Opportunities, Pitfalls in 1031 Tenants-in-Common Exchanges

By Michael Dubes

Michael Dubes explains the benefits and risks associated with 1031 tenants-in-common exchanges and emphasizes important planning suggestions for investors who may be interested in this planning strategy.

The confluence of two momentous events—one economic, the other demographic—has triggered a resurgent interest in 1031 property exchanges and with it, an unparalleled opportunity for estate planners.

The two events are the onset of the greatest transfer of wealth from one generation to another in history, and the unprecedented accumulation of real estate equity. The correlation has spurred an average annual increase of over 100 percent in the 1031 market since 2000.

Code Sec. 1031 exchanges are named for the Tax Code permitting investors to exchange business or investment real estate for other like-kind properties while deferring capital gains taxes on the appreciated value. When the IRS issued new guidelines in 2002,[1] the popularity of tenants-in-common (TIC) structures soared. From a standing start in 2002, the TIC industry will raise about $4 billion in equity in 2006, the result of transactions valued at close to $10 billion. At the current growth rate, those numbers could double in the next three years.

TICs offer investors a way to participate in larger properties, previously the exclusive realm of institutional investors. TIC properties provide passive investors with fractional interests in properties often anchored by major corporations, retailers or developers. Wealthy retirees and those nearing retirement especially like the long-term income without the inherent problems of active property management.

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While the income and tax advantages of TICs are appealing, there are also pitfalls to avoid, not the least of which is the complexity of putting these transactions together successfully while avoiding invalidation by the IRS. Procedures must be followed to the letter and deadlines met without exception. A 1031 exchange can be disallowed for a hundred different reasons. Once an exchange is disallowed, looming deadlines can eviscerate the chance of salvaging the transaction and the attendant tax benefits. In short, done inaccurately, a TIC can cost an investor dearly and can cost the planner a client. Executed correctly, TICs can solve a host of estate planning issues.

Unusual Opportunity for Planners

The extraordinary opportunity in 1031 TIC exchanges for estate planners lies in the attractiveness of TICs as a viable strategy for affluent clients or business owners—a genuine value-added service. Offsetting the obvious benefits are the strenuous requirements and complexity of the transactions and the fear of IRS disallowance, also the tendency among many advisors to include only liquid investable assets in planning presentations.

Considering the vast number of wealthy Baby Boomers entering retirement, their cumulative net worth, the high percentage who own second homes, investment real estate or business property, and the trillions of dollars of real estate that will be sold over the next quarter century, estate planners might be wise to learn more—or connect with professionals who know more—about 1031 TICs as a planning and investment management alternative.

TIC Applications

TICs can be used to achieve a variety of estate planning objectives, including estate growth, cashflow, consolidating scattered holdings, geographic preferences, portfolio upgrades and diversification, among others.

According to Leo Wells III, president of Atlanta-based Wells Real Estate Funds, as investors age and consider the implications of their real estate holdings on their estate, they want to become more tax-efficient:

> They often no longer want the hassles of investment property management. They make the decision to sell and when they do, estate planners should know about 1031 exchanges as an option worth considering. The strategy can be used to upgrade, change geography, diversify, consolidate, add or remove cashflow, or any combination. Any or all of the benefits can have appeal to investors, aside from the obvious tax benefits. Often the decision is based on a combination of lifestyle changes and estate wishes. And of course not paying taxes on the sale means more money stays in the portfolio and continues to earn for and grow the estate.[2]

Many 1031 exchanges are the result of aging investors looking to trade non–income producing properties—such as large land holdings or farms—for properties that generate cashflow for their estate. Wells cites examples of "[i]nvestors who no longer want to deal with active property management or simply want to enjoy their retirement, move to a warmer climate, and relax without worrying about tenants or other real estate related issues. It is often a good way to shift from receiving little or no cashflow with high maintenance to having no maintenance and receiving enhanced cashflow."

