Industry Leaders

Just what the doctor ordered: Management-free real estate investing strategies

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So, you have owned real estate as an investment for many years and have been involved in the day-to-day management of these assets. You are at the point in your life where you can't afford to sell because of the tax associated with your gain (profit) and are tired of being an active investor handling the day-to-day management.

The following solution allows you to stay in real estate as an investment, dispose of your management-intense properties, pay no tax as well as switch into a management-free form of a real estate investment.

In many cases, depending on how long you have owned your real estate investments, you may lose as much as a third of your selling price in the form of taxation that is associated with your gain. Most people are only aware of the capital gains tax, but very few people realize that in addition there is a recapture of depreciation tax, depending on the size of the gain, an additional tax called the medicaid surtax as well as state tax.

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The following strategies could be just what the doctor ordered for this problem. The first is the ability to dispose of your income-producing, investment-held or secondary residence properties through a 1031 Exchange. This opportunity to pay no tax is nothing new it has been part of the Internal Revenue Code since the early 1900's when the first exchange laws were enacted. Keep in mind there is a need for a professional qualified intermediary to handle a 1031 Exchange.

The second part of our formula is how to come out of management-intense properties and go into management-free properties. Any time you take advantage of a 1031 Exchange, you have to acquire as a Replacement Property what's called "like-kind" property to complete the 1031 Exchange. Like-kind, means any real estate other than ones primary-residence.

So, if you own doubles, duplexes, larger multifamily properties that you have been actively managing in what's called your Relinquished Property you can go back into management-free property such as a NNN leased investment property or even a co-ownership real estate investment, in which both would qualify as like-kind property to complete a successful 1031 Exchange.

An example of a NNN leased investment property would be a property that is rented long term to a tenant like Walgreens, CVS, Dollar General, Auto Zone, Advance Auto Parts just to name a few. Normally the real estate is a free-standing building which is occupied by one of these tenants, which guarantees the rent anywhere from 15 to 75 years and not only pays the rent but also is responsible for the property taxes, property insurance, property maintenance and utilities truly management-free. You own the real estate. The equity investment may require as little as $350,000. to own the whole asset to as little as $100,000 to own a partial interest in one of these arm-chair investments. Because these properties are truly management-free, it doesn't matter where they are located. The tenant is responsible for all the day-to-day activities.

Another management-free investing strategy would be a co-ownership arrangement such as an institutional size apartment building that may range from 125 units to 250 units in size. A sponsor will go out to locate such an asset, acquire it and manage it on behalf of a group of co-owners who today can participate with as little as $100,000 equity investment. The objective may be to hold the asset anywhere from 5 to 7 years and then dispose with the intent to receive all the same benefits of ownership that you would receive as if you owned the asset by yourself without the management.

So, if you like real estate as an investment, but are tired of the day-to-day headaches, through the use of a 1031 Exchange there are management-free ownership options available to choose from.

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Rent Regulations: A New York phenomena - A simple understanding

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Owners of regulated apartments are required to register their apartments every year with NYS Division of Housing & Community Renewal (DHCR). In addition, any building with more than 3 apartments or where an owner does not reside on the premises must register with New York City Housing Preservation & Development (HPD). Failure to so register will have negative impacts on owners. Non-regulated buildings and apartments are allowed to raise rents as the market dictates. Regulated apartments have increases dictated effectively by the mayor of New York City. The increases are almost never equal to the increases in owners expenses (e.g. real estate taxes or water & sewer charges) imposed by the same mayor.

New York City is the only large city in the world that has laws designed specifically to only protect tenants. There are, currently, well in excess of 1 million rent stabilized tenants (up to 3 million). In addition, under 28,000 tenants enjoy the protection of Rent Control Status.

Rent Control Laws were first passed by the Federal Government 1920 to protect tenants. They protect tenants who have resided in their apartments since 1971. In addition to the tenants, certain delineated persons are allowed to succeed to the apartment, as well. In effect to inherit, without paying inheritance taxes.

Rent Stabilization Laws began in 1943, at one point expired, and then were re-enacted in 1974. The laws mostly apply to buildings with 6 or more apartments. The original intent of the law was to protect WW II veterans. New York City regulates, through the Rent Guidelines Board (RGB), a board admittedly controlled by the New York City mayor, the amount of increases that owners of these apartments may get each year. The current increases are 0% for one year and 2% for two year renewals.

Under very specific conditions, an owner may deregulate an apartment. A recent court decision subsequently codified by NYS legislators (upon the insistence of NYS's governor), may result in some apartments previously deemed deregulated from rent stabilization to become regulated again. See also the Stuyvesant Town decision by New York Courts where the owners of a large housing complex had its units put back into Rent Stabilized status.

Over the years, the regulations have been constantly extended by politicians, even though the initial purpose of the laws was temporary in nature. The laws surrounding this are the source of major, regular political battles, currently culminating every six years in political turmoil and the dissemination of misinformation by those seeking greater strengthening of the laws. The political party in power in NY determines whether the laws are changed and usually, to what extent, previous changes not so onerous to owners are rescinded or modified to protect tenants. Also, in New York, what the legislature cannot accomplish in protecting tenants, you will often find the Judicial System affording additional protection to tenants.

When you compare the voting power of millions of tenants - and their families - to the 27,000 owners - and their families - the reasons are clear.

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Non-regulated buildings and apartments are allowed to raise rents as the market dictates. Regulated apartments have increases dictated effectively by the mayor of New York City. The increases are almost never equal to the increases in owners expenses (e.g. real estate taxes or water & sewer charges) imposed by the same mayor. To add to the burdens of New York City owners, New York City always increases penalties imposed against owners and enforcement, knowing the owner cannot just pick up their building and leave. Examples include Summonses to owners when tenants fail to separate their recyclables from garbage or when enforcement agents sit in front of buildings waiting for litter to alight onto an owner's property or the massive fines levied on owners when a tenant violates New York short term rental law, through websites like Airbnb, by renting out their apartment for less than 30 days. The law provides no penalties for tenants and places the responsibility on owners for actions of their tenant. Such is the mindset of New York Politicians. Tenants are to be protected at all costs, even from their own violations of the law.

Accordingly, if you are going to venture into the New York City regulated market it is absolutely essential that your team include specialists in rent regulations and DHCR registrations. Leases and filings must be reviewed with a fine tooth comb.

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