DECEMBER
2024

Peak Possibilities
Your Monthly Guide to Informed Real Estate Decisions

ICOR™
Investment Community of the Rockies
COLORADO'S REAL ESTATE INVESTORS ASSOCIATION
6795 E. Tennessee Avenue
Suite 401
Denver, CO 80224
970-682-4267
icorockies.com

Table of Contents

The Reason We Invest

By Jeffery S. Watson

One of the questions I ask real estate investors when I'm doing consultations or taking them on as new clients is, "What is your goal?" I'm not looking to discuss particular types of transactions, but rather what they are looking to accomplish with their investments from an economic standpoint. Obviously, the answers vary due to each individual's specific situation, but they should have some consistent themes as to why investing is being done:

- For the purpose of generating consistent, recurring cash flow.
- For the purpose of gaining wealth through appreciation of assets which can be achieved through multiple methods, not just the passage of time and inflation.
- For both cash flow and appreciation.
- Because the investor has the opportunity to take a cash-flowing or appreciating asset and use it to benefit the local community.

The ideal investment does all of these things, and it does it in a way that improves the local community by providing safe, affordable housing; improving the street appearance and quality of residential real estate, thereby lifting the value of the properties in the area because the ugliest house in the neighborhood is no longer the ugliest house; provides consistent, predictable cash flow when managed appropriately; and over the passage of time, because of amortization, inflation, improvements, etc., the property appreciates significantly in value. These should be the goals and reasons behind why we invest in real estate.

There is, yet, a deeper, fundamental reason why we invest, and that is because deep within our souls, somewhere in the American DNA, is the unquenchable thirst (described in the Declaration of Independence as the "pursuit of happiness") to achieve something and leave for our family and the world something better than what we were given. We are looking to build upon that with which we have been blessed to bless those who come behind us.

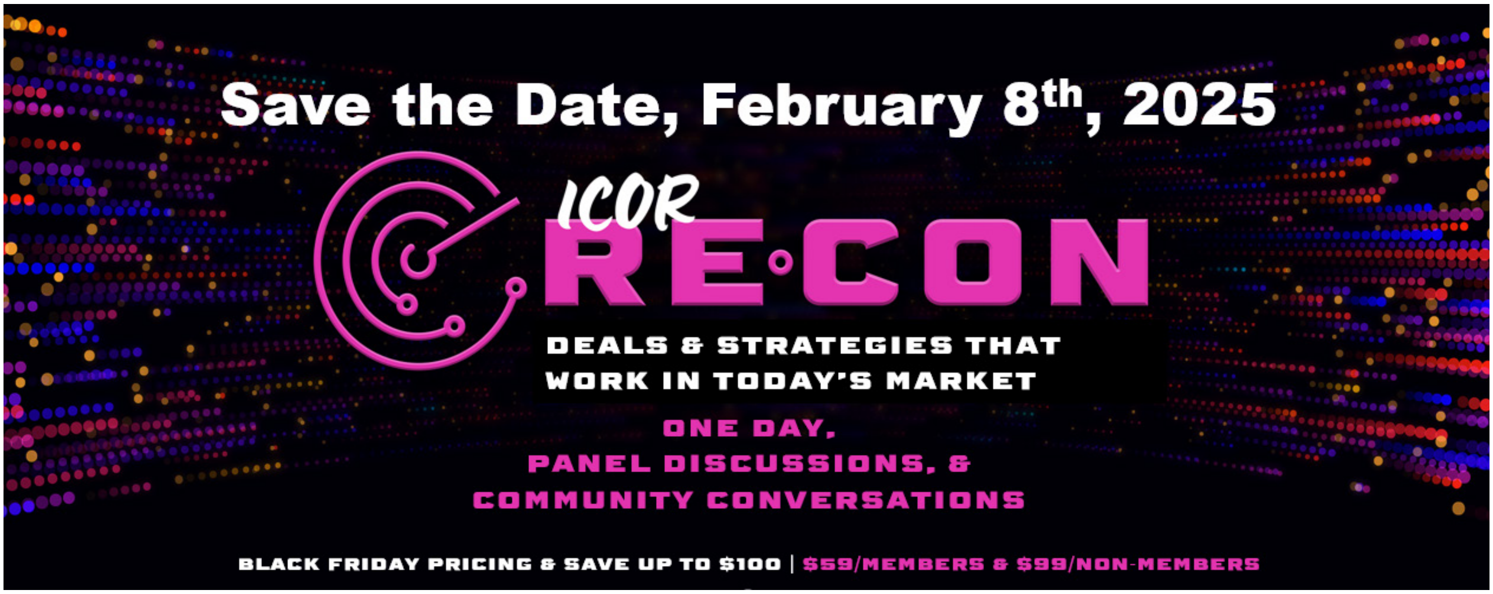
I want to remind you of something the Declaration of Independence says. It states that governments were instituted among men for the purpose of securing the rights of life, liberty, and the pursuit of happiness. When 56 men of means and substance signed off on these powerful words, it represented a different standard of living and thinking about life. At that time, America was 13 colonies to which all of the English common law rules applied. Right and privilege were a matter of birth in England, but in America, anyone could own real estate and determine their own destiny, and they could do with their land as they saw fit. That concept was foreign to those in Europe.

Almost 250 years later, some of these things have changed, but not for everyone. Many of Americans have lost some of the individual liberty they used to have over their own property, while many in Europe still don't have the same ability to own real estate as we have in the United States. Yes, those in Europe can own real estate, but it's often more difficult and complicated to achieve.