Wells adds investors can also move in the opposite direction. For example, those who do not need additional ordinary income and prefer to remove income generated by, for example, an apartment building or shopping center. They can convert into properties with little or no income or dividends but with greater potential for asset growth.

In situations where retirees move to a warmer climate or to be closer to children or grandchildren, they may wish to exchange real estate holdings for properties closer to their new locations. They may also own several properties in their old location or have real estate scattered around the country that they would like to consolidate into one or two properties near their new residence. "It can be an effective way to simplify as well" says Wells. "Let's say an investor has ten smaller properties. They can be sold off and the proceeds channeled into a single property in a 1031 exchange, or perhaps converted into a different type of property that simplifies or facilitates an estate plan."

Wells points out the diversification potential for 1031s. "In many areas of the country, investors have a significant portion of their assets tied up in a single property with enormous equity. The 1031 allows them to diversify in several ways: multiple properties, by industry or geographically."

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Investors can also utilize TICs to upgrade their real estate portfolios, for their own comfort or that of their beneficiaries. Wells notes:

> If the estate contains duplexes or commercial buildings in an area that has become less desirable from an investment perspective, they can be sold and converted into something better suited to the estate's directives. Heirs may be uncomfortable holding certain kinds of properties, timberland for example, if they oppose depleting natural resources. The investor may simply want to exchange that property for property with a better opportunity for appreciation within the estate, or for property closer geographically to the beneficiaries. Some investors who relocate in retirement just feel better having investment property nearby where they can see it or visit it occasionally. Of course, an exchange can remedy more than one problem or issue simultaneously. Finally, investors can boost estate preservation simply through the tax benefits of a 1031 exchange. Unlike some other planning strategies, a

1031 used to avoid taxes can be effected quickly and anytime, even at a late stage of life. Properties can be moved to minimize taxes and maximize the value of the estate.

Errors Are Killers

The IRS revenue procedure established basic prerequisites to obtain a favorable ruling for a TIC in a 1031 exchange. The most common errors by advisors involve marketing overtures, qualified intermediaries, mismatching clients and sponsors, missed deadlines and the private placement memorandum. Tripping up in any of these areas can deal a deathblow to the transaction and the loss of a commission, the loss of a client, a NASD violation, or a lawsuit.

Marketing Overtures

Regulation D rules of the Securities Act of 1933, restricts the sale of 1031 TIC exchanges exclusively to accredited investors, briefly defined as individuals whose net worth exceeds $1 million or whose annual income exceeds $200,000 in each of the previous two years, or a trust with assets in excess of $5 million. Advisors cannot solicit the transaction. Clients must initiate contact or be referred by another advisor, such as a CPA or attorney. Advisors must be able to document that the information on the TIC was requested by the client, not solicited by the advisor.

Qualified Intermediary

Only a qualified, insured third-party intermediary should hold the funds realized from the sale of a current property until a replacement property is purchased in a 1031 exchange. But who is qualified? According to the IRS, it cannot be any of the advisors directly involved in the transaction, including the client's real estate agent—or the agent representing any of the parties in the exchange. It also cannot be the client's financial advisor or CPA if the latter has prepared the client's tax return within the previous two years, or an attorney who has had a relationship with the client during the previous two-year period.

The term "qualified" is actually a misnomer; the intermediary does not have to be qualified. There is no government guideline, minimum level of expertise or net worth required. Steven Crawford, a Certified Financial Planner™ and President of The Main Street Group in Glen Allen, Virginia suggests using a corporate exchange intermediary, such as IPX Investment Property Exchange. He notes, "This is probably the safest alternative for advisors since they do thousands of 1031 transactions each year, and are licensed and bonded for millions of dollars in liability coverage."

Many cases of IRS disqualification occur when the wrong person holds the money or where an attorney uses improper language. In either case, the tax-free exchange of the proceeds is invalidated. Unfortunately, there have also been cases where intermediaries embezzled the funds, in one case over $2 million.

