. The vacancy bonus permits the legal regulated rent for a vacant apartment to be increased by 18.25% for a one-year lease and 20.00% for a two-year lease.

Further, upon vacancy, an owner can renovate an ETPA apartment and increase the base rent by 1/40th of the cost of the **unit renovation work**. For example, a $17,000 apartment renovation would yield a $425 monthly increase in legal rent. Smaller apartments will cost less, and larger apartments will cost more. The incremental return on the renovation work is high: $425 a month increases in rent x 12 months = $5,100 annual rent increase, or a **30% return on the incremental investment** ($5,100/$17,000 = 30%). Prior New York State Department of Housing and Community Renewal ("DHCR") approval is not required for 1/40th rent adjustments based on individual apartment improvements. This rent adjustment is a permanent addition to the legal regulated or maximum rent and does not expire after the forty month period. We renovated every apartment that became available.

Major Capital Improvement (MCI's): Additionally, when an owner makes an improvement or installation to a building subject to ETPA, the owner is permitted to adjust the rent based on the actual, verified cost of the improvement or installation. To qualify as an MCI, the improvement or installation must: 1) be deemed depreciable under the Internal Revenue Code, other than for ordinary repairs; 2) be for the operation, preservation and maintenance of the building; and 3) directly or indirectly benefit all tenants. DHCR computes the rent adjustment for a rent stabilized or rent controlled apartment based upon a seven year period (84 months) of amortization of the costs of the major capital improvements (MCI's). This rent adjustment is a permanent addition to the legal regulated or maximum rent and does not expire after the seven year period. Further, the rent increase can be passed on to the tenants upon the completion of the work and approval by DHCR – at any point in the tenant's lease term. Also, all cost savings accrue to the benefit of the Landlord. The incremental return on the MCI work is also quite attractive: A new boiler may cost $250,000 which as an MCI, equates to a permanent rent increase of $2,976 a month increase x 12 months = $35,712 annual rent increase. This is a legally permitted 14.3% return on the incremental investment ($35,712/$250,000 = 14.3%).

Actual on-site improvements for the property: We obtained all permits, site plan approvals, Architectural board approvals, variances and all other environmental and governmental approvals. The property-wide capital improvements included:

1. Removed two centrally located oil-fired boilers which distributed hot water via 2-miles of underground piping to the 14 separate buildings and installed 10 gas fired boilers throughout the property.
2. Removed and remediated the contaminated soil associated with two 10,000-gallon underground oil tanks.
3. Replaced all doors and windows.
4. Established new signage.
5. Renovated and or created 3 centrally located laundry rooms.
6. Repaired, replaced and or upgraded portions of walks, parking lots, landscaping and the storm water drainage system on the property.

Within the capital improvement program, ninety-three residential units were renovated simultaneously. Typical unit renovation costs ranged from $15,000 - $20,000. Unit renovations included the following:

1. New tiles in kitchens and baths [mud job]
2. New kitchen cabinets and countertops
3. New bath vanities
4. New tubs and shower stalls
5. New toilets
6. Tiled bath surrounds
7. New shower bodies and heads
8. New interior doors
9. New closet rods
10. New light fixtures--all
11. New kitchen sinks and faucets
12. New appliances --refrigerators, microwaves, gas stoves
13. Hot and cold water shut offs for each unit
14. New sub-feeder to units, panels and breakers, GFI protected circuit for kitchens and baths, circuit for microwaves, A/C circuits in living rooms, updated outlets and switches, pre-wire units for phones and cable, additional outlets as required by law, and hard-wired smoke detectors as required by law
15. Repaint entire unit
16. Refinish hardwood floors.

Postscript: After we sold the property (IRR +27%), the purchaser renovated approximately one hundred additional apartment units in the six years following the acquisition. Although no data is publicly available relating to the costs or rent increases associated with the work, public records confirm the property was resold to an institutional buyer on May 11, 2016 for $50.4 million.

This postscript highlights the importance of our buy and hold strategy for Voyager Pacific High Yield Fund III. For this example, we must ignore that the initial investment was made in a neighborhood retail strip shopping center where we doubled the net operating income during our three-year hold, sold the asset and utilized a Section 1031 tax deferred exchange to purchase a shopping center, added value and resold at a profit and again utilized a Section 1031 tax deferred exchange to purchase the subject property. At the time of our acquisition, we were simply reinvesting tax deferred profits! Utilizing the value of the resale at $50.4 million, the cost of the 100 additionally renovated units at $2.0 million (100 units x $20,000 renovation costs per unit), we would have refinanced the property recovering more than 100% of our investment capital and continued to own and operate the property.

	Purchase Price	Equity
Our basis	$21,000,000	$1,000,000
Renovation costs (estimated)	$ 2,000,000	$2,000,000
Total	$23,000,000	$3,000,000
Property Value at Sale/Refi.	$50,350,000	
65% mortgage loan	$32,727,500	

Available tax-free mortgage proceeds to the Sponsor to distribute or reinvest:

65% mortgage loan	$32,727,500
Estimated total basis	$23,000,000
Net available to Sponsor	**$ 9,727,500**

Benefits of the cash-out refinance (buy & hold) Strategy to be utilized by Voyager Pacific High Yield Fund III:

- ✓ Voyager keeps well maintained assets in its portfolio.
- ✓ Voyager pays off the existing mortgage using the new loan, thereby pocketing the cash difference. This new source of capital, almost $10,000,000 in this example, can be used to either make improvements to an existing property, be directed toward purchasing a new property or distributed to investors.
- ✓ The interest on a cash-out refi is tax-deductible, as are (generally) much of the closing costs associated with the transaction.
- ✓ No monies were spent on transaction costs such as real estate commissions or legal fees. In the above example, real estate commissions at 3% would amount to more than $1,500,000.

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