

# The Benefits of Using Multiple 'Single-Asset' Limited Liability Companies for Investment Properties

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October 14, 2016



Practicing real estate law means that I'm constantly talking with all types of clients, including large scale developers as well as individuals simply looking to do a little investing in real estate. Interestingly and somewhat counterintuitively, people tend to make just as many mistakes, and in some cases more serious ones, when the transactions are small by comparison.

One of the most frequent areas of mistake is failing to use a limited liability company ("LLC") to own real estate.

Many people have probably heard about owning their investment properties in an LLC, but don't know why it is important, how to go about doing so, and why they should make this relatively minimal expenditure. In today's legal environment, it's wise to understand how to protect your investment assets in this way, where the benefits massively outweigh the drawbacks.

Consider this situation as an example. "Jane," had saved modestly during her twenties and thirties, and after having created a small nest egg, decided that she wanted to invest in some real estate so that, as she grew older, she would have some "mailbox money" (her financial advisor calls this "passive income"). Over the course of the last seven years, Jane has acquired five rental properties, which are each occupied by long-term, stable tenants. Recently, one of her first and most trustworthy renters, "Renta," suffered a serious injury in the home she was renting when a kitchen appliance malfunctioned and caught on fire. Renta had been a reliable and easy-going tenant for years, but her injuries were extensive, and she filed a lawsuit alleging that the owner's negligence contributed to her injuries.

During the course of the lawsuit, it was determined that the appliance had been recalled several months before Renta suffered her injury, but that no one had taken steps to have the appliance replaced. If Jane owns the property in her own name, or in an LLC that owns all four of her other real estate investments, Jane's personal assets or the investment properties in which Renta has never stepped foot could be threatened or lost during the course of the lawsuit. If that is the case, Jane might really regret ever getting into the real estate game. However, if the property that Renta occupies is owned by a separate LLC that Jane formed, then Jane's other assets, both personal and investment, will be protected. In that still stressful, but much less costly scenario, Renta will have to sue Jane's LLC, rather than Jane, and the only asset that can be lost or subject to lien in the lawsuit is the property Renta lived in that is held by that separate LLC.

**The Benefits of Single-Asset Multiple LLC Ownership**

## Limitations on Personal Liability

Holding each investment property in its own LLC limits the liability that could be owed to any tenant, guest, invitee, or trespasser to the value of that specific investment. As shown in the example above, if Jane has formed five LLCs for each of her five investment properties, then when any one of those LLC-owners is found liable to a tenant for negligence or other claim, Jane's personal residence, bank accounts, and unrelated investment properties held in the other LLCs will not be threatened.

This is especially important in a scenario where, for example, Renta's damages in light of her medical injuries surpass the value of the home she is renting. In that event, if Jane has shielded her other assets from liability with the formation of an LLC to own each property, while the home Renta was injured in may have to be sold in order for Jane to pay damages to Renta, Jane's other assets would not be exposed to lien or loss in order to cover any excess of Renta's damages over the value of the house rented to her.

Jane certainly would be wise to have her LLC carry homeowner's insurance on the property rented and occupied by Renta, but it is clear that real estate investors who rely solely on insurance as a means of protection from personal liability take a significant risk. Liability policies typically have limits, exceptions, and carve-outs. While the chance of a loss that exceeds policy limits may be remote, if it happens, as with the example above, the consequences can be devastating, and the protections afforded by a single-asset LLC can be indispensable.

## Simple Formation Process

Forming and maintaining an LLC is a straightforward process. Simple Articles of Organization are filed with the North Carolina Secretary of State. If more than one person will hold an interest in the LLC, an Operating Agreement should be created.

For example, if Jane has a business partner with whom she is purchasing investment property, she will want the Operating Agreement to clearly provide the framework by which the members of the LLC will co-own the property, i.e., which member has the right to hire a property manager or obtain a mortgage secured by the assets of the LLC, which member has the right to sell the assets of the LLC, and what might occur if the members come to an impasse on an important issue, or one of the members dies or becomes incapacitated. With a solid Operating Agreement in place, groups of investors can co-own real estate assets within the structure of an LLC, which further simplifies the way that a group of investors can take title in the property, operate it for a profit, and pass it to others.

## Simplified Management of the Legal Entity

Additionally, an LLC's maintenance is easier than the maintenance required of a corporation. For example, unlike other corporations, an LLC does not have to issue stock, hold annual meetings, or keep written minutes in order to preserve the liability shields afforded to its owners.

More importantly, holding real estate in an LLC is much more favorable from a tax standpoint than in another type of corporation. While LLC's provide "pass-through" taxation, meaning that an LLC member does not pay taxes at the business level, corporation owners face a double tax, at both the corporate and personal income tax levels. Furthermore, while real estate can go into a corporation tax-free, it can never come out tax free, which is not the case with LLCs.

The management of an LLC is often much simpler than the management of a corporation, but an investor must still take certain precautions in order to maintain the separate and distinct identity of the owner from that of the LLC. For example, an LLC member must not co-mingle personal and business funds, i.e., by using personal credit cards to pay for expenses incurred by the LLC. If the member does co-mingle funds, the

integrity of the liability shield provided by law will be compromised and potentially expose all of the members to personal liability.

### Privacy Considerations

In addition to the liability protection created, LLCs are also beneficial in terms of affording privacy to investors. For example, if a valuable property is owned by "Lexington Avenue Properties, LLC" rather than by "Jane Doe," it is harder for the general public to determine that Jane Doe owns the property, or to search for all properties in which Jane Doe has an ownership interest. This is especially true where the Articles of Organization are prepared in a way as to avoid disclosure of Jane Doe's name or personal information.

### **Limited Drawbacks to LLC Formation**

The drawbacks of creating an LLC are limited to costs. In North Carolina, at the present time, the filing of Articles of Organization with the Secretary of State costs \$127, and the preparation of that filing and an Operating Agreement between members will involve legal fees. Additionally, an Annual Report must be filed with the Secretary of State each year in order to keep the LLC active and recognizable as a legal entity, at a filing fee of \$200 per year. Investors will also incur expenses for the tax preparation of each LLC's K-1. These costs are relatively quite low, however, in comparison to the asset protection and privacy that LLCs afford to investors.

### **Minimize Risks and Evaluate Your Options**

There is simply no way to eliminate all the risks associated with starting a real estate investment business, but you can easily improve your chances of success by complying with the corporate formalities required by applicable entity formation and operation laws, and taking time to consider whether or not acquisition through an LLC is the right choice. If so, it is much easier to purchase property through an LLC to begin with, as opposed to trying to transfer it to an entity at a later date when a lender might have to consent to the transaction.

Even though