Crawford recalls two investors who bought a commercial lot for approximately $300,000. The property appreciated and the pair borrowed another $800,000 against it. They later sold the lot to a major retailer for $3.8 million. They wanted to do a 1031 exchange but decided to forgo using a financial advisor in favor of their attorney. The investors paid the attorney a $40,000 fee for work that, according to Crawford, "could have been done by an advisor for perhaps $1,500." After completing the 1031 exchange, the pair bought a motel. Their CPA later discovered the attorney paid off the debt on the original property before completing the exchange, which created a taxable event. Code Sec. 1031 regulations state that debt on a property being sold must be transferred to a purchased property with an equal or greater amount of debt. By paying off the debt on the original property, the attorney triggered a capital gains tax of $180,000. Added to the attorney's $40,000 fee, the two investors suffered an avoidable loss of $220,000.

Crawford's firm intervened, sued the attorney and was able to recoup most of the investor loss from the attorney's errors & omissions carrier, but as Crawford explains, "Besides being a prolonged and stressful experience for the investors, they were unable to recover the capital gains tax."

Mismatched Clients and Sponsors

Not every 1031 that misfires is the result of an IRS disqualification. Clients can lose interest or become discouraged if they are mismatched with property vendors, if the benefits are not properly explained or all the options are not presented accurately, or if one of the necessary advisors is left out of the process. Clients may decide it is simply less hassle to pay the capital gains tax than to go through the procedural quagmire the 1031 qualification process entails.

Some investors shy away from 1031 exchanges because of illiquidity. While an advisor is required to review the financial qualifications of a potential investor for appropriateness, in many cases, the illiquidity issue is not explained properly and the transaction never happens. While TIC illiquidity is a drawback for some investors, retaining a highly appreciated investment property or one that no longer generates a satisfactory return hardly constitutes a liquid position. So while an investor may not improve liquidity with a 1031 TIC exchange, chances are the new position will be no less tenable.

There is a lot to be said for dealing with large sponsors. Only a small percentage of TIC sponsors—about 10 to 15 percent—are large companies with a substantial pool of properties. Larger sponsors have more market leverage and tend to attract higher value properties because they may do dozens or even hundreds of deals per year versus small sponsors who may do only a single transaction. Better properties and financial arrangements increase the odds for positive long-term investment results and the opportunity to do additional transactions with clients. Currently, there is no sponsor-provided secondary market for TICs. Sponsors report they are seeking ways to create greater liquidity and it is certainly in their interest to do so. The idea to eventually convert TICs into REITs continues to surface and seems a likely development, but sponsor concerns over IRS disqualification understandably slow progress.

As a result, TIC investors are in charge of their own secondary market and there is no guarantee they will be able to sell for a favorable price at a given time in the future. As with any security, market forces dictate prices. However, larger sponsors doing more TIC transactions seem to offer investors a better opportunity to liquidate or exchange their shares for an alternative property as they tend to be market makers with larger investor client bases. Having multiple properties available also allows investors to purchase a combination of properties to avoid boot capital gains tax liability for portions of sold properties not reinvested.

The more investors a sponsor has, the more likely the sponsor can find an investor to buy shares from someone interested in getting out early. Larger sponsors also have a financial interest in getting investors to reinvest, and so would appear to be more flexible in situations where investors want to liquidate or trade their interests. Their experience in doing many transactions should give them an advantage in terms of evaluating properties, and they tend to have more experienced due diligence departments, an important consideration for advisors and investors. Since the TIC arena is in its infancy commentary on future liquidity is mere speculation.

Advisors should take care to properly match clients with real estate sponsors. Each sponsor has a different set of procedures, and may accept clients based on different net worth requirements or financial ratios.

Documentation also varies from sponsor to sponsor, further complicating an already complex process. If a client's initials are missing where requested or a single piece of background information is omitted, the sponsor will kick back the application. The corrections can always be made, of course, but if time factors in, which it almost always does, even a minor delay can have severe repercussions.

