Financial Advisory

Diversify Your Real Estate Portfolio with Partial Interest Properties

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As real estate investors, we sometimes have a tendency to put "all our eggs in one basket." We'll buy only four-unit properties in LA County, only small retail properties or focus all our investments in Southern California, for example. In all three of these examples, we expose ourselves to regulatory risks of new anti-landlord laws (especially in LA County or California as a whole) or economic risks such as the slow decline of the retail real estate market or of further deterioration of California's economy.

"Concentration Risk" comes from holding a large portion of your assets in one type of investment. Remember the dot com stock investors from 2000? Or someone who bought office space in Detroit, Michigan in the 1950's? How about someone who ran a chain of dry cleaners when the 2020 pandemic shutdown hit? Would you like to be managing a company that owns indoor malls nationwide? Diversifying our real estate holdings can allow us to lessen our concentration risk while still enjoying the potential for income, growth and tax benefits: the reasons that we bought real estate in the first place.

MAYBE OTHER AREAS OF THE COUNTRY CAN BE BETTER FOR INCOME AND GROWTH

As I discussed in last month's article, perhaps we have seen all the explosive growth that California is going to get. After decades of this tremendous growth, today the population in our state's major metro areas is growing much slower than the national average. At the same time, the higher concentration of wealth in the state pushes demand and therefore prices higher. We have slowing growth rates and a regulatory environment that is very unfriendly for property owners, but much higher prices! By shopping for properties in other states, we can seek lower prices – and gain potentially higher income and appreciation rates.

WITH PARTIAL INTERESTS, DIVERSIFY INTO OTHER REAL ESTATE ASSET TYPES

In addition to providing diversification by geographic area, partial interest properties can allow us to do the same across real estate categories. Owning 100% of a Walgreens store, an Amazon distribution warehouse or a senior living center are far outside the reach of most individual real estate investors. By

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using partial interest properties, I can sell an 8-unit apartment building in Los Angeles and put my sales proceeds – through a 1031 exchange - into all three of these properties.

AN OPPORTUNITY TO OUTSOURCE MANAGEMENT RESPONSIBILITIES

The real estate syndication companies that I work with will buy institutional-grade investment real estate, re-sell it as partial interests, then stay on as the property and asset manager to guide the building through the business plan they created for it.

Many of my clients, after 30 or more years as landlords, decided to "retire" from that business through selling their properties and completing tax-deferred 1031 exchanges into partial interest properties. By exchanging concentrated holdings for more diversified partial interest ones, these investors can also delegate management and accounting duties to a professional company that oversees billions of dollars in real estate. This management company takes care of everything – including sending my clients their monthly income by direct deposit. At tax time, an income statement is provided that is ready to hand to your CPA for reporting on Schedule E. No more compiling everything for tax time, no more managing cash flow and paying bills every month and no more communicating with tenants!

COULD PARTIAL INTEREST PROPERTIES BE A GOOD FIT FOR YOU?

This month, I have discussed why my clients have decided to sell some of their real estate assets and complete tax deferred 1031 exchanges into partial interest properties. By doing so, they can maintain monthly income and capital appreciation potential, diversify their investment portfolio by geographic location and asset type, and retire from management responsibilities. If this sounds appealing to you, perhaps partial interest properties are worth learning about. My toll-free number is (877) 313-1868.

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Christopher Miller is a Managing Director with Specialized Wealth Management and specializes in tax-advantaged investments including 1031 replacement properties. Chris' real estate experience includes work in commercial appraisal, in institutional acquisitions for a national real estate syndicator and as an advisor helping clients through over four hundred and fifty 1031 Exchanges. Chris has been featured as an expert in several industry publications and on television and earned an undergraduate business degree and an MBA emphasizing Real Estate Finance from the University of Southern California. Chris began his real estate career in 1998. Call him toll-free at (877) 313 – 1868.