Business

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Tom Kubik Personal Finance

Real estate exchanges offer a way out for landlords

For some owners of investment real estate, owning that real estate is mundane stuff.

Being a landlord carries some less-than-desirable responsibilities. You are the one called at 3 a.m. when the water heater breaks. You are the one to worry about occupancy rates, cash flow and debt obligations.

Many owners fail to factor in their own time and sweat equity when computing a return on their investment. Some want out, but have been concerned about the tax ramifications.

Dan Forbes, a broker-owner of The Premier Team Inc. of Bradenton, said, "Many people who enter the real estate investing market like the idea of the money to be made, but later discover they are not cut out to be landlords."

Forbes added that many investors hire a management company to oversee the property, which is another added expense.

Enter the 1031 real estate exchange - named for the IRS code that allows it.

Previously, you could exchange investment real estate for "like-kind" investment real estate and defer the capital gains taxes. Like-kind used to mean a shopping center for a shopping center, a duplex for a duplex. A recent change in the IRS ruling on like-kind now means as long as the real estate is exchanged for investment real estate, it does not matter the specific type of real estate being exchanged.

As long as it stays investment to investment, the capital gains taxes will be deferred.

With the change in the IRS view of like-kind comes an opportunity for investors to maintain their tax advantages and walk away from the problems of being a landlord. Using tenants-in-common as a form of ownership, there are now real-estate investment companies that allow you to buy into an existing property.

Usually the existing leases are triple-net, meaning the tenant pays for all taxes, maintenance and pass-throughs.

The investor receives a fairly consistent cash flow, some of which will be tax sheltered due to depreciation. Should they decide to sell their share, pass it along to heirs, whatever, they are free to do so.

In some cases there may be a requirement that the other owners agree prior to a sale, but this would be dependent upon the specific venture the investor might be considering.

One major advantage to the investor of a 1031 exchange is it streamlines the process of finding and/or defining another property within the 45-day limit and should assure closing will transpire within the 180-day requirement. Many of the real-estate investment companies offering these programs have real estate attorneys and CPAs on staff to facilitate a smooth and legal transaction. They can work as your professionals or with professionals that you already use.

Dan Forbes and I agree that anyone interested in doing a 1031 exchange should consider using a team of an attorney, an accountant, a financial adviser and a Realtor to determine a strategy best for them. Forbes added that to some Realtors, a 1031 exchange using an investment program may not seem advantageous to them. The Realtor gets a commission on the sale of the existing property but does not participate on the sale of the new property.

However, Forbes said knowing this does not deter him from presenting it to clients. He said, "As a Realtor, I have to look at the big picture. I have to help the client in achieving their goals, not my commissions."

This type of investment will not be suitable to every investment real estate owner. As with any type of investing, there is no one investment that is right for everybody. Real estate exchanges are complicated. The person considering one should ensure that they use a team of professionals and those professionals are educated in the nuances and details of a 1031 exchange.

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