



## Real Estate as an Investment

Why it should be part of your investment portfolio



Presented by:

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# Asset Exchange Company

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Member of the Federation of Exchange Accommodators



Errors and Omissions Insurance and Fidelity Bond through Lockton Insurance Brokers

Department of Consumer Affairs  
California Board of Accountancy

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## **Galaxy Office Park, Concord CA**

- \$42,000,000 Sale Price
- 3 LLC owners, with multiple LLC members
- \$11MM in unsecured debt
- Buyers and sellers decided to prorate the sales price in different manners between 3 parcels



## **Sandy Springs Apartments, Atlanta GA**

- \$26,000,000 Sale Price
- 27 individual TIC owners
- Each individual owner conducting separate exchange



## **Brittan Ave Condo, San Carlos CA**

- \$617,000 Sale Price
- 2 owners
- One owner conducting an exchange

# Real Estate

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## December 2011 Housing Numbers

### Price segments

The data show that buyers are still chasing lower-priced properties. The number of total homes sold for less than \$200,000 increased almost 9 percent when comparing December 2011 to December 2010. Furthermore:

- Less than \$300,000: up 10.5 percent from a year ago.
- \$300,000 to \$800,000: down 6.6 percent from a year ago.
- More than \$800,000: down 13 percent from a year ago.

### Absentee buyers

They're also known as investors or buyers of vacation properties. The percentage of total buyers that fit into this category was 26.1 percent in December, up from 24.6 percent in November and 23.8 percent from a year ago. The record was set in February at 28.3 percent. For context, the historical average is 19.2 percent, based on a data set that started in 2000.

### Cash buyers

They made up 27.2 percent of December's buyers, slightly lower than November and in December 2010. The peak was 30.5 percent in February. Average: 16.5 percent, based on statistics that go back to 1988.

## Absentee/Investors Buyers

- 26.1% "absentee buyers"
- 19.2% is the historical absentee buyer average

# Real Estate as an Investment

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## **Why Real Estate is a Good Investment**

- Income
- Leverage & Appreciation
- Hedge Against Inflation
- Tax Advantages

# Income

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## Los Angeles-Riverside-Orange County CA Apartment Rental Rates

Average rental prices for one and two bedroom apartments within the Los Angeles-Riverside-Orange County CA area as reported by renters on ApartmentRatings.com.



# Income

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## NAHB Reports a Rising Demand in Apartments; Sees Lack of Credit to Finance New Multi-Family Communities



Posted by Michael Gerrity 01/13/11 11:50 AM EST

[Author Bio](#) | [Archives](#)

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(ORLANDO, FL) -- According to officials at the National Home Builders Association's (NAHB) annual International Builders Show in Orlando Florida this week, new job creation amid a slowly recovering economy is creating increased demand by new renters seeking to move into apartments. However, the lack of credit needed to finance the development of apartments is already causing rents to increase and is likely to lead to a shortage of available apartments in the next few years.

"Although we are forecasting construction of 133,000 new multifamily residences in 2011," said the National Association of Home Builders' chief economist, David Crowe, "that is far short of the 250,000 to 300,000 units that would be required to keep supply and demand in balance. In addition, we have yet to make up for the insufficient number of new apartments that should have been built over the last two years. The capital needed to finance that construction is just not available to apartment developers."



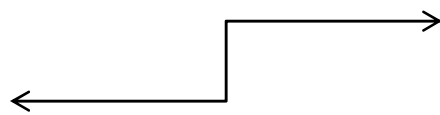
David Crowe

# Leverage and Appreciation

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## Example

**\$1,000,000 Property**  
**10% Appreciation**



**\$1,100,000 Property**

## Leveraged Returns:

**10% down = 100% ROI**

**20% down = 50% ROI**

**30% down = 33% ROI**



# Hedge Against Inflation

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With real estate a low-rate, 30-year, fixed mortgage, you hedge against inflation because:

- Your property value will rise
- Your rental income will rise
- Your mortgage payment will remain fixed
- You will repay the loan with cheaper dollars

# Tax Advantages

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## **Owning Real Estate?**

- Mortgage Interest Deduction
- Expense Deductions
- Depreciation

## **Selling Real Estate**

- Home Owners Exemption (Section 121)
- 1031 Exchange

# Tax Advantages - Owning

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## Owning Real Estate?

