



nerej

Timing is right to invest in 1030 eligible oil and gas

July 11, 2008 - Financial Digest

Selling investment real estate and deferring taxes through a 1031 exchange can be tricky today. The greatest difficulty is not just finding suitable replacement real estate, but finding low-interest debt may be problematic in today's difficult financing environment.

Those interested in selling property through a 1031 exchange can choose to re-invest their escrow funds into oil & gas offerings. The eligibility of certain oil & gas investments to meet 1031 criteria surprises many real estate investors. Not only can it be done, I've helped many clients invest in 1031-eligible oil & gas offerings of different types. These offerings avoid the need for financing, and may pay a very healthy income stream due to the world's great demand for energy. Recent offerings offer the potential for immediate double-digit income streams, with growth potential if oil & gas prices continue to climb over the years.

There are two types of oil & gas investments available for 1031 exchanges. The first type is working interests. These are ownership interests in wells that are either currently producing or have produced in the past. Most offerings have a combination of wells - currently producing wells (which provide current income), and re-works of

wells that produced decades ago. Re-worked older wells can have excellent potential for additional income. These wells may have been abandoned decades ago - but with today's improved technology and higher oil & gas prices - they now can be re-drilled to provide investors with the potential for significant returns. Working interests contain more risk than royalty interests, the other type of oil & gas investing eligible for 1031 exchanges.

The most conservative, and thus most popular, method to invest in Oil & Gas via a 1031 exchange is thorough royalty programs. Investors buy just the mineral rights to the land in oil & gas producing areas. When the major oil & gas companies extract minerals from the land - royalty owners receive from 8-25% of the income generated from that production. Royalty owners do not drill, and do not have any drilling risks. My favorite royalty company offerings contain reserves large enough to pay investors for at least 30 years - although the wells currently in production may not last that long - solid royalty offerings include rights on thousands of acres with undeveloped reserves. Payments usually are made about 3 months after the oil & gas is produced from the wells. The primary risk with royalties is the future commodity price. As prices go down - your income will go down as well. Conversely, if prices go up, your income will go up.

When considering Oil & Gas for your 1031 exchange, you must be sensitive to the debt requirements of your exchange. All debt on your sold property must be replaced in your replacement property (unless offset by cash). If you sold a piece of real estate for \$1,000,000 and held a \$500,000 mortgage on that property, your replacement property must also have \$500,000 in debt. Since Oil & Gas has no debt - you would not be able to invest solely in Oil & Gas replacement properties. Someone selling a \$1,000,000 property with a \$200,000 mortgage must have at least

\$200,000 in debt on their replacement properties. They may choose to invest \$700,000 in conventional real estate (TIC, net-lease, or self-managed) while investing \$300,000 in oil & gas. Their 1031 debt requirements would be met with the real estate, allowing them to enjoy a higher income stream with a sizable oil & gas investment.

Thus, consider oil & gas as replacement property for your 1031 exchange. We are available for complimentary consultations to show you how these programs work in detail.

Ronald Birnbaum, CLU, ChFC, CASLT is co-host of "The Financial Consultants with Birnbaum & Burwick" Mon.-Fri. at 7 a.m. on WBIX, 1060 AM.

New England Real Estate Journal - 17 Accord Park Drive #207, Norwell MA 02061 - (781) 878-4540