This takes us back to my initial question of why we choose to invest. Some may choose to invest in real estate simply because they believe they can make large amounts of money quickly, which is possible, but it isn't as easy as those get-rich-quick, overnight-success gurus make it seem.

You also have to understand that those activities are subject to a greater level of taxation. Taking advantage of certain rewards in the Tax Code influences why and how we invest, but investing solely for the Tax Code is allowing the tail to wag the dog. Being tax aware is important to be a good investor, but doing everything the way you do simply because of

Continued on page 3


Save the Date, February 8th, 2025
ICOR
RE·CON
DEALS & STRATEGIES THAT
WORK IN TODAY'S MARKET
ONE DAY,
PANEL DISCUSSIONS, &
COMMUNITY CONVERSATIONS
BLACK FRIDAY PRICING & SAVE UP TO $100 | $59/MEMBERS & $99/NON-MEMBERS


ISC
rent
perfect
Create your
perfect
landlord
experience
with...
ICOR MEMBER OFFER!
Enjoy a lifetime membership for just 95¢
ICOR discount sign up link: bit.ly/3fLtoW2
RentPerfect.com | 877-922-2547
• Online application process
• Credit, criminal and eviction screening
• Custom lease creator with digital signatures
• Online move-in and move-out inspection process
• Online Rent Pay with payment reminders
AN EASY TO USE, ONLINE PLATFORM FOR LANDLORDS AND PROPERTY MANAGERS

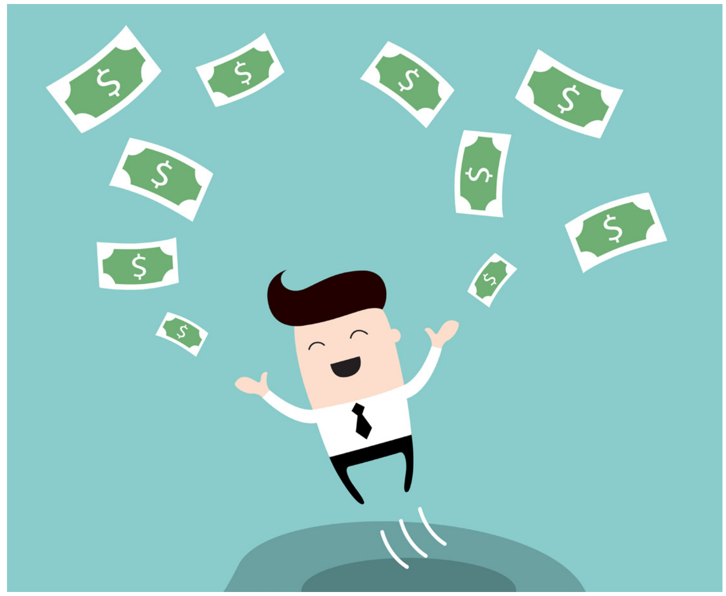
The Reason We Invest

Continued from page 1

the taxes is not necessarily prudent. It has to make tax sense, cash-flow sense, and business sense.

I encourage you to take a few minutes to write down the reasons I've laid out here as to why we invest. This will help you process them. Then evaluate each one on a scale of 1 to 10 as to how much it matters to you. How important is cash flow? How important is having current large chunks of money? How important is gaining long-term wealth through appreciation? How important is it to be tax savvy? And how important is it to benefit your community?

Once you have assigned a number to each, list them in their order of priority for you, and insert your own reasons for investing into the list. You will now have a checklist to apply to the various deals that come before you to help you determine if a deal is consistent with your overall investing strategy and theme.



INSURANCE EXPERT
EVE HOELZEL / EVE.DSTANSFIELD@FARMERSAGENCY.COM / EVEINSURANCECOLORADO.COM

Increasing Costs for Property Insurance

As a landlord or property manager, renting a unit to a new tenant involves numerous responsibilities. From ensuring the property is in excellent condition through maintenance and repairs to screening tenants and finalizing lease agreements, there's much to manage. One crucial, yet often overlooked, component of the lease agreement is requiring tenants to carry renters' insurance.

While renters' insurance may seem like an unnecessary expense to some tenants, it is an affordable and mutually beneficial policy that provides essential protection for both tenants and landlords. Here's why requiring renters' insurance should be a standard part of your rental process.

Benefits of Renters Insurance for Tenants

1. Protection of Personal Belongings

Many tenants mistakenly believe their landlord's insurance will cover their personal property in the event of a disaster. However, a landlord's policy typically only covers the building's structure, not the tenant's belongings. Renters insurance bridges this gap by covering personal property against perils such as:

- Fire and smoke
- Theft and vandalism
- Wind and hail
- Water damage (excluding flood damage, which requires separate coverage)

This protection extends to items such as furniture, electronics, clothing, sports equipment, and more. Tenants can replace or repair their belongings without incurring substantial out-of-pocket costs.

2. Liability Protection

Renters insurance includes personal liability coverage, which protects tenants if they are found legally responsible for injuries to others or damage to the landlord's property.

- **Example 1:** A guest slips and falls inside the rental unit and sues the tenant for medical expenses. The policy can cover the associated legal and medical costs.
- **Example 2:** A tenant accidentally causes water damage to the rental property (e.g., an overflowing bathtub). Liability coverage can help pay for repairs to both the tenant's unit and neighboring units.

3. Pet-Related Liability

Renters insurance often includes coverage for pet-related incidents, such as dog bites. This protection applies on and off the rental property. As an insurance agent, I recommend tenants carry at least $100,000 in liability coverage if they have pets and confirm that their policy covers their specific breed, as some insurers may exclude certain breeds.