### Mortgage Interest Deduction

- Original Indebtedness plus \$100K (homes)
- All interest expense on rental property

### Expense Deductions

Advertising	Professional fees
Cleaning and maintenance	Rental of equipment
Commissions	Rents you paid to others
Depreciation	Repairs
Homeowner's associations dues and condo fees	Supplies
Insurance premiums	Trash removal fees
Interest expense	Travel expenses
Local property taxes	Utilities
Management fees	Yard maintenance
Pest control	

# Depreciation and Expenses

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## Facts:

\$1,000,000 purchase price  
 \$200,000 Land Value  
 \$800,000 Building Value  
 27.5 Depreciation Schedule

## Expenses

Prop. Mgt, Travel, Etc. **\$7,000**

## Depreciation:

Building Value	\$800,000
Depreciation Schedule	÷ 27.5
<b>Yearly Depreciation</b>	<b>\$29,000</b>

## Depreciation and Expenses as a Tax Shelter

Yearly Rental Income	\$36,000	\$36,000
(Expenses)	(\$7,000)	(\$7,000)
(Depreciation)	(\$29,000)	(\$39,000)
<b>Total Taxable Rental Income</b>	<b>\$0</b>	<b>(\$10,000)</b>

# Tax Advantages - Selling

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## **IRC Section 1031?**

- Investment Real Estate
- Tax Deferral

## **IRC Section 121?**

- Primary Residence
- Tax Avoidance
  - \$250K single
  - \$500K married

# Gain Calculation

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## Gain Calculation:

Sale Price	\$1,000,000
(Adjusted Basis)	(\$425,000)
<u>Gain</u>	<u>\$575,000</u>

## Adjusted Basis

Purchase Price	\$500,000
(Depreciation)	\$100,000
+Capital Improvements	\$25,000
<u>Adjusted Basis</u>	<u>\$425,000</u>

## Facts:

\$500,000 purchase price  
\$100,000 depreciation  
\$25,000 capital improvements  
\$1,000,000 sales price

## Taxes:

### **25% Dep. Recapture**

$$\$100,000 \times 25\% = \$25,000$$

### **15% Fed. Cap Gains**

$$\$475,000 \times 15\% = \$71,250$$

### **9.3% State Cap Gains**

$$\$575,000 \times 9.55\% = \$53,475$$

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**Total Taxes Due: \$149,725**

# 1031 Guidelines

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## **Basic Requirements**

- Property Qualifications
- Tax Deferral Requirements
- Timeline
- Identification Rules

# Guideline #1

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## ➤ **Property Qualifications**

- Held for productive use in trade or business or for investment.
- Like kind
  - Foreign property is NOT like kind



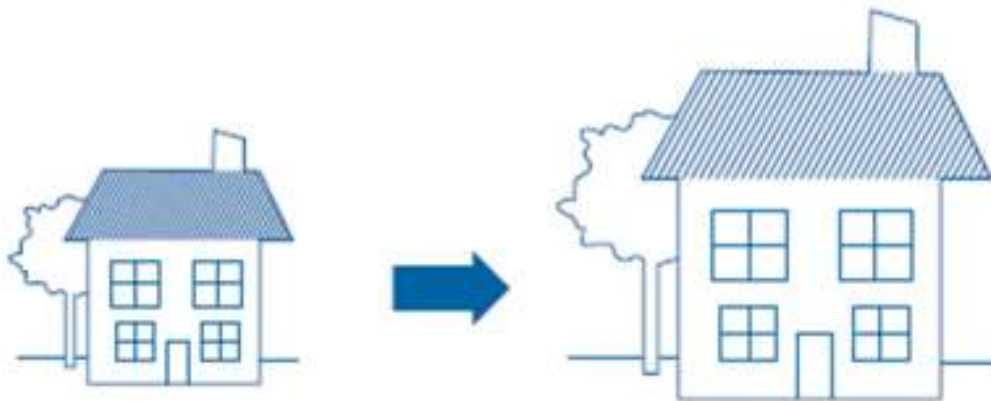


# Guideline #2

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## ➤ **Tax Deferral Requirements**