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TICs cannot utilize REITs; properties must be free-standing buildings owned by 35 investors or fewer. If the majority of investors decide against selling a property, an investor faces a liquidity problem, as the only recourse is to sell the share on the secondary market. However, most major real estate management companies have been buying properties for their 1031 inventories with virtually identical specifications as their REITs. The trend appears to be that 1031 properties will eventually be moved into REITs, converting investor 1/35 ownerships[3] into corresponding shares of the REITs, which should provide greater liquidity in the future.

Missed Deadlines

Investors have 45 days from the sale date of a property to identify potential replacement properties, and 180 days to close on a replacement purchase. That sounds simple enough, but it often becomes a race against the clock. Finding a like-kind property of the right size and type within the required time period can be a formidable task. The time pressure can build and become onerous. Writing in REAL ESTATE WEEKLY, Joseph Darby estimates "... over 200,000 real estate transactions are structured, at least initially, to be a like-kind exchange, and estimates are that well over $100 billion of these anticipated exchanges fail because of the inability to find acceptable replacement property."[4]

Given the consequences of missing either the 45-day identification or 180-day replacement deadlines, advisors working a 1031 exchange transaction would be wise to identify at least one TIC property as a *backup* should the pending deal blow up. In other words, if a client is exchanging family farmland in Michigan for a working ranch in Wyoming and a week before the deadline, the ranch owner discovers his land has valuable water rights and he backs out of the sale, the advisor has a TIC replacement property at hand to save the day. If the ranch exchange goes through as hoped but there is $ 250,000 of unused funds that need a home, the TIC replacement property once again becomes the safety valve.

Writing in the JOURNAL OF FINANCIAL PLANNING, Clarence Rose, Ph.D., notes that, "Perhaps the greatest risk associated with the complexity of the (1031 TIC) transaction, as with any type of like-kind exchange, is that the deal may fall through and prevent an investor from completing the like-kind exchange within the time limitations allowed, thereby subjecting the investor to capital gains taxes and possible penalties."[5]

Real estate sponsors fear IRS intervention and rarely deal with part-time TIC advisors. The more TIC transactions an advisor brings to the sponsor, the more that advisor receives first right of refusal on the sponsor's various offerings. The size and mixture of an advisor's TIC inventory are critical to saving clients from the ramifications of missed deadlines.

The entry of larger sponsors has brought higher quality, higher valued properties into play for individual investors. Having an inventory of potential replacement properties available helps ease the pressure on clients and advisors. The inventory also helps alleviate the fear of missing time deadlines should pending deals fall through, sellers renege, properties not be what investors imagined, and similar issues.

Private Placement Memorandum

Estate planners cannot discuss a TIC with an investor before first filling out a broker/dealer's investor profile to ensure the investor is accredited and the advisor did not initiate the inquiry. A separate investor profile from the property sponsor must also be completed, and the investor must be provided with a private placement memorandum (PPM) describing the proposed replacement property.

Each property comes with a private placement memorandum, a disclosure booklet from the sponsor typically 75 to 100 pages in length, which must be reviewed in detail with the client. Going through a hundred or so pages and answering questions can be tedious, to say the least, but failure to cover the material fully can have harsh consequences. Crawford's firm uses a formal checklist and has the client initial each step as it is completed, acknowledging that area has been discussed. In addition to helping safeguard the firm's position, Crawford believes the checklist is a sign of professionalism and helps reassure clients.[6]

The PPM describes the property and provides other key information, such as the fees and risks. There are numerous signatures and initials necessary, as well as disclaimers, and in most cases, the document must be notarized. A single error (commission or omission) will require the document to be redone. This may appear to be only a paperwork issue, but if the property sells out during the delay, the investor must identify another property—assuming the 45-day limit has not expired. The clock is always ticking on the 45-day identification and 180-day exchange periods; there is little time to waste on misunderstandings or bad judgment.

