

# 1031 EXCHANGE INSIGHTS

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Providing tax advice on like kind exchanges.

Strategic Property Exchanges, LLC serves as Qualified Intermediary on

Section 1031 Exchanges, including forward, reverse, and parking arrangements.

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## INVESTMENT STRATEGIES- PART 1

We speak to many real estate investors every day, some old timers and some newly initiated. Some of these investors are satisfied with their investment style and some are looking for something different. The most common switch is for long time investors to move away from active management to a more passive style. Younger investors move from the first couple passive investments to a more active as time goes on.

The common thread for each investor is their desire to reduce their taxes and keep more of their wealth at the end of the day. Section 1031 is generally the best way to accomplish this, but by no means the only way to accomplish this goal. As many of our readers know, I am a practicing tax attorney, Board Certified since 2002, and, as such, we may advise that a Section 1031 might or might not be the best solution.

The most important information I need to know to help an investor reduce their taxes are their Investment Goals.

**The following discussion illustrates typical investment Goals.**

**Buy and Hold** –A pure “buy and hold” strategy can be a recipe for profits over the long term, provided you can withstand downward cycles in your market and lack of liquidity. This type of strategy lends itself well to a Section 1031 exchanges. On the sale of these properties, the owners can defer their taxes with the purchase of replacement property or properties.

We can discuss the exact requirements with you.

**Flipping** – “Flipping” has become a “hot” approach recently due to the extremely rapid price appreciation for real estate in some areas of the country, particularly the South and Southwest. These types of transactions are not generally eligible for Section 1031 exchange due to the fact that many times the investor has no intention to hold the property for investment, but rather is looking to sell immediately. There are other excellent methods to reduce or defer taxes in the case of flipping. There are two styles of flipping.

When market conditions are right, rapid buying and selling of properties can be profitable. However, this type of flipping is really pure speculation, which is gambling, not investing, and is dependent on what economists call the “greater fool” theory, which only works in “bubble” markets, and then only for a short time.

Flipping as an investment, however, has different characteristics. What this type of investing really involves is finding properties which can be purchased inexpensively, and then once the property is secured, quickly placing these properties with purchasers.

Good candidates for properties to flip generally are in neighborhoods which have declined and are generally in poor condition. Because of these problems, these houses often do not qualify for conventional financing, making them more difficult for the owners to sell and virtually impossible to purchase by anyone who would consider living there. Moreover,

because they generally are unoccupied, these properties are a current cash drain on the owner, primarily because of accumulating property tax liabilities.

Properties generally are found through a combination of advertising and drive-bys by the flipper. The types of properties that make good flips usually are in neighborhoods where there is revitalization activity and there are other investors who are rehabbing and renting properties. Once the owners are found the flippers generally enters into a contract to purchase the property at a deeply discounted price, making the sale subject to an inspection or other due diligence investigation to be conducted over a short period.

The flipper then works to find a buyer for the property during the due diligence period. These people often are other investors, who are focused on other types of real estate investing such as rehabs or rentals and are willing to pay a flipper a reasonable profit to essentially locate suitable properties for them. The flipper either sells the property to the buyer in a back-to back transaction or simply assigns the purchase contract to the buyer, taking his or her profit when the transaction closes. If the flipper cannot find a buyer, the due diligence clause in the purchase contract is usually broad enough to allow the flipper to get out of the initial purchase contract deal. Flippers play a numbers game, making offers on numerous properties knowing that only a small percentage of those will be accepted. Flippers might lose money on some deals, and make money on others.

**Coming Next Month**

**Investment Strategies Part 2**

**Lease with an option to Buy and Rehabbing**