professional services

Comparing a tenant-in-common (TIC) to other investment methods

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Most people know that in order to ensure financial stability, it is essential to invest your money wisely. However, choosing the best financial strategy isn't simple and takes careful thought and planning. There are many avenues for investment, from stocks and bonds to mutual funds or real estate. Even once you decide which investment method works best for your situation, the next step is to choose specifically which stocks to buy or what kind of property would garner the most return.

One financial strategy that continues be the choice for a growing number of investors is a 1031 exchange. A 1031 exchange provides for the capital gains taxes from appreciated real estate to be deferred if the funds are put back into another real estate investment. TICs, which include office, multifamily residential, retail and medical, offer a group of up to 35 investors the ability to purchase a share of institutional quality real estate. Each investor owns an undivided fractional interest in the property and shares in the net income and potential growth. Because TIC properties offer management-free ownership and flexibility in the amount invested, they're a popular choice for those looking to utilize section 1031 of the federal tax law.

The prime reason why people use the 1031 exchange is because it allows the investor to defer property taxes. By deferring the tax, the investor has more money to put into another property, allowing them to maximize on the return. As a result, the investor can utilize all realized cash and re-invest in another property. Since the bulk sum is greater than that which would result after a tax deduction, the investor enjoys a return on the entire profit from the previous sale. Additionally, a TIC property is a worry-free mechanism that affords the investor using a 1031 exchange the ability to see his portfolio grow without putting in high levels of time and effort. Since a TIC is managed by the sponsor, the sponsor is responsible for insuring the property is properly maintained and the budgets are met. The investor can enjoy monthly distributions without having to worry about the day-to-day realities of managing and overseeing a property.

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TICs offer additional benefits compared to stocks, mutual funds or a standard real estate investment purchase. For one, investing in a TIC allows the purchaser to choose the dollar amount they wish to invest. Because most TIC properties allow investors to choose to buy into the property in a flexible denomination, it allows the investor to match their available funds dollar for dollar, maximizing on their resources without compromising on the quality of the property.

However, all investments, whether stocks or real estate, carry risks. There are no guarantees that the investment will perform to your expectations. Whether you are purchasing new stocks or buying an investment property, it is important to be comfortable with what you're putting your money towards. However, TIC investors can feel confident that a team of professionals work diligently to see the property achieves or exceeds expectations. At DeSanto Realty Group (DRG), our dynamic team uses experience to explore properties in markets with stable economies. Upon locating potential offerings, a thorough due diligence process is completed to ensure the offering will have stable yields and lower downside risks, while offering the investor the opportunity to enhance a portfolio. In-house management, finance and marketing professionals give DRG an edge in the industry. As a sponsor, we carefully select each offering based on key characteristics, including location, economy and population trends. These factors are closely contemplated so that, as a sponsor, we are confident in the products we're offering.

Once investors have a stake in the property, we continue to uphold an excellent level of management to ensure the offering performs at or above expectations. This allows the investors to take a passive role and be free of the day-to-day worries that often come along with sole ownership of real estate.

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Obtain tax deferral/portfolio diversity with 1031 and TICs

Michael Burwick

1031 Property Group

Part two continued from the June 17, 2008 Financial Digest edition of the New York Real Estate Journal.

There are a multitude of theories on what makes for a balanced portfolio and how this balance should shift with prevailing economic winds. As the investment pyramid demonstrates, for investors to be truly diversified, they should have a mix of equities, fixed income, cash, real estate, and commodities – especially energy. The import of these last two components is substantial and the utility of IRC section 1031 with regard to these investments cannot be understated.

Advisors know the benefits of TIC programs include geographic diversification, asset class diversification, renewed depreciation, the ability to own institutional grade real estate, to command advantageous financing, and to utilize high caliber asset and property management. Since the issuance of IRS Rev. Proc. 2002-22, advisors have had six years of history to evaluate then-existing sponsors. We have seen new entrants to the market, some who have been "one-hit wonders" and some who have become industry leaders. There were sponsors who were substantial players in 2002 but have since dropped out and others who continue to thrive. Advisors who have been in the arena for some time are now able to examine both sponsor and offering on a case-by-case basis to ascertain the most favorable vehicles for their clients' exchange proceeds. However, there remains the lingering issue of cash flow.

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With respect to diversification, commodities (especially energy) have become an essential element of any portfolio. Specifically germane to this discussion is the availability of 1031-compliant royalty programs. In these programs, the exchanger purchases mineral deeds to oil and natural gas deposits in the sub-surface. One offering that recently closed consisted of more than 12,500 acres. As zoning laws set the maximum density at one well per forty acres, there is the potential for more than 300 wells on the property. In this offering, there were seventeen operators. Each was a multinational, multibillion dollar corporation. Geologic surveys – not just from the sponsor, but from the operators and from a third party engineering firm – showed more than fifty years worth of oil and gas under the surface. At the time the offering documents were written, there were sixty-four wells in place and oil was selling in the 55 to 60 dollar range. Natural gas was in the six dollar range, and the sponsor was projecting a 12.5% return based on these figures. By the time the offering hit the street, there were three additional wells in place and 59 additional drill sites. Oil was selling at more than $100 and gas was approaching ten dollars. As the current geopolitical economic climate indicates an increasing demand for oil and natural gas and a diminishing supply; advisors should look at 1031-compliant investment in oil and gas royalties as a useful tool in providing portfolio diversification and increasing clients' average cash-on-cash returns.

In closing, we at 1031 Property Group believe that combining TIC (or DST) real estate programs and 1031-compliant royalty programs in percentages appropriate to each investor's unique circumstances is a great strategy for deferring taxes, boosting cash flow, and remaining in quality real estate. When employed correctly, this strategy enables 1031 exchangers to stay invested in real property while also recognizing significant cash flow from the combined real estate / energy reinvestment.

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Understanding the basics of section 1031 exchanges by Hairston of OREXCO

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Relinquished Property

Sale price ($2 million) minus existing debt ($1 million) minus closing costs ($60,000) equals cash proceeds of $940,000.

Replacement Property

Purchase price ($3 million) minus new debt ($2.06 million) equals cash down of $940,000.

Smith's down payment on the replacement property must be $940,000 to avoid receiving taxable cash. Smith has balanced his equities by investing all of his cash and by acquiring equal or greater debt on the replacement property. Smith can pay the additional cost of the replacement property with either a larger loan or with an increased cash down payment.

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