4. Additional Living Expenses (ALE)

In the event of a covered loss that makes the rental unit uninhabitable, renters insurance provides coverage for additional living expenses. This coverage ensures tenants aren't left without shelter or financial support during such emergencies.

Benefits of Renters Insurance for Landlords

1. Property Damage Reimbursement

Landlords benefit indirectly from renter's insurance when tenant negligence causes damage to the property. The tenant's liability coverage can reimburse repair costs that might otherwise lead to disputes.

- Example: A tenant leaves a space heater unattended, causing a fire that damages the property. The liability portion of their renter's insurance can help cover the landlord's losses up to the policy's limits.

2. Reduced Risk of Legal Disputes

Requiring renters insurance minimizes disputes over liability and financial responsibility for damages. This policy ensures that tenants have the resources to handle situations where they are at fault, reducing the likelihood of costly legal conflicts for landlords.

3. Requesting to Be Added as an Additional Insured

Landlords can request to be added as an additional insured or as a certificate holder on the tenant's policy. This allows the landlord to receive notifications of policy cancellations or non-renewals, ensuring continuous coverage throughout the lease term.

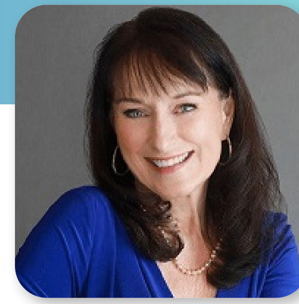
4. Encourages Responsible Tenants

Tenants who are willing to purchase renter's insurance often demonstrate responsibility and a proactive mindset. This simple requirement can help landlords attract tenants who value preparedness and accountability.

Conclusion

Requiring renter's insurance is a simple yet impactful decision that benefits both tenants and landlords. For tenants, it offers critical protection for personal property, liability, and additional living expenses. For landlords, it reduces financial risks, legal disputes, and property damage caused by tenant negligence.As an insurance agent, I strongly recommend landlords make renters insurance a lease requirement. It's an inexpensive policy that can save both parties significant financial and emotional stress in the event of an incident. Be sure to consult with an attorney to ensure your lease agreements align with local laws and regulations regarding renter's insurance requirements.

By prioritizing renter's insurance, you create a safer and more secure rental experience for everyone involved.



Your November and December Blueprint: How to Prep for a Breakthrough 2025

Before the calendar changes to a new year, we have a great opportunity as investors to reflect on where we've been, and to use that insight to prepare for the year ahead. These last two months are not only a great time to tie up loose ends, but a chance to build a foundation for a thriving 2025. Before diving into numbers, strategies and other practical tasks, consider that the most impactful preparation begins within.

Step 1: Conduct a Mindset Audit

Your mindset shapes every investment decision you make. Take time to evaluate your mental and emotional readiness for the year ahead.

- **Assess Limiting Beliefs:** Ask yourself, "What beliefs are holding me back?" Common doubts like "I can't find deals in this market" or "Raising capital is too hard" can sabotage your progress before you even begin. Replace these with empowering beliefs such as, "Opportunities exist for those who adapt," and, "Raising capital is about creating value for others."
- **Clarify Your Why:** Why are you investing in real estate? Reconnecting with your purpose, whether it's financial freedom, legacy building, or personal growth, will anchor you during tough times.
- **Visualize Success:** Envision what a successful 2025 looks like for you. Picture your ideal deals, partnerships, and personal milestones. This mental rehearsal creates the clarity and confidence needed to take bold action.

Step 2: Strengthen Your Foundation

Once your mindset is primed, focus on laying the groundwork for success.

- **Review and Refine Goals:** Evaluate the goals you set at the start of the year. Are they still relevant? Break down big objectives into actionable steps for Q1 2025. For example, instead of "Buy more properties," aim for "Identify and analyze 10 potential deals per month starting in January."
- **Build Your Knowledge:** Take advantage of the quieter months to sharpen your skills. Attend ICOR trainings such as ICore Skills, utilize the ICOR Digital Learning Center and attend ICOR events. Knowledge compounds over time and prepares you to act with confidence when opportunities arise.
- **Evaluate Your Finances:** Know your current financial standing. Understand your liquidity, credit access, and potential funding partners. A clear financial picture ensures you can move swiftly when deals emerge.

Step 3: Align Your Team

If you're part of a team—or rely on third-party professionals like agents, contractors, or property managers—it's vital to ensure everyone is aligned and committed to shared goals.

- **Communicate the Vision:** Share your 2025 vision with your team. Explain not only the goals but also the "why" behind them. When your team understands how their efforts contribute to the bigger picture, they're more engaged and motivated.
- **Identify Gaps:** Are there skill or resource shortages in your team? Use this time to recruit new members, invest in training, or restructure roles to optimize performance.
- **Plan Collaboration:** Establish regular check-ins for the upcoming year to track progress and keep everyone accountable. Tools like shared calendars, project management software, or recurring meetings can streamline communication and prevent bottlenecks.

Step 4: Implement a System of Accountability

Preparation means little without execution. A robust system of accountability is the glue that turns plans into results.

- **Create Personal Accountability:** Set deadlines for yourself and share them with a trusted mentor, coach, or accountability partner. For instance, commit to completing a market analysis by December 15 or attending three networking events by the year's end.
- **Foster Team Accountability:** Ensure each team member has clear, measurable responsibilities and timelines. Celebrate milestones together and address challenges openly to maintain momentum.
- **Measure Progress:** Regularly track your progress against your goals. Use tools like scorecards, dashboards, or even simple checklists to keep everyone on track.

