

This is the first piece in a series of articles covering planning considerations relating to ownership of real property, starting with individual ownership and moving outward to discuss agents, trusts, the role of legal entities in ownership and income and estate tax planning matters relevant to investors holding significant real property investments. In presenting these articles, we hope to provide a basic education on issues faced by real estate investors and to provide a referral source to attorney resources in your state to the extent that you wish to explore estate and tax planning opportunities in more detail. As always, Asset Preservation, Inc. stands ready to facilitate your tax deferred exchange when you are ready to sell an investment property.

OWNERSHIP AND OWNER OBLIGATIONS

In an increasingly complicated world, most individual investors continue to hold title to investment property in their individual names. It has been said that ownership of real property consists of a bundle of rights and a bundle of obligations. Anyone who owns a residence knows the basic truth of this statement when, from the comfort of their living room, they sign the property tax or casualty insurance check. Apart from paying for the property, the owner's obligations include: maintaining the property and ensuring that the property is not a nuisance, paying property taxes and assessments, regulating access to the property, hiring contractors, property managers and leasing brokers, preparing and executing leases, collecting rents, managing tenant deposits, paying for tenant improvements, ensuring that tenants maintain adequate liability and casualty insurance, servicing mortgage debt, participation in the activities of local government and sometimes prosecuting or defending legal actions arising out of the sale, transfer, use or occupancy of the property.

Of course, few property owners handle all of these tasks personally. An owner will usually employ a variety of professionals to manage the day to day operations. Even though many tasks may be delegated, a significant failure on the part of the owner to continue to meet these obligations or to adequately respond to potential liability relating to the property could mean the loss of the property or the loss of other property owned by the owner. Accordingly, an owner must be in a position to respond to changing circumstances if only to make the high level management decisions necessary to respond to changed circumstances. Given the stakes, a prudent investor will maintain a level of involvement with the property manager and tenants necessary to ensure that operations continue as planned. Even so, it is fairly easy to imagine events that might interrupt the high level of supervision that an owner must provide.

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So how could things go wrong? They might go wrong if the owner leaves the country and is unable to timely respond to an unexpected event such as the departure of a major tenant, a lawsuit or a property manager's theft. The same result follows from the owner's unexpected death or the onset of mental incompetence resulting from age or serious illness. Is there any way to protect the owner and the asset under these circumstances? Of course, there are a variety of ways to ensure that management continues uninterrupted during the owner's absence, death or disability.

A POWER OF ATTORNEY

The simplest and most common method used to provide for continuity of management authority is to authorize a trusted and competent person to act in the owner's place under a power of attorney. All states have laws authorizing a person to delegate management authority to another person under a legal instrument called a power of attorney. A power of attorney may be "special" in that it authorizes the agent to exercise limited powers of specific property owned by the principal or "general" if it confers broad powers over all property owned by the principal. Depending on how it is drafted, the management authority delegated can be effective immediately (useful if you are leaving the country for an extended period) or it may spring into effect upon the future incompetency of the principal (in this context, a "principal" is the investor owner).

Authority delegated to an agent under a power of attorney generally ceases upon the incapacity of the principal but with proper drafting, a so called "durable power of attorney" will continue in force after the onset of the principal's incapacity. Thus, a "durable springing power of attorney" effectively delegates authority to an agent on the principal's incapacity and continues during the period of the principal's incapacity. Given the obvious advantages, a competent estate attorney will generally prepare a springing durable power of attorney for a client that owns investment property in order to mitigate management risks arising out of the owner's incapacity. While it may never be used, the management authority conferred might just save the client's estate if something serious goes wrong. In all cases, however, powers delegated under a power of attorney, whether general, special, durable or otherwise, cease on the death of the principal. A competent estate plan should address the ultimate interruption of management authority that occurs at death.

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