The closer to the end of the discovery period, the more debilitating errors become.

Candidates

TIC exchanges are not for sophisticated real estate investors or market players, who are apt to find their own properties and complete transactions with their own advisors.

TIC candidates include accredited investors with highly appreciated property or property that is no longer generating a satisfactory income. Crawford's firm recently completed a $3.5 million TIC transaction for a client who wanted to exchange a family farm that had been generating only enough income to pay property taxes. The TIC will generate six-percent annual income for the client with no further property management concerns, and the investment is no less liquid than was the farm.

Replacement properties can include residential, commercial or industrial properties, including office buildings, shopping centers, manufacturing plants, apartment buildings, restaurants, senior living facilities and others.

Crawford recalls an offering his firm received from a real estate sponsor: a stand-alone CVS Pharmacy building available in a $1.5 million TIC offering. "Of course, the appeal to investors was the ability to own their own building with an advantageous 20-year lease," says Crawford. "As with investors who buy gilt-edge stocks or are limited partners in a golf course development, celebrity-backed restaurant or entertainment venue, TIC investors love cocktail party bragging rights about owning prestige properties or those with highly regarded anchor tenants. As an advisor, however, you cannot afford to have stars in your eyes in a TIC transaction. We looked at the downside of this TIC offering. What if CVS breaks its lease? What could the investors do with the building? CVS buildings are not properties than can be easily converted into something else. They are invariably located on the corner of an intersection—where a gas station might logically be located. If CVS vacates, investors would have few options for converting the building into another viable enterprise without major expense. Certainly a gas station was not an option. So we decided to walk away from that property."

Another property Crawford decided not to recommend to his clients was an aircraft factory leased to a major defense contractor. "It was a beautiful and highly functional facility with a great tenant, but who would lease it if the aircraft company left? Factories one story tall and a city block wide have only so many uses," he adds. Again, advisors and clients should evaluate a TIC property as an investment first, and a tax strategy second.

Investors who may be better off paying the capital gains tax include those who may need their funds before the estimated liquidation of the property. There's no guarantee when any property will sell and no vigorous secondary 1031 TIC market. In Crawford's experience, "investors forced to liquidate early typically do no better then 75 cents on the dollar. Investors who otherwise qualify for a TIC but lack sufficient assets outside the TIC to weather potential needs should not participate. If a benefits analysis reveals the numbers are close between paying the taxes and doing the TIC, the more prudent choice may be for the investor to pay the capital gains tax. The TIC should be overwhelmingly supported by the numbers."

Protecting Investors

A TIC should move investors into a better position, not merely an alternative. Notes Crawford, "Sometimes, advisors and clients get so focused on saving taxes in order to maximize estate value, they forget that, first and foremost, this is an investment; it must stand on its own. In any TIC transaction, it's advisable to ask if the investor would buy the property if there were no tax issues involved. If not, it's best to look for another property."

Advisors must fully explain the 1031 TIC load to qualified investors, including fees, expenses and commissions. Typically, the load amounts to 10 to 15 percent of the property value. The client should be advised to consider the alternative of simply paying the 15-percent capital gains tax, and in some cases, this is the prudent action for the client. However once the taxes are paid, that money is gone and unavailable for estate investment returns and growth. In a TIC, the money paid for the load can be recouped if the property appreciates. In addition, the client receives an annual return—generally five to seven percent—on the entire value of the property before the load is extracted. So even if the property never appreciates—an unlikely scenario—the client is no worse off than paying the taxes but still *receives income on the full value of the property.*

Heirs of an investor's estate receiving TIC shares get a nice benefit. They pay no capital gains and enjoy a stepped-up cost basis—the value of the property at the time of the investor's death—for future tax purposes. The benefit would be lost should the TIC shares be gifted to heirs while the investor was alive, as the original cost basis would be passed on to the recipients.