- Reinvest all cash.
- Purchase price equal to or greater than replacement property sale value.



# Guideline #3

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## ➤ **Timeline**

- 180 days
- 45 day identification period.



# Guideline #4

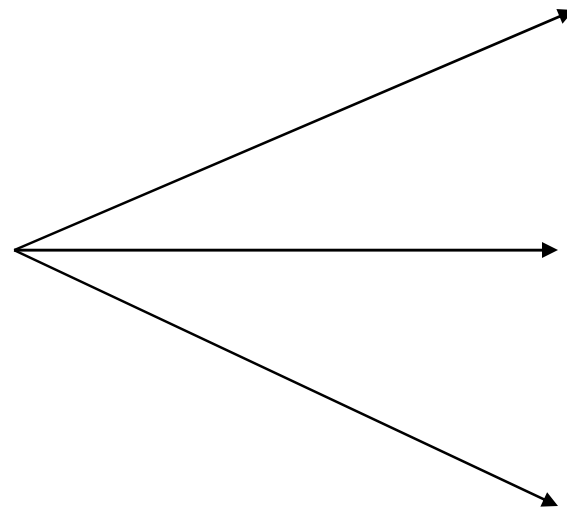
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- **Identification**
  - 3 Property Rule
  - 200% Rule

# Guideline #4

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## ➤ 3 Property Rule



# Guideline #4

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## ➤ 200% Property Rule



200%

# Exchange Examples

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Sell



\$500K

Identify



\$510K



\$505K



\$495K

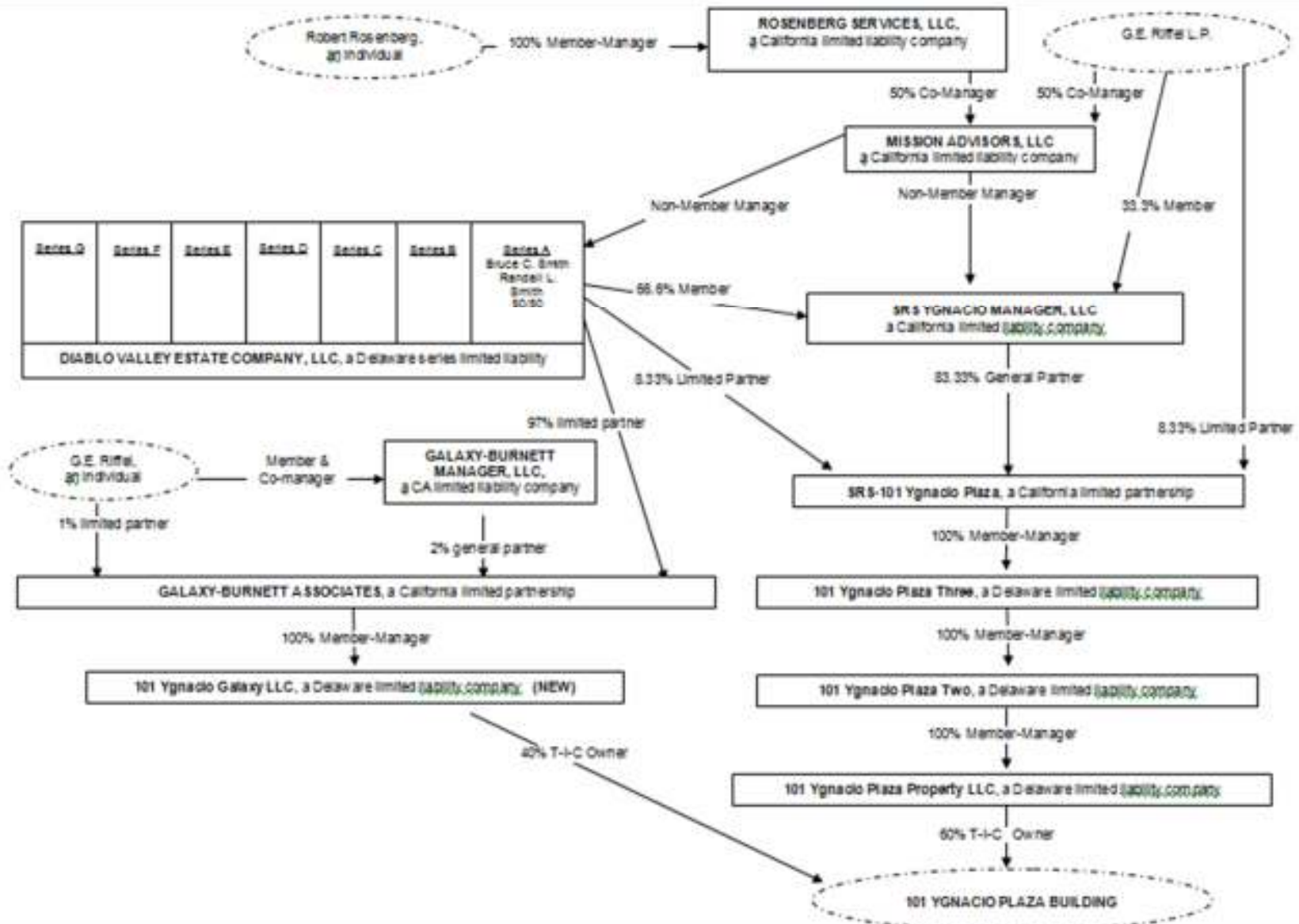
Acquire



\$510K

# Exchange Examples

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# Marketing to Investors

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## Why Investors Buy, Sell and Exchange:

### **Tax Deferment**

- 15% Federal Capital Gain Tax for assets held > 1 year.
- 9.3% State Capital Gain Tax.
- 25% Depreciation Recapture Tax.

### **Buy "MORE" Property**

- Utilize "saved/deferred taxes" to leverage into a larger property.
- Exchange from a property that has a high equity position into a much more valuable property.

### **Diversification**

- Geographic diversification.
- Asset class diversification.

### **Longtime Ownership Issues**

- Relief of management burden.
- Exchange from a fully depreciated property to a higher value property that can be depreciated.



# Farming Investors

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## **Farm lists**

