

What you should know about buying investment real estate today.

Are you considering buying real estate to repair and flip or to repair and hold? How the title is held is of major importance. Many homeowners and business owners, especially seniors, whose properties were seriously damaged or destroyed by the hurricane are electing not to repair or rebuild their homes and commercial properties. This has created a market for individuals who are buying these properties at discounted prices and/or repairing and rebuilding them. Many of the properties are being purchased by individuals from different professions - such as attorneys and/or doctors partnering with contractors or contractors partnering with other service industries such as plumbers, electricians, air conditioning & heating contractors, etc.

Some of the properties are being acquired as investment properties to be held, whereas others are being repaired/rebuilt and sold at hefty profits. In the purchase of these properties how should the properties be acquired? Individually or in an entity such as an LLC?

Some of these properties are being purchased by persons in their individual capacity. The bulk of the properties are being purchased by entities such as a limited liability company (LLC). The property is purchased and owned by the LLC, and the individual members have designated percentage interests. The operating agreement of the LLC is an extremely important document. It is executed between the individual members and the percentage ownership of each individual is specified. In an acquisition by several persons individually without the benefit of an entity such as the LLC, the individuals becomes co-owners of the property - So What! Who Cares?

There are major differences in these two (2) types of acquisitions of property which is illustrated by the following examples.

EXAMPLE NO.1:

Jack, a contractor, and John and Mary buy an office building for \$200,000 which pre Katrina was worth 1 million dollars. As co-owners each individual has an undivided one third (1/3) interest in the whole of the property. As co-owners each individual has an absolute right to partition or divide the property. If the property can be split into three (3) portions that is what occurs. This is known as a partition in kind. If the property can not be partitioned in kind the individuals have an absolute right to have the property sold and the net proceeds of the sale divided among the co-owners equally three (3) ways. The property can be sold by the individuals, outside of the court system; however, if they can't agree to such a sale, the property will be sold through the court at a public sale.

This mode of acquiring the properties can give rise to serious consequences which don't have easy solutions. Of course, when people buy with co-owners they expect to be able to settle any differences amicably. However, life experiences tell us that many times, people who thought they would always agree, rarely do and especially when it involves money and/or property.

Also, in this type of acquisition the individuals' personal assets are not protected in the event of a lawsuit and a judgement against the individuals. Therefore, you could lose your personal assets if you were sued on this investment property. You are not protected!

EXAMPLE NO. 2:

Tom, Dick, and Harry purchase an office building for \$200,000.00 which pre-Katrina was worth 2 million dollars. Tom, Dick and Harry do not acquire the property individually but their attorney set up an LLC with an operating agreement to take receipt of the damaged/destroyed property. The LLC owns the property. The operating agreement for the LLC spells out the percentage of ownership interest of each of Tom, Dick, and Harry. They are known as members. The operating agreement also provides what percentage interest is required by its members to sell the property, generally a majority or 2/3rd vote is required for approval. The LLC owns the property, therefore, the LLC sells the property and proceeds are split between the members based on the ownership interest of each member. Also the individual members do not have a personal liability in the event of a lawsuit where the LLC loses. The members' of the LLC personal assets are protected.

In conclusion the acquisition of post Katrina properties should not be as co owners in light of the consequences described above. It is recommended that the individuals, who plan to acquire post Katrina properties as investments to hold or resell, seek the advice of an attorney and an accountant to determine how the properties should be acquired.