Clients are likely to inquire what, in addition to the five- to seven-percent annual dividend, they will receive in exchange for the load. Advisors can respond that clients receive critical due diligence on the property, a properly set up LLC structure, attendant legal work, professional property management and the reassurance that the transaction will stand up to IRS challenges. In the case of a $1 million property, the six-percent annual income they receive on the $150,000 that would have been surrendered to capital gains taxes amounts to $9,000 per year they would not have received. If the property is held for 10 years, that's $90,000 in additional income they would have surrendered.

Crawford warns advisors to beware of TIC offerings with excessive loads—up to 25 percent or more—charged by some sponsors. Rarely can fees of that size be justified by any property or terms. As Clarence Rose notes in the JOURNAL OF FINANCIAL PLANNING, "An additional risk to consider is the selection of a knowledgeable and experienced financial advisor and TIC sponsor. The complexity of the transaction leaves little room for error."[7]

There is one other element of a TIC transaction that advisors may wish to consider: visiting the property site with the investor. This is certainly not a revolutionary concept but having the investor physically inspect the property can alleviate potential problems. One advisor was sued for damages by a 1031 investor who did not visit the property. The suit was based on the fact that the investor did not know the building was on a one-way street with limited access.

While the cost of flying across country to visit a property or the sponsor's home office with an investor can be substantial, Crawford believes the expense typically represents a minor percentage of the advisory fees. "More important," he adds "the visit helps reassure the client, solidify the transaction and is a huge due diligence chip for the advisor. Given the cost of a lost transaction because the client was uncomfortable buying an unseen property, a couple of airline tickets are cheap insurance. Despite the obvious advantage of this investment, I don't know any other advisors who take every client on a personal tour of the 1031 property. I strongly recommend it."

The Real Estate Market

Wells, whose firm has been one of the nation's top purchasers of real estate during the past five years, has virtually all of his current personal property in 1031 structures. He believes advisors should be especially wary of major media coverage regarding real estate. "The real estate market is diverse and has many segments. The media tends to focus on residential real estate, and of course, that segment has gone down recently, so what we hear is gloom and doom from the broadcast and consumer press media. However, the real estate market as a whole has not receded. Housing has, but offices and hotels are now hitting new highs. Overall, real estate is up. Our firm sponsors the only real estate mutual fund that tracks the S&P REIT Index. As of early September 2006, that index is at an all-time high, despite the fact that housing stocks in the index have dropped. Everything else in the index is up and the overall index is approaching new highs. Even within the housing segment, while certain areas of country—the costs and in particular condos—are suffering weakness, other areas such as here in Atlanta are experiencing an escalation of new housing starts. While the media may think so, the housing segment is by no means the sole driver of the real estate market; investment real estate is a huge factor."

Are They Worth the Work?

While the concept behind the 1031 TIC exchange is simple, the execution is complex, and the reporting requirements deter many advisors. Choosing an experienced, qualified intermediary is vital, as is matching the investor to a competent sponsor. Since most advisors lack the time or recognize the importance of visiting exchange properties with their clients, and since property pictures can be misleading, advisors should work with products sponsors know. Working with larger property sponsors is advisable because they have larger inventories to match specific client needs, and as back up for when deals fall through or if the numbers don't match up and the extra money needs a home. Larger sponsors also tend to look at more properties and get the larger ones with better tenants. Leo Wells acknowledges there is rarely an office building worth over $50 million anywhere in the United States that his firm does not get to see before it is sold. Larger sponsors also tend to be market makers and so, it is in their interest to help investors who want to sell secondary buyers. As Crawford says, "It costs nothing for investors to have a Plan B."

One way to evaluate a sponsor is to inquire about their due diligence process. Preferred sponsors will only sell to accredited investors, and the definition varies among sponsors. Avoid sponsors lacking a due diligence process. Steven Crawford recalls one real estate sponsor (now defunct) who had a commercial building in its inventory that later proved to have a serious asbestos problem. "That's not good due diligence," warns Crawford, "whether it applies to the selection of property or investors. You certainly don't want to put an investor into a property that's a bio hazard!"

