FINANCIAL ADVISORY

The Long Term Plan for Partial Interest Properties

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Since 2001, I have worked in the partial-interest real estate industry, helping investors complete tax-deferred (potentially forever) 1031 Exchanges from their individually owned properties to partial interests in larger institutional properties across the United States. A common question I hear is "If I buy part of this (for example) 300-unit apartment property in Dallas, what happens when it sells some time in the future?" This month's article will answer that question.

PROPERTIES BOUGHT ACCORDING TO BUSINESS PLANS

I work with a group of management companies that I have known for many years. When these companies send their latest property to me, I will perform my own due diligence review on those individual offerings. If I like what I see, I will then share that deal with my clients. I prefer properties that come with business plans – conservative ones. I have found that any property can look great on paper if future income is projected too aggressively: Anybody can say they will raise rents 10% every year forever, but few can deliver on that promise. A complete and thoughtful business plan will always include an exit plan. How long does the manager plan to hold this property, collecting potential income for investors, before selling for a potential profit? I think a hold period for any real estate of "7-10 years" is conservative.

WHEN PROPERTY SELLS AT THE END OF THE BUSINESS PLAN

Since I have been in this business for 23 years and have completed over 525 1031 Exchanges for clients, so I have seen a lot of properties go "full cycle" and sell. When your partial interest property sells, you will be in the same position that you were in before you bought it. You can take the cash and pay taxes,

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(the IRS would never want to stop you from doing that), or you can complete another 1031 Exchange to defer (potentially forever) your taxes again. If you choose to do another 1031 Exchange, you'll be able to buy any type of investment property that you want: another partial interest property, or a property on your own. I have had some investors do all three of these from the same property sale: 1. Take a bit of cash and pay taxes on just that amount, 2. Exchange some of their equity into a partial-interest DST property and 3. Purchase a property on their own.

A 1031 EXCHANGE CASE STUDY

Back in 2007, I helped a client purchase a TIC interest in a property as part of a 1031 Exchange. (A DST can be considered a modern, improved advancement in technology compared to the TIC structure.) This property was very successful, and in 2012 he received $800,000 of sales proceeds. He received $200,000 of this as cash boot (he needed to pay tax on this amount), exchanged $250,000 into a DST property and spent the remaining $350,000 as a down payment on a single-family investment property in Palm Springs that he intended to rent to short-term tourists on AirBNB. He later decided that the short-term rental business wasn't for him and sold that property to exchange into another DST.

PARTIAL INTEREST PROPERTIES PROVIDE GREAT FLEXIBILITY

Many of my clients are looking to de-complicate their lives by gradually exiting from the active management of their real estate holdings. The flexibility mentioned in the previous paragraph allows them to sell one of their properties and "try it out." If partial ownership isn't for them, they can then exchange back into "traditional real estate." Most of my investors do like their partial interest properties and will follow their first purchase with additional acquisitions from more sales and 1031 Exchanges. Are partial interest properties something that you're interested in trying? My toll-free office 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 five hundred twenty-five 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.