

1031 Exchanges Now Provide "No Headache" Alternatives by Chris Kirchwehm

IRC Section 1031 has long since been the obvious option for real estate investors who are selling one investment property and are looking to buy another. But until recently, these investors seeking cash-flowing properties were forced into buying another "actively managed" property. This makes for a tough decision for those looking to escape those management headaches that come with the typical leased property. These investors now have an option; enter Tennant in Common (TIC).

Beyond the tax savings, the investor is now provided with the opportunity to trade-in those management headaches of investment real estate for a truly passive alternative.

Real estate is the investment of choice for more and more baby boomers as new ways to buy fractional shares of big projects open the market to more potential buyers. Many boomers, who led the charge in earlier decades into stocks and mutual funds, now are facing retirement and are diversifying into something they perceive as more steady and sure: investment-grade real estate. They're finding steady income checks, no hassle property management and deferral of capital gains taxes through the TIC ownership method.

When combined with a 1031 exchange of investment real estate, a TIC investment allows the owner of appreciated investment property to exchange into a fractional ownership position of a potentially much larger property without realizing the tax liability otherwise due upon the sale of the old property. Beyond the tax savings, the investor is now provided with the opportunity to trade-in those management headaches of investment real estate for a truly passive alternative.

With the fairly recent release of IRS Revenue Procedure 2002-22 (Rev. Proc. 2002-22), the IRS has provided investors with guidelines as to the necessary structure of the transaction to qualify for 1031 tax-deferred treatment. The revenue procedure sets forth 15 requirements, but a few of those requirements are highlighted here:

- The number of TIC owners can not exceed 35;
- Sponsors of the TIC interest may own the property (or an interest therein) for only six months before 100% of the interests are sold;
- Any decision that has material or economic impact on the property to its owners must be unanimously approved by the owners; and
- Any management agreements must be renewable annually and must provide for market rate compensation.

With guidance comes demand. Now that investors know the IRS's standpoint of the transaction, many investors are giving the green light. In just two years, the TIC industry is expected to go from \$756 million in equity raised in 2003, to a projected \$2 billion in equity raised in 2004. This is an increase of 171% in just two years. Investors are attracted by the numerous advantages that come along with this type of investment. Some of these advantages include:

- TIC owners own a percentage interest in the property providing the same rights as a single owner
- "Packaged" with management and financing already in place
- Efficiencies in identification, acquisition, financing, closing and operations
- Cash flow normally paid monthly
- Tax-sheltered via depreciation pass through and interest deductions
- Truly a passive investment

While the advantages are numerous, each investor must also weigh the disadvantages to this type of investment before rushing out to invest. The major disadvantages include:

- TIC investment is only available for "Accredited Investors"
- Unlike a REIT, these are non-liquid investments
- Demand is currently greater than available supply
- High price tag for entry: normally \$100,000 - \$250,000
- Investments controlled by SEC - sold through a broker/dealer

As with any investment, an investment in a TIC property is not a risk-free venture. Many investors make the mistake of failing to conduct proper due diligence into a potential TIC investment. While a TIC investment provides for a very efficient method of gathering pertinent information, many investors still fail to do their homework. The investor must not only confirm the information provided to them in the Private Placement Memorandum (PPM), but also the appropriateness and suitability of the particular investment within their portfolio.

Exclusive 1031 Options is focused exclusively on the 1031 exchange replacement property industry. For more information contact Chris Kirchwehm at 877.233.1031 or visit www.exclusive1031options.com