- 25, 26, 27 years of ownership
- 5+ properties in the same town
- Absentee Owners
- Retired/Older Investors

# Understanding Diversification

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## ➤ Illustrate Diversification Benefits

- \$1,000,000 in SF



- Cash Flow = \$2,000/month

- \$1,000,000 in Sacramento



- Cash Flow = \$5,400/month

# Provide Solutions

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## ➤ Relief of Management Burden



# Provide Solutions

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## **Strategy for Total Tax Deferral/Avoidance**

- 1. Move out of property**
- 2. Rent property for 12-16 months**
- 3. Sell property as investment**
- 4. Conduct 1031 Exchange**
- 5. Take \$500K tax free as homeowners exemption**

**Taxes paid: \$0**

# Marketing

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**RE.**  
**REALTY EXPERTS**

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# Creating a Team

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- Asset Exchange Company
  - Newsletters
  - Tax and Legal Consultations
  - Investor Seminars/Workshops
  - 1031 Exchange Services
- TIC Brokers
  - Replacement Property Solutions
- LoopNet.com
  - Investment Property Marketing

# Available Tools

# 1031

**Asset Exchange Company**  
Tel: 877.471.1031 | Fax: 877.480.1031 | [a1031.com](http://a1031.com)

KEEP CAPITAL SHAKING IN THE BALANCE OF BUSINESS BUYERS REAL ESTATE

KEEP YOUR MONEY WORKING FOR YOU

## 1031 Exchange

SECTION 1031 OF THE INTERNAL REVENUE CODE IS ONE OF THE GREATEST WEALTH BUILDING TOOLS AVAILABLE TO INVESTORS.