Wells says he has talked to some advisors, CPAs and attorneys who think 1031s are just too complicated to mess with, or fear making a mistake and having the transaction bounce back into their face. Some have even told him their clients should be willing to pay taxes on their investment gains. "I doubt the advisors would say that if it were their money involved," offers Wells. "They make it sound as though it's too much trouble to learn about 1031s so just let their clients pay the taxes; unbelievable."

Wells acknowledges that many CPAs and attorneys are unaware that there are professionals who can help guide them and their clients through the process, get things done right, and find appropriate properties. Wells says "In some cases, it appears CPAs or attorneys hesitate to refer their clients to an advisor who understands 1031s because they are afraid it makes them look uninformed or incompetent, but that is not a realistic concern if they are working with ethical professionals. For some, it is a control issue. Others just dismiss 1031s, telling their clients they are just too risky and clients tend to believe their CPAs and attorneys. The impact of simply paying the taxes on investor estates can be enormous, however, given the tremendous transfer of real estate wealth anticipated in the coming years. If can save your client $40, $50 or $100,000 in taxes and keep that money in the portfolio earning more money for the estate, why not do it?"

Crawford adds that some well-intentioned but inexperienced advisors try to handle 1031s alone and make mistakes that cannot be rectified and cost their clients dearly.

Summary

TIC investors must have a long-term investment horizon, and the product can lend itself ideally to estate planning strategies. Investors should fully understand the fee structure and the fact that they are unlikely to have access to their money until the investment property is sold, typically five to 10 years or more. In the case of aging investors, this could mean after their death. They should know there is currently no formal secondary market if they wish to liquidate their shares before the property is sold. In addition to administrative and paperwork accuracy, it's equally important to evaluate, case by case, whether the investor's cost of a 1031 TIC is justified by the resulting capital gains tax savings and potential appreciation of their estate.

Although the value of a TIC is based on real estate, and only real estate licensees can broker real estate transactions, only securities broker-dealers can sell TIC shares. This obvious conflict should alert estate planners to the dangers of improperly marketing or processing a TIC transaction.

Here are some fundamentals, courtesy of advisor Steven Crawford, to successfully adding TIC exchanges to an estate planner's product menu:

- Establish a working relationship with an experienced TIC advisor.
- Locate real estate sponsors with comprehensive due diligence procedures and a large and varied inventory of replacement properties.
- Keep a current inventory of properties from preferred real estate sponsors on hand.
- Have funds held by a qualified intermediary.
- Complete broker/dealer and sponsor investor profiles before discussing a TIC with an investor.
- Never shortcut the private placement memorandum review with investors.
- Be aware of regulatory deadlines; there is no second chance.
- Include all members of the client's advisory team in the process.
- Compile a checklist to ensure procedures are followed correctly and investors are fully informed.

While estate planners may be uncertain about offering clients 1031 TIC exchanges because of their complex structure, regulatory requirements and the ease with which errors can occur, TICs can provide a significant value-added dimension to an advisor's menu of services, help retain wealthy clients, and provide opportunities for future transactions.

Endnotes

1 Rev. Proc. 2002-22, 2002-1 CB 733.

2 Leo Wells, phone interview with author, Sept. 2006.

3 *Supra* note 1. This Rev. Proc. allows up to 35 tenants-in-common owners in any one property.

4 Joseph Darby, *When Tenant in Common Structures Make Sense*, Real Estate Weekly, Sept. 28, 2005.

5 Clarence D. Rose and Douglas Brinkman, *Using the New Tenancy-in-Common Interests in Section 1031 Real Estate Changes*, J. Fin'l Planning, May 2006.

6 A copy of the checklist is available through The Main Street Group at *steven.crawford@lpl.com*.

7 *Supra* note 4.