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Creative selling solutions in a changing hospitality market

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In today's volatile real estate market, the opportunity to utilize creatively structured transactions has become more and more frequent in the hospitality industry. Understanding what steps need to be taken is a complex task, and having a facilitator, such as a hospitality real estate broker, is an essential part of closing a complicated sale. Different types of 1031 tax deferred exchanges, wrap-around mortgages, installment sales, the use of SBA 504 loans, lease-purchase agreements, in addition to negotiating the allocation of sales price, are various tactics utilized by experienced real estate brokers to transact a sale.

A 1031 tax deferred exchange is a common technique used in hospitality real estate transactions. This type of exchange involves a real estate transaction in which a seller will purchase another property within a certain amount of time to protect or defer capital gains. The replacement property must be similar to the previous property or of "like kind." A hotel sale exchanged to investment real estate qualifies under the regulation. Although there is no immediate tax on the exchange, the tax is deferred and must be paid at the outright sale of the property, according to the Federation of Exchange Accommodators. This means that instead of paying taxes on each property as it is sold, only the last sale will require a tax payment.

A 1031 exchange can also be completed with the acquisition of a Tenant-in-Common (TIC) property. A TIC is a popular form of ownership in which multiple purchasers enter into a co-ownership of a property. For example, if a property is split between 5 purchasers, each is responsible for a fifth of all aspects of the investment, from taxes to profits. This type of purchase allows an investor to acquire commercial property with a low investment, which can allow the investor to own a percentage of multiple properties. It is important to note that a TIC purchase does not bar one person from buying more than one section of the ownership and co-owners may not be aware of other owners' identities.

A strategically structured 1031 exchange that integrates credit tenant financing may be one of the most effective ways to maximize cash proceeds of a property sale. A hospitality real estate broker would suggest this type of exchange and subsequent financing with non-recourse debt to allow the seller to withdraw proceeds untaxed. The purchaser would guarantee to the financer that the property would be leased, structured as a triple net lease or NNN. According to the industry experts, the benefit of an exchange for credit tenant property is that the owner has no responsibility regarding the maintenance costs or the actual management of the property, providing secure, management-free cash flow with outstanding liquidity and high leveragability.

Credit tenant property presents unique advantages, performing like corporate bonds while preserving the benefits that real property offers. Additionally, credit-based financing enables the exchanger to maximize the cash proceeds of a sale through post-exchange refinancing proceeds. It is possible to finance over 90% of the value of the sale, and then use the refinancing proceeds to purchase new property without deadline restrictions, and at full basis.

Fortunately for real estate investors with a good credit history, financing has been more readily available through local and regional banks. While the underwriting requires stiffer qualifications, transactions are still being completed in an appropriate time frame.

Part two will appear in the October 10th edition of NEREJ in the Financial Digest section.

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