



Is it time to sell?

Part 2: Potential solutions to the management dilemma

As promised in my last article, this month I plan to address more common factors that help people decide whether to sell and some of the potential solutions to these issues. Some of the most common reasons for selling are as follows: management headache, partnership differences, little or no cash flow, death and retirement. I plan to address the first this month with more discussion of the others in future installments.

Management headache: As we all know, owning and managing multifamily properties almost always involves more management than we would like--particularly in a city like Berkeley, and a state like California where we are burdened with a slew of rules, regulations, procedures, and fees that would amaze many other landlord's nationwide. One potential solution that many owners resort to is a professional management company. There are various companies to choose from, but they all have something in common: no matter who they are, someone out there feels that they don't manage well enough. People that have a harmonious relationship with their management company realize that a management company will NEVER manage as you might yourself. They may not argue over a bill that seems a few dollars too high, or rent out units as fast or high as the landlord wants. A cheaper but less reliable and somewhat more risky alternative, is to hire an on-site manager to do as much of the work as possible, but this does not relieve much of the oversight necessary, this individual generally assumes little or no liability or responsibility, must be supplied with appropriate forms and procedures, and may be completely unaware of important rules and regulations.

Solution # 1: A 1031 exchange from apartments into a NNN leased investment. The recent popularity of NNN leased investments as a solution has been due largely to the need that exists for a real estate investment with little or no management headache that still has respectable returns and qualifies for a 1031 tax-deferred exchange. This is typically a commercial building occupied by a few or quite commonly only one tenant. This tenant should be on a NNN lease, which would require them to do all of their own management and pay all bills—often including real estate taxes and insurance. There are many pluses and minuses, but essentially a **1031 exchange from apartments into a NNN leased investment** should get rid of most or all management responsibilities with the same or better cash flow and with manageable risk.

Solution # 2: Real Estate Investment Trusts(Real Estate Companies whose shares are bought and sold like a common stock on the stock market) generally cannot be used for tax deferred 1031 exchanges. This may be a good way to hold real estate while avoiding some liability, management, etc., but since it does not qualify for a 1031 exchange, selling to buy a REIT

typically involves paying taxes, and is similar to simply selling to buy stocks, bonds, etc. except that the money remains in a real estate investment.

Solution # 3: Tenant in Common(or TIC) investments have recently received rulings from the IRS that have been considered favorable by many as to their qualification for a 1031 exchange. The returns can be good, and the management should be zero. A typical TIC is where an investor purchases a small piece of a larger real estate holding like a class A office building, or apartment complex. The investors do not participate in the management or decision-making process and can typically buy or sell their interest through the management entity without consulting other members. Like any potential investment there are other somewhat detrimental aspects. They may have forced exits—where one can only sell within a predetermined time, the management company may take large fees depending on the agreement in place, there may be other entry, and exit fees, and some fear the lack of control over their small piece of the larger investment.

Another issue to take into consideration no matter what product type you plan to exchange into, is how great your management headache really is. Some are simply tired of the routine management, but their building presents no greater challenge than any other. Others have large management issues: an argumentative or uncooperative tenant, severe deferred maintenance or a fundamentally poorly constructed building, a bad neighborhood where neighbors are abusive to the property, etc. If this is the case and it is a curable issue, the Seller clearly gives up a dollar amount of the potential purchase price in forcing someone else (the Buyer) to deal with these issues.

Thanks to those of you that called me regarding last month's article(See my advertisement for contact information). One astute reader pointed out that the amortization(reduction of principal balance) of a real estate loan does not always benefit the bank only. Often as the principal of the loan is paid down, the owner is also growing older and more conservative and the lower leverage makes sense. This is true on some levels, but I will address this more thoroughly next month.

I have touched on the tip of the iceberg here, but am happy to answer any questions and give my more detailed thoughts on your personal situation. I will attempt to cover more issues relating to this topic in future issues.

Please keep in mind that my area of expertise is Real Estate Brokerage. The tax consequences, exchange validity, accounting rules and legality of various strategies are best discussed with the appropriate professional. I have several that I will be happy to recommend. If you missed last month's installment, you may contact me for a copy of the last issue.

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