Why This Matters

The most successful real estate investors are not those who simply work harder but those who work smarter—with clarity, alignment, and self awareness. By preparing now, you create the momentum needed to close strong in 2024 and enter 2025 with confidence.

Take these final months seriously. Reassess your mindset, strengthen your foundation, align your team, and put an accountability system in place. With these pieces in order, you're not just preparing for a productive year—you're setting the stage for transformative growth.

Join an ICOR/INC Mastermind Team

Nothing will get you farther, faster than to regularly meet with your own consistent community who has your back and is committed to your success. Investment Community of the Rockies (ICOR) has teamed up with Investors Network Community (INC) to provide just that. The ICOR/INC Mastermind is a professionally facilitated 5-7 member group that meets regularly to brainstorm solutions to your challenges, share resources, create solid plans, and provide the most important ingredient for you to stay on track — accountability.

To learn more and to schedule a call where you can ask questions and find out if a Mastermind is right for you, go to https://www.icorockies.com/mastermind-groups.

INVESTMENT STRATEGIST
BYRON ELLIOTT, ESQ. / BYRON@3PILLARSLAW.COM / 3PILLARSLAW.COM

Sponsor Incentives in Real Estate Private Equity Offerings: "Promote" and "Carried Interest"

In real estate private equity offerings, "promote" and "carried interest" are terms often used interchangeably, but they describe slightly different aspects of the compensation structure for general partners (GPs) or sponsors. Here's a breakdown:

1. Promote

- **Definition:** Promote refers to the share of profits allocated to the general partner (GP) as a performance-based incentive for successfully managing and delivering returns on the real estate investment. It represents the GP's "bonus" for exceeding a certain return threshold, such as the preferred return to limited partners (LPs).
- **Mechanics:**

- Limited partners typically receive a preferred return (e.g., 6-10%) on their invested capital before any profits are shared with the general partner.
- After the preferred return is met, the remaining profits are distributed according to the agreed-upon waterfall structure, where the GP receives a disproportionate share of the profits (the promote).
- Example: If the LPs invest 90% of the capital and the GPs invest 10%, the promote might allow the GP to receive 20-30% of the excess profits (even though they only contributed 10% of the capital).

2. Carried Interest

- **Definition:** Carried interest is the actual portion of profits that the general partner earns, based on the promote structure. It is the GP's "share of the upside" and is typically performance-based.
- **Key Features:** Carried interest is not a guaranteed payment; it depends entirely on the success of the investment.

- It is calculated after LPs receive their preferred return and sometimes after the return of their capital contributions.
- The amount and timing of carried interest depend on the agreed-upon profit distribution waterfall.

Relationship Between Promote and Carried Interest

- Promote is the concept or mechanism that allows the GP to earn carried interest.
- Carried interest is the specific amount the GP receives under the promote structure.

Example Scenario

1. Capital Structure:

- LPs contribute $9 million (90%).
- GPs contribute $1 million (10%).

2. Preferred Return:

LPs are entitled to an 8% annual preferred return on their $9 million.

3. Profit Distribution:

After the LPs receive their preferred return, profits are split:

- 70% to LPs.
- 30% to the GP (this 30% is the promote).

4. Outcome:

If the total profits are $5 million:

- LPs receive their preferred return (8% of $9M = $720,000).
- Remaining profits of $4.28 million are split 70/30:
  - LPs receive $2.996 million.
  - GPs receive $1.284 million (this is the GP's carried interest).

Why It's Important

- **Aligns Interests:** Promote and carried interest align the incentives of the GP with the LPs by rewarding performance.
- **Risk-Reward Balance:** GPs take on significant risk in structuring and managing the deal, so the promote serves as compensation for taking on that entrepreneurial risk.

If you'd like to explore specific structures or scenarios in detail, feel free to ask!

TAMMY HAYUTIN / TAMMY@ELEVATEDTITLECO.COM/ ELEVATEDTITLECO.COM

The Holiday Season: A Hidden Gem for Real Estate Investors

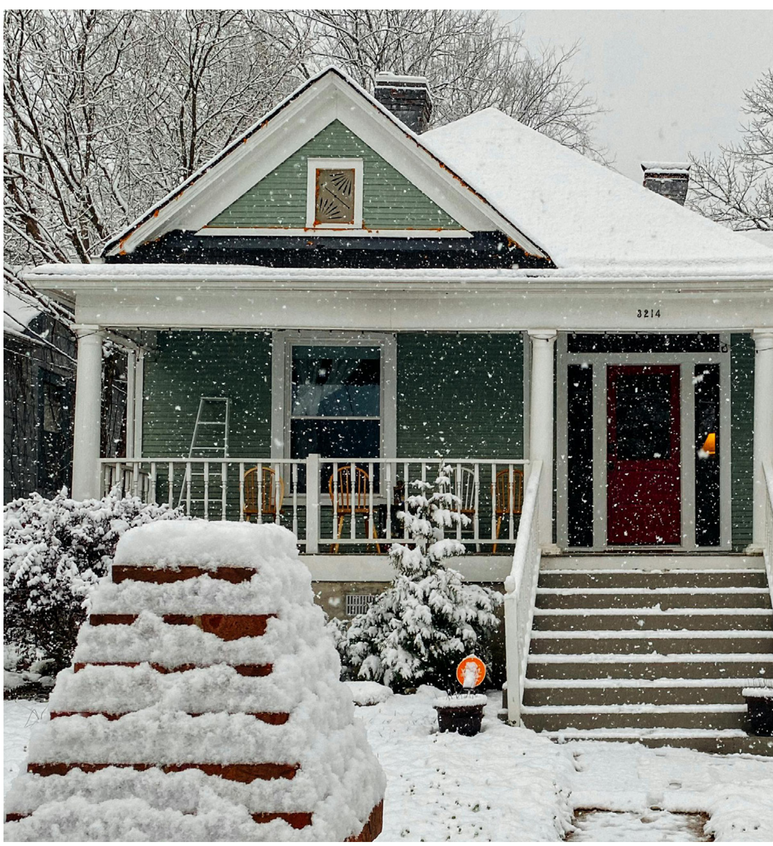
As the holidays approach and the year winds down, the real estate market enters its traditional hibernation phase. November, December, and early January are often viewed as slow months, with many prospective buyers stepping back to focus on festivities and personal obligations. For real estate investors, however, this quieter period can be a treasure trove of opportunity—if you know how to navigate it strategically.

