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Reliable 1031 tax deferred exchanges in the current capital market

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For many seller's, the idea of a 1031 tax deferred exchange is new and counter-intuitive. Imagine immediately needing to purchase another property on the heels of profitable sale. Section 1031 was introduced in the early 1920's and has become better understood and more frequently used in recent decades. Within the Real Estate world, 1031 has fueled a robust niche market involving developers, tenants, lenders and buyers and sellers which range from small business owners with real estate in tow to major developers and institutions.

The changes which occurred in the capital markets late last summer caused some property sales to fall out, negating the need for 1031 exchanges for those proposed sales. We saw this slowdown in exchange activity continue through the fall of 2007. However, we saw momentum for tax deferred exchanges pick up later in 2007. This was the result of many factors: Alternate financing from portfolio (non-securitized) sources came into the market to fill the credit "gap"; Sales resumed and closed; Sellers began to act in a more proactive manner, setting up their replacement property and financing earlier to add certainty to their trades. This behavior shift underscores the growing understanding of the exchange process, of its challenges and pitfalls.

The financial markets continue to fluctuate without clear resolution, creating anxiety for involved parties. Last week saw the demise/purchase of Bear Stearns. What will the coming weeks bring? Nonetheless, attractive financing is, in fact, available, largely through portfolio lenders such as banks and life insurance companies. Terms are more conservative, but still workable. With this more conservative mindset, transactions with triple net properties, backed by long term leases and strong credit, are often favored.

As replacement property for the 1031 buyer, net leased properties can be purchased readily, like off-the-shelf products, in a range of sizes, assuring availability on cue. Triple net leases place the management of the real estate on the tenant's shoulders and can enable the taxpayer to transition from active to more passive ownership, backed by the guarantee and cash flow of a high-credit tenant corporation.

The basics of a successful exchange:

Raw material: A combination of highly leveraged and cash flowing net lease deals offers efficiency, diversification and can enable the taxpayer to achieve precise outcomes of investment return and take-away cash based on the taxpayer's goals. While net lease properties are widely available, niche experts can often locate off-market deals and deals still in the making, and are equipped to generate a wider range of alternatives tailored around particular financial goals.

Financing: In the past few months, portfolio lenders have played an increasingly important role by filling the financing gap left by the constricted capital markets. Portfolio lenders offer a range of fixed rate debt so that even in the current unsettled market, attractive financing is available.

Execution: In 1031 exchanges, the tax payer gets one chance. Strict deadlines are triggered by the sale of the relinquished property; 45 days to identify replacement property, and 180 days to close. The process of buying a quality replacement investment in that time can be daunting due to the numerous moving parts involved, from a changing property market to the need to acquire funds in a tightening financing environment. The net lease property's ready availability, long term lease, and corporate guarantee of rent income provide stability and certain availability even in an uncertain time.

Alternatives for replacement property, financing structures, credit, and strategic goals are numerous and changing. In this climate, the advice of specialists can be invaluable.

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