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What Every Real Estate Professional Wants To Know How Can I Make Section 1031 Work For Me?

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What every real estate investor wants to know is “How can I make Section 1031 work for me? Isn’t that just for investors who have multimillion-dollar properties?” And, the best question of all; “I want to sell my property and I don’t want to manage real estate again, how can I have my cake and eat it too?” The power of 1031 is that it is for every investor, regardless of size, as long as the

current property has been used for business, productive use or investment purposes. So, no matter whether investors are selling a two family dwelling that they acquired five years ago, undeveloped land, a strip mall or shopping plaza or hotel property, 1031 is a powerful tool to defer capital gains and un-recaptured depreciation.

Investors that were previously chasing market appreciation have begun to realize that their investments must make financial sense and produce sufficient cash flow to justify their portfolio space. Section 1031 provides an avenue to redirect those investment dollars without incurring capital gains tax. Realigning their real estate portfolio may be the biggest favor investors can do for themselves in this tenuous market. There will be bargains in the marketplace as investors reinvent their strategies for long-term results and strong balance sheets will attract the financing to make the right acquisitions.

The biggest development in Section 1031 is the variety of replacement property choices that now exist. Previously, investors were confined to locating new property that would carry the same headaches of their old property. Revenue Procedure 2002-22 codified tenant-in-common (TIC) ownership and the birth of a new real estate industry.

Investors can become fed up with hands on management, endless capital improvements and ever-rising operating expenses, Section 1031 can be the solution to a perfect real estate exit strategy. Further, as the population matures, older investors are seeking income streams without the hassles of hands-on management. Now they can sell their property using a Section 1031 Exchange and acquire a TIC interest, handing over the management and profit and loss statement to a team of experts and receive a steady income stream. Another powerful aspect of Section 1031 is that eventually, investors can exchange into their dream house as their primary residence, having avoided capital gains altogether!

A wide range of properties are available and in a variety of markets (geographic) and market segments (tenant mix). There are strong markets throughout the country, as an example, medical facilities are expected to provide attractive returns for the future. Whether investors are concentrating on cash flow or market appreciation, there are choices that will meet virtually every appetite. TIC's can be sold as either real estate or as securities and the TIC companies are committed to performing thorough due diligence on each prospective offering before it is presented for investor consideration. This due diligence, or the thorough analysis of property facts and risks, should be performed on every TIC offering before the decision is made to invest. TIC's offer different risk and reward profiles, varying maturities, professional management and easy transitioning for every investor. TIC interest can be exchanged again upon sale (aka "swap till you drop").

TIC's are NOT the only choice for passive real estate. An Umbrella Partnership Real Estate Investment Trust (UP-REIT) provides a mechanism to invest real estate exchange proceeds into real property that is later converted to marketable securities through the mechanism of Section 721. These products are sold by Securities Dealers and carry the scrutiny of the Securities and Exchange Commission. Sale will trigger tax but REIT shares are far more liquid than TIC interests.

The challenge for utilizing Section 1031 has always been finding the right Replacement property in the allotted 45-day time frame. Institutionalizing the process can result in a large list of potential properties. Even in today's challenging market, the best TIC properties don't stay in the marketplace for very long, so timing will still be critical. Having a due diligence package delivered to the investor with an offering certainly makes the process more palatable.

Its time for investors to take a hard look at their real estate portfolio and visualize realigning their holdings to produce long-term results; they will most probably recognize the power of Section 1031. As Mark Twain once said "history never repeats itself; but sometimes it rhymes."

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