During this time, motivated sellers often become more prominent. Whether they're looking to relocate, finalize a sale for tax purposes, or simply move on before the new year, sellers tend to be more willing to negotiate. Homes that have lingered on the market for months suddenly become ripe for offers, and creative deal-making can yield tremendous value. Investors who remain active and engaged while others take a break can uncover deals that may not be available during the busier spring and summer months.

One of the biggest advantages of investing during the holidays is the reduced competition. Many buyers put their searches on hold, leaving less demand in the market. This creates a dynamic where offers are more likely to stand out, and negotiations are less likely to turn into bidding wars.

Success during this season requires preparation and persistence. With fewer homes being listed, investors should explore alternative channels, such as off-market properties or expired listings. Building relationships with wholesalers, real estate agents, and other investors can also be invaluable for uncovering hidden opportunities. Additionally, having financing ready and the flexibility to move quickly can make all the difference when a deal emerges.

At Elevated Title, we understand the unique complexities of the real estate calendar. The holiday season might feel quiet, but for investors, it's a time of immense potential. Stay active, stay strategic, and watch your portfolio grow.



JENNIFER REINHARDT / JENNIFER@REALATLAS.COM / REALATLAS.COM

The Importance of Regular Portfolio Reviews for Real Estate Investors

In real estate, staying ahead of market trends and financial shifts is key to long-term success. Regular portfolio reviews are not just a best practice—they are an Atlas for optimizing performance, mitigating risks, and capitalizing on opportunities. Here's why conducting a comprehensive portfolio review is more important than ever, especially considering recent election results and shifting economic conditions.

I am a seasoned real estate strategist and have been doing 2-3 portfolio evaluations a week with my team. We have uncovered a lot of trends. Investors want to one day replace the income from their day job to have both time and money. The portfolio evaluation is the vehicle to take you from where you are today in investing to where you need to be to reach your goals.

Here are some things I consider when doing a portfolio review:

1. Election Results Impact Strategy

Elections often bring policy changes that directly affect the real estate market, including taxation, zoning laws, interest rates, inflation, and housing initiatives. A portfolio review allows you to evaluate how these changes might influence your investments and adjust your strategy accordingly. For example, could shifts in inflation or property regulations make certain areas attractive? Understanding these implications is vital to making informed decisions. We are also monitoring how new immigration laws could influence vacancy and cap ex costs.

2. How Is Your Property Performing?

A key part of any portfolio review is assessing the performance of each property you own. Are your rental incomes and cost ratios aligned with market rental rates? Are maintenance costs and insurance costs eating into your profits? Reviewing your properties regularly ensures you're not leaving money on the table and helps identify underperforming assets that might need adjustments or strategic divestments.

3. Could Your Money Work Harder Elsewhere?

Real estate investments tie up significant capital. During a review, ask yourself: **If I sold this property, how could I reinvest the proceeds? ** Whether it's diversifying into other markets, upgrading to higher-yield properties, or exploring different asset classes, analyzing alternative investment opportunities could reveal pathways to maximize your portfolio's overall performance.

4. How Are Costs Looking This Year?

Expenses like property taxes, insurance premiums, maintenance, property management, and utility rates can fluctuate year to year. A portfolio review is the perfect time to identify trends in your operating costs. Are expenses rising disproportionately? Are there opportunities to reduce overhead through energy-efficient upgrades or renegotiating service contracts? Keeping cap ex costs under control is just as critical as maximizing revenue.

5. What Is the Vacancy Rate?

Vacancy rates can significantly impact your cash flow and profitability. Use your review to analyze tenant turnover, time-on-market for rentals, and the competitiveness of your rental pricing. If vacancies are trending upward, it might signal a need for strategic adjustments, such as enhancing property amenities, refining marketing strategies, or adjusting rental rates.

6. How Is Your Stress Level?

Real estate investing is not just about numbers—it's about the investor's quality of life. High stress levels can indicate inefficiencies or challenges in your portfolio management. Are you dealing with frequent tenant issues, unexpected maintenance problems, or properties that require constant attention? You do not want your property to be able to be a popular reality show. We want slow and steady. A portfolio review can help identify these stressors and guide decisions to outsource tasks, sell problematic properties, or streamline operations. People invest in real estate for peace of mind and stability, not to have constant problems. If you can't sleep because your investment is giving you nightmares, let's analyze it so the situation can be resolved. A plan is important, and so is your mental health. You are worth it.

7. Why Now Is the Perfect Time

As we approach the end of Q4 or the start of Q1, it's an ideal time to conduct a portfolio review. This period provides the opportunity to assess your performance for the year and plan strategically for the next. By addressing potential weaknesses, optimizing cash flow, and aligning your investments with emerging market trends, you'll set yourself up for success in the coming year. The upcoming winter is a great time for rest and reflection, and a good time to plan to begin again in the new year.