### The 1031 Exchange Process

Select adherence to the legal requirements of Section 1031 of the Internal Revenue Code is required for a successful exchange. Investors should be aware of four basic requirements when entering into a delayed exchange, and should seek the advice of a tax accountant or attorney to ensure proper adherence to the tax code. The four basic requirements for a successful exchange are:

**Property Qualification:**  
The Internal Revenue Code states that the properties involved in an exchange must be held for productive use in trade or business or for investment, and they must be "like-kind".

**Timeline:**  
The IRS provides a maximum of 180 days to complete an exchange. The timeline begins upon the close of escrow (COE) of the relinquished property. The new property (or properties) must be acquired on or before midnight of the 180th day. No Exceptions! In addition, the IRS requires that all potential replacement properties be identified by midnight of the 45th day of the exchange.

**Identification:**  
Identification of all potential replacement properties is required on day 45 of the exchange. Identification must be in writing and

the description of the properties must  
IRS provides two rules for identifying property:

**The 3 Property Rule:**  
The 3 Property Rule allows for identification of any price, anywhere in

**The 200% Rule:**  
The 200% Rule is an option for identification of properties. With the 200% Rule, four can be identified. However, the total properties identified cannot exceed 200% of the value of the property sold.

**Tax Deferral:**  
To defer 100% of the capital gains tax requirements must be met:  
a) Retain all the Cash - all the generated from the sale of the relinquished property must be reinvested into the new property (or properties) must be value to the property sold.

The subject matter in this newsletter is intended as general information only, and not intended as tax or legal advice. Please always consult your tax or legal advisor for any specific tax or legal matters.

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August 11, 2006

Joe D. Investor  
1234 Main Street  
AnyCity, CA 94110

Dear Joe,

Property values in California are at their highest levels ever. You can **maximize your investment return** by utilizing one of the last significant tax advantages remaining for real estate investors – the Internal Revenue Code Section 1031.

IRC Section 1031 allows investors to dispose of their current investment property without incurring a capital gain tax liability. By taking advantage of the IRC Section 1031, you have the opportunity to do the following:

- Improve your investment position by acquiring larger properties to depreciate,
- Acquire different types of investment real estate, and
- Diversify your investments geographically or by asset type.

Please call me and we can discuss your specific goals and whether exchanging makes sense for you. As an investment specialist with intimate knowledge of AnyCity, I can also prepare a market profile on your investment property at no cost or obligation.

