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Diversifying Through a 1031

One fascinating use of a 1031 exchange is the ability to diversify your equity into multiple properties. Many of the clients we work with wish to take advantage of the 1031 rule that allows you to take the proceeds from selling one property and splitting up the funds into several properties. This means that if you had $1,000,000 of cash from the sale of an apartment building (your "down-leg"), you could purchase interests in, say, three new properties in your "up-leg."

Most of our investors like to split their equity into different types of properties in different markets. For example, you could put a portion of your proceeds into an apartment building in Atlanta, GA, a portion in a triple net credit lease property in Dallas, TX and, say, a portion into a medical building in Ft. Lauderdale, FL.

This is very similar to diversifying your stock portfolio, which is encouraged by any prudent financial advisor. Just as you could split up your investment dollars into Blue Chip stocks, international stocks, small-cap stocks and different bonds, the 1031 exchange rules allow you to diversify your portfolio with different properties.

Geographical areas can make a large difference in your property as well. We've all heard the catch phrase; "Location, location, location." Different areas of the country have varying appreciation rates and cap rates. Los Angeles, for example, has an excellent history of appreciation, but currently the prices of property has gone up so much in relation to the rents, that the cap rates on apartments in much of Los Angeles has gone done markedly. This is great for apartment owners, as now they have a lot of equity in their properties, but the relative rental income is comparatively low. By selling the LA property and taking that equity and buying a property in another market where the cap rates are higher, the investor have the potential to increase their actual cash-into-pocket rental income noticeably. Again, it depends on the investor's goals, some are more focused on increasing their net worth through appreciation of their rentals and others usually more mature investors that have already built up a lot of equity over the years through appreciation, are now more focused on how much income they can receive from their rents and how to protect their equity.

Right now we're finding that in large urban areas on the coasts (like LA and NY) property values have risen quite a bit and therefore the cap rates in those markets in relation to other parts of the country are very low. For the investor that is looking to maximize their income, it makes a lot of sense to sell some of their property in these highly appreciated markets and move it to other markets where the property values are lower and the rental income is much higher in relation to the property value. This is also a way of spreading your risk. We've all seen some big drops in property values when there's a recession in an area, so selling some assets when the price is high isn't such a bad idea, but you do have to be careful when doing so.

No one has ever gone broke making a profit!

For more information on 1031 strategies, or for a personal, private consultation, give me a call at (626) 588-1520.