Final Thoughts

A portfolio review is more than just an analysis of numbers—it's a comprehensive check-in on the health and direction of your real estate investments. It allows you to adapt to external changes, evaluate internal performance, and make adjustments that ensure you remain competitive and successful in an ever-changing market.

Take the time to schedule your review. I can do them at no cost, please email me at jennifer@realatlas.com or text me at 303-514-8491.

JOHN BOWENS / J.BOWENS@TRUSTETC.COM / TRUSTETC.COM

$96K Profit from One Investment: The Power of Smart Research in Real Estate

Real estate investment strategies can vary widely, and some approaches can lead to unexpected and noteworthy outcomes. One such example is Brad, a real estate investor from Indianapolis, who turned a modest $823 investment into over $97,000 in just a few years—all tax-free in his Roth IRA.

The Beginning: A Small Investment with Big Potential

Brad's journey began with thorough research and strategic planning. He was particularly interested in investing in tax liens, recognizing that they could be a powerful way to grow his Roth IRA with a relatively small initial outlay. After conducting due diligence on various markets around Indianapolis, he identified a promising opportunity: a half-acre parcel located near a major hospital.

The area was clearly in the path of progress, with new office complexes being developed to support the hospital system. Brad saw that the parcel, adjacent to a medical office building, had significant potential. He hypothesized that the land would eventually be needed for additional parking by the medical office developer—a bet that would soon pay off handsomely.

The Purchase: Securing the Tax Lien

Brad attended a tax lien auction, where he successfully bid $823 on the tax lien for the parcel. This amount was transferred directly from his Roth IRA to the county to secure the lien. At this point, the tax lien certificate was held by Equity Trust Company as custodian for Brad's Roth IRA.
Securing the tax lien was only the first step. Over the next two to three years, Brad had to go through a legal process known as "quieting the title," which would allow his Roth IRA to gain full ownership of the property. This process incurred additional costs, including legal fees, bringing the total investment to around $3,000.

The Payoff: Turning a Lien Into a Lucrative Sale

Once the title was secured, Brad's Roth IRA officially owned the half-acre parcel. Understanding the value of his asset, Brad engaged in multiple negotiations with the medical office developer, who initially offered a lower price for the land. However, Brad's patience and confidence in his investment paid off when the developer, needing the land for additional parking, offered $97,500 for the property.

The entire $97,500 was deposited back into Brad's Roth IRA, completely tax-free. After deducting the $3,000 all-in investment, Brad's net profit was over $94,000. This was not only a significant return on investment but also a powerful demonstration of how smart research and strategic planning can turn a small amount of capital into a substantial profit.
Lessons learned: The power of patience and research

Brad's story illustrates several key lessons for real estate investors, especially those using self-directed IRAs:

- **Thorough research is crucial:** Brad's success was largely due to his diligent research. He identified a property in a high-growth area and correctly predicted its future value to developers.
- **Patience pays off:** Rather than accepting the first offer, Brad held out for a better deal. His patience allowed him to maximize his profit.
- **Leverage the power of tax-advantaged accounts:** By using a Roth IRA, Brad was able to grow his investment tax-free, significantly increasing his net profit.
- **Small investments can lead to big returns:** Brad's initial investment was modest, but with the right strategy, it grew exponentially. This is a reminder that you don't need a large amount of capital to make a significant impact on your financial future.

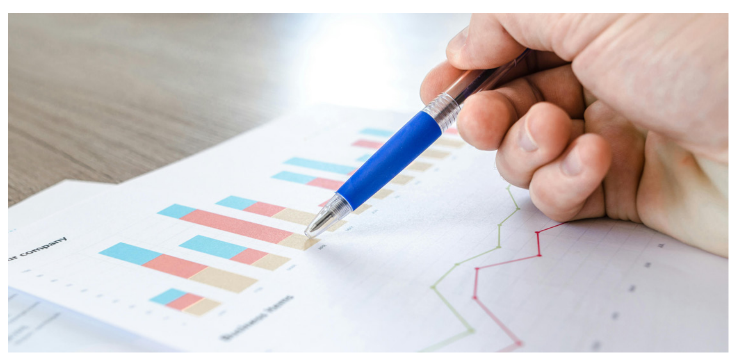
Expanding Your Horizons: Beyond Tax Liens

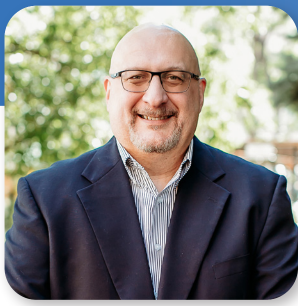
While Brad's story focuses on tax lien investing, it's worth noting that there are many ways to grow a Roth IRA. From private money lending to outright property purchases, the options are vast. Brad's experience is just one example of how a small amount of money, when wisely invested, can lead to substantial wealth accumulation.

Special Self-Directed IRA Offer for National REIA Members Only

In addition, Equity Trust Company is a national sponsor of the National Real Estate Investor Association (NREIA) and is offering NREIA members and its affiliated chapter members a special introductory self-directed account offer. NREIA members can open an Equity Trust account for a discounted rate of $99 and receive bonuses worth $720 or more:

- National REIA GOLD Level membership (includes priority processing and an experienced client service team dedicated to members) for one year
- Digital download of #1 ranked book on Amazon - Self-Directed IRAs: Building Retirement Wealth Through Alternative Investing
- More exclusive wealth-building education





1031 EXCHANGE EXPERT
DAVID GORENBERG / DAVIDG@ACCRUIT.COM / ACCRUIT.COM

Using a 1031 Exchange for Transferrable Development Rights

What are Transferrable Development Rights?

