Time for a change: How to stay invested in R.E. without the burden of management

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Many real estate investorsÂ are increasingly looking to capitalize on their highly appreciated property by selling. There is an obvious dilemma for those choosing to defer paying taxes on the sale of a property by utilizing a section 1031 like-kind exchange. That is, "What kind of property should I exchange into?" Real estate investors typically fall into two camps: those who want day-to-day management responsibility and those that don't. If you are the latter, you have a decision to make: Should I choose betweenÂ a tenant-in-common (TIC) investment or a single tenant net-leased (STNL) property? How do I determine which investment type is the best option for me?

First, let's define these two options. STNL properties are usuallyÂ commercial or industrial properties leased on a long term basis to tenants backed by corporate credit. These leases obligate the tenant to pay for real estate taxes, insurance, and building maintenance. Commercial properties of this type are frequently leased to regional or national retailers. STNLs allow the owner to drive income from the property net of expenses.

TIC investments, on the other hand, are multi-owner investment properties with in-place professional management. Much like STNL properties, TICs provide income net of expenses without day-to-day management responsibilities. One big difference is thatÂ the TICÂ structure can be used for virtually anyÂ property type.Â TIC investors areÂ deeded, fractional owners who proportionately share in the gains and losses ofÂ the particular investment property.Â

So how do you determine which type of property is for you?Â There are three primary phases we look at to compare and contrast any given TIC to aÂ STNL: Pre-sale, closing, and post-sale.

* Pre-Sale:Â This is whereÂ one should evaluateÂ the amount of time, money, and energy it takes to determine what property to buy.Â A STNL property requires aÂ traditional negotiation and contract period. This is a variable, but one could assume this takesÂ anywhere from a few weeks to a few months depending on the situation. With a TIC the sponsor company has already completed the negotiationÂ and arrived at a purchase price by the time the property comes to market, thereby saving the investor a lot of time and aggravation.

The due diligence process is alsoÂ vastly different. In a typical STNL transaction, the buyerÂ bears the responsibility and cost ofÂ any third party due diligence reports, includingÂ a PropertyÂ Condition Report (PCR),Â Environmental Survey, and Appraisal. This process can potentially add another few weeks to the timeline. Whereas inÂ a TIC transaction, the due diligence reports have already been completed and are available toÂ the investor forÂ review.

* Closing:Â If an investorÂ desires financingÂ on an STNL investment, they are responsible forÂ locating aÂ source of funds andÂ negotiating theÂ terms. TIC property sponsors take the responsibility of finding a lender and negotiating the terms on the investors'Â behalf. A TIC property sponsor'sÂ banking relationshipsÂ allow it to secure institutional-quality, non-recourseÂ financing.

This has the potential of saving the investor a substantial amount of time and money. Otherwise, closing on both types of investmentsÂ is relatively easy. Attendance of the investorÂ is typicallyÂ not required.

* Post-Sale: Once the sale is complete,Â both types of ownership require little or noÂ active management on the part of the investor. STNLsÂ rely on the tenant to takeÂ responsibilityÂ for the building's general maintenance. A TIC owner relies on a third-party property manager for such duties.Â Both TIC and STNL owners customarily receive rental income checks on a regular basis. One big difference between the two is that TIC property managers are in regular communication with the investors regardingÂ issues affecting the property, including financial data and the property's performance. TIC propertyÂ sponsors have a built-in exit strategy before the property isÂ marketed.Â This provides the investor with an estimated hold time for any given TICÂ investment.Â In addition, the sponsor acts asÂ the brokerÂ or enlists a professional to help theÂ investors evaluateÂ prospective buyers' offers.Â STNL owners canÂ putÂ aÂ similar exit strategy into place, but they are on their own in evaluating the sale.

TICs also offer an investor the opportunity to diversify by asset type and geography more easily thanÂ a typical STNL buyer could. For example, a NNN, corporate-leased Advanced Auto Parts in Bedford, IN isÂ selling for $1.5 million.Â That $1.5 million couldÂ easily be diversified betweenÂ three to five TIC investments into ownership of larger, more desirable assets in stronger markets throughout the country. The old adage of "don't put all your eggs in one basket"Â remainsÂ as true in real estate investing as it does inÂ yourÂ brokerage account. Creating a diversified portfolio of real estate holdings not only mitigates riskÂ but also increases the potential greater returns.

So what's the best option? This depends on what type of investor you are. For the investor who desires completeÂ ownership control without active management, a STNL investment may be the answer. For the investor who seeks toÂ diversify their investment dollars, ownÂ larger institutional-quality property, andÂ still have the freedomÂ from management responsibilities, TICs may be aÂ more suitableÂ option.

What type of investor are you?Â You may want to reevaluate your answer toÂ thisÂ question. The type of investor you are todayÂ may be different from theÂ type you were years ago. The real estate investment market has changed in the past five years. Prior to 2002, when the IRS gave guidance toÂ real estate companies regarding TIC offerings, net-leased propertiesÂ were theÂ first choice for those wanting toÂ remain invested in real estate withoutÂ actively participating in property management. The TIC marketplace has since grown to over 60 real estate companies offering hundreds ofÂ institutional-quality propertiesÂ in which to invest each year. Do yourself a favor and researchÂ the options available in the TIC market. Before jumping into that next Walgreens or Rite-Aid,Â seek education on how TICs work andÂ how they differ fromÂ net-leased property. You may be surprisedÂ at what you find.

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