Best Regards,

Jane D. Realtor  
ABC Realty Company

# Advanced Strategies

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## **IRC Section 1031?**

- Investment Real Estate
- Tax Deferral

## **IRC Section 121?**

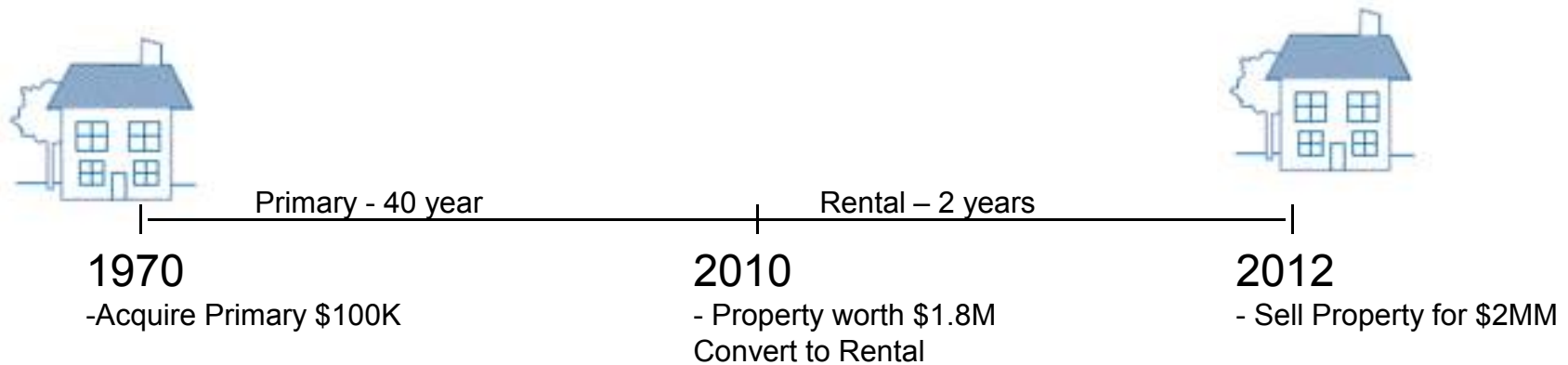
- Primary Residence
- Tax Avoidance
  - \$250K single
  - \$500K married



# Primary To Rental

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## Conversion of a Primary Residence to a Rental



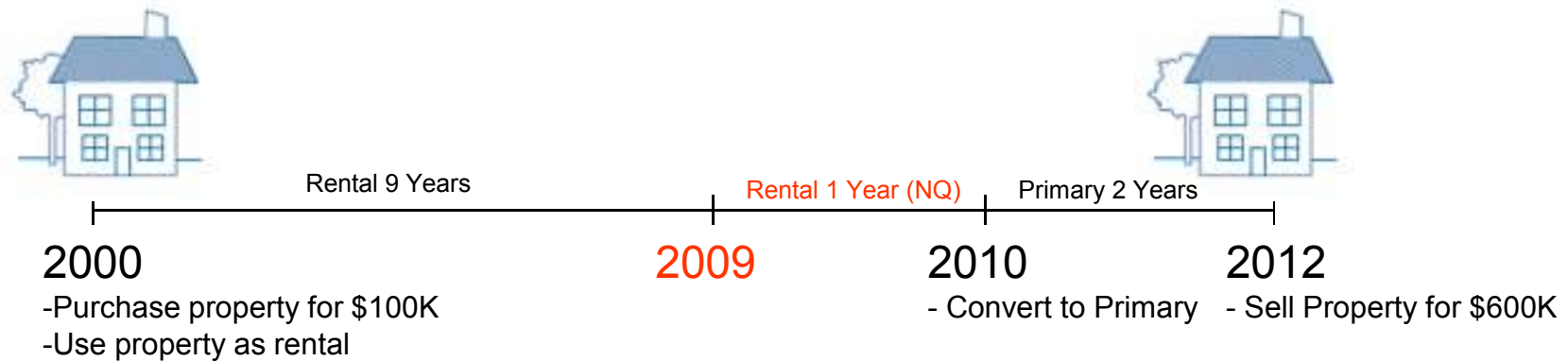
### **Tax Implication: \$0K**

- First \$500K of gain tax exempt
- Remaining \$1.4MM of gain tax deferred via 1031 Exchange

# Rental To Primary

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## Converting a Rental to Primary



### **Tax Savings: \$138,000**

- 11/12 of Gain Exempt (\$460K)
- 1/12 of Gain taxed (\$40K) – taxes approx. \$12,000

### **Facts:**

- 1 Year of "Non Qualified Gain"
- 2 Years as Primary
- Eligible for Homeowners Exemption
- 1/12 of Gain allocated to "Non Qualified Rental Period"

# Rental To Multiple Primaries

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## Defer, Defer, Die



# Contact Info

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## Asset Exchange Company

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