"Development Rights" are defined as the unused rights to develop a property within the limits set by state or local laws. With states and municipalities increasingly imposing restrictions on new construction, the value of development rights has skyrocketed. Since 1916, more than 140 state and local governments have introduced regulations allowing unused development rights to be transferred to different parcels. Property owners can consult with a local land use professional to determine whether they can benefit from such a program. These rights can then be used to construct improvements, such as buildings with more floor space or height, or to build at higher density than would otherwise be allowed. Consequently, an owner with unused development rights can achieve significant financial gain by selling these Transferable Development Rights (TDRs) to another parcel owner looking to further develop their property.

The use of TDRs is a planning and preservation tool that is often used to protect agricultural, historic, or environmental resources while accommodating the needs of development. TDRs are the creation of state and local laws around the country that permit the owners of "preservation area" land to carve out the development rights of their property and sell them for use in a "receiving area", usually nearby. Generally, developers purchase "development credits" and apply them to areas designated for growth at higher densities than would otherwise have been permitted. Once the property owner has sold their development rights, their land will be permanently restricted from further development.

The Internal Revenue Service addressed the issue of Development Rights in 2008 with the release of PLR 200805012. Simply stated, the question asked in that private letter ruling was whether Development Rights are like-kind for the purposes of IRC Section 1031 to a fee interest in Replacement Property . The IRS noted that state law defined an "interest in real property" to include:

"title in fee, a leasehold interest, a beneficial interest, an encumbrance, development rights, air space and air rights, or any other interest with the right to use or occupancy of real property or the right to receive rents, profits, or other income derived from real property."

The IRS also noted the Treas. Reg. §1.1031(a)-1(b) provides that "like-kind" refers to the nature or character of the property and not to its grade or quality. Thus, real property in one asset class may be exchanged for real property in another asset class under §1031. The IRS concluded that the Development Rights to be acquired in this 1031 Exchange were like-kind to the fee interest being relinquished in the exchange.

The IRS addressed a similar issue a year later with the release of PLR 200901020. The specific question to be resolved in this PLR was whether residential density development rights are like-kind to other interests in real estate. As with the earlier PLR, the IRS pointed out that Development Rights constitute interests in real estate under state law. The Exchanger was to dispose of development rights within a 1031 Exchange and then acquire a fee interest in real estate, an additional leasehold interest in real estate with 30 years or more remaining, and certain land use rights. After a detailed historical analysis of Development Rights and easements in 1031 Exchanges, the IRS concluded that the Development Rights to be transferred by the Exchanger are of like-kind to the fee interest in real estate, a leasehold interest in real estate with 30 years or more remaining, and the land use rights.

In December 2020, the IRS issued the long anticipated Final Regulations for real property transactions under Section 1031. The Regulations provided many examples of what constitutes real property as well as a framework for analyzing items that were not listed. Relevant to this discussion, Treas. Reg. §1.1031(a)-3(a)(5)(i) specifically identified "land development rights" as real property for the purposes of 1031 Exchanges. Additionally, property that is real property under state or local law will also be treated as real property for purposes of Section 1031 under Treas. Reg. §1.1031(a)-3(a)(6).

Based on this guidance from the IRS, Exchangers may sell or purchase Transferable Development Rights within a properly structured 1031 Exchange.

To further understand Transferable Development Rights and the utilization of 1031 Exchanges involving TDRs, let's walk through a hypothetical scenario involving two property owners and how they both can utilize TDRs.

Utilization of 1031 Exchange with Transferrable Development Rights

What does the owner of a three-story brownstone in New York have in common with the owner of a 100-acre farm in New Jersey? They each own something that they're unaware of: **Transferable Development Rights.**

Our New York City brownstone is owned by a widow who lives comfortably, though with little money left over each month. She has considered selling her home and moving but is reluctant to do so given the sentimental value of the home and high interest rates. She recently consulted with one of her trusted advisors who suggested that she consider TDRs. Her home is approximately 3,000 square feet on a lot that would allow for a home of up to 6,000 square feet. Because her home is in a 'special purpose district', she could sell those unused 3,000 square feet to a developer of a 'designated receiving zone', and still retain full ownership of her home and land. While the values of TDRs vary widely across the state, for purposes of this illustration we will assume an incredibly modest $200 per square foot (NYC TDRs ranged from $51 to $223 per square foot in 2013.) Thus, multiplying $200 by 3,000 square feet, our homeowner will receive $600,000 for her TDRs.

The owner of Cherry Hill Farm is a third-generation farmer, raising a variety of crops on the last remaining active farm in the town that was once three-quarters farmland. Development has steadily encroached upon the family farm. Residential subdivisions border the farm on three sides and a county road runs through the middle. Developers have long targeted this property for the potential to build 75 or more homes. At the same time, the family farm, and its farmers market business face increasing pressure from supermarkets and warehouse clubs that sell corn, tomatoes, strawberries, and other competing products for lower prices. As with New York, prices of TDRs in New Jersey vary widely, so we will assume $10,000 per housing credit. (Nearby TDRs ranged from $10,000 to $50,000+ in recent years.) Thus, multiplying $10,000 by 75 housing units, our farming family will receive $750,000 for their TDRs. As in New York, the farming family will retain full ownership of the farm, with a deed restriction prohibiting future non-agricultural development. For both transactions, the result is exposure to significant capital gains on the value of the TDRs. The top tax bracket in New York is 10.9%, and in New Jersey it is 10.75%.

The Benefits to Our Property Owners

Our New York widow generated approximately $600,000 from the sale of TDRs associated with her brownstone. Absent a 1031 Exchange, she faced a potential tax bill of over $208,000 ($65,400 to the state, $120,000 in federal capital gains, and $22,800 in NIIT). Our New Jersey farmer garnered $750,000 from the sale of TDRs associated with their farm. Without the benefit of a Internal Revenue Code Section 1031 states that "no gain or loss shall be recognized on the exchange of property held for productive use in a trade or business or for investment if such property is exchanged solely for property of like kind which is to be held for productive use in a trade or business or for investment." 1031 Exchange , they faced a potential tax bill of nearly $260,000 ($80,625 to the state, $150,000 in federal capital gains, and $28,500 in NIIT). However, because we now know that they can utilize the benefits of a 1031 Exchange, they can defer associated taxes by deploying those funds toward the purchase of qualifying real estate, including management-free options like Delaware Statutory Trusts.

The Benefits of TDRs to Developers

Developers who acquire TDRs from other properties benefit by being able to add height or density to their projects. In the case of our New York City brownstone, for example, the developer may have been able to build a 9,000 square foot duplex instead of a 6,000 square foot single family home. This effectively allows him 50% more density on the lot than he may have had without the TDRs. For the developer who acquired the TDRs from our farm family, perhaps he can now build 150 homes in his new subdivision rather than 75, because he bought that additional density from the farm family.

The Benefits to the Community at Large

The TDR system is considered to be a mechanism for controlling urban sprawl by concentrating or encouraging development in a specific direction. The use of TDRs is generally viewed more favorably than imposing harsh zoning restrictions on one area, which could cause landowners in that area to claim that there was an unconstitutional "taking" of their property rights. Instead, TDRs offer those property owners a financial incentive to participate in the conservation of their properties for environment, agricultural, or heritage purposes.

As always, Exchangers are reminded to consult with their tax and legal advisors, as state and local laws differ around the country. Further, under the terms of every Private Letter Ruling, Exchangers are advised that each PLR applies only to that Exchanger on that set of facts. Thus, this blog is not a substitute for the advice of competent tax and legal advisors.

David Gorenberg is a third-generation real estate investor, an attorney and Certified Exchange Specialist®, and serves as Director of Education for Accruit. Members of National REIA can take advantage of special pricing from Accruit. Learn more by contacting David directly at 215.770.6354, or by visiting www.accruit.com.

ICOR's Business Member Directory

Service	Contact/Business	Phone	Email
Cleaning/Fencing	Susanna Tabares | Heart & Home Solutions	720.477.8268	heartandhomesolutionsllc@gmail.com
Contractors	Andrew Laverence | Contractors of Colorado	720.422.4600	andrew@businessfoundry.com
Contractor/GC	Alex Lovera |ManyBuild	720.354.2630	alex@manybuildsolutions.com
Contractor/Electric	James Hornof | B&W Electric, LLC	303.505.3543	j.hornof@bandwelectric.com
Contractor/Electric	Applied Electric	303.420.1518	gmarquardt@appliedelectric.com
Energy Investing	Derreck Long | Eckard Enterprises	800.527.8895	dlong@eckardenterprises.com
Estate Planning	Pam Maass | Law Mother	702.706.0036	pam@lawmother.com
Financial Planning	Sarah Shelllman | Quest IRA	800.320.5950	Sarah.Shellam@questtrust.com
Financial Planning	Jason Powers | Unbridled Wealth	303.957.9175	jpowers@unbridledwealth.com
Foundation Repair	Drew Rogers | Colorado Foundation Repair	720.266.9331	diggingcolorado@gmail.com
Insurance	Eve Hoelzel | Farmers Insurance	970.970.8019	eve.dstansfield@farmersagency.com
Lender	David Nielson | COPA Capital	480.244.4698	david@copacapital.com
Lender	Alex Nigh | DIYA Finance	720.850.8459	anigh@diyafinance.com
Lender	Chuck Townsend | Forrest Financial	303.877.3221	chuck@forrestfinancial.com
Lender	Greg Osborne | Bridge Capital Resources, LLC	303.475.5873	gregosborne@bridgelending.com
Lender	Justin Cooper | Pine Financial	303.916.5366	justin@pinefinancialgroup.com
Lender	Tyler Ideker | Indicate Capital	303.567.6333	tyler@costfund.com
Lender	Drew Jeffers | Phoenix Loans	970.420.6472	drew@phxloans.com
Lender	Vanesa Montoya|Boomerang Capital	480.410.0945	vanessa@boomerangcapital.com
Photography	Kyle McGowen | Visual Points Media	720.454.2211	v.visuals@gmail.com
Property Mgmt	Cory Rassmusen | Atlas Real Estate	303.242.8980	info@realatlas.com
Property Mgmt	Terry | Inefrity Realty Management	303.332.4583	terri@integrityrealtymanagement.com
Property Mgmt	James Brown | Co Living	720.807.8098	james@coloradocoliving.com
Rental Property	Brittany Katalenas | B-Konnected	720.551.7039	getkonnected@b-konnected.org
Roofing & Restoration	Jacob Lightfoot | APEX Roofing & Restoration	303.691.5035	jlightbody@apexdenverroofing.com
Structural	Byron | Colorado Structural Repair	720.266.9331	diggingcolorado@gmail.com
Syndication	Byron Elliott | 3 Pillars Law	303.284.3850	byron@3pillarslaw.com
Title	Tonya Stevens | Elevated Title	720.734.2767	tonya@elevatedtitleco.com
Title	Bill McAfee | Empire Title, Colorado Springs	719.499.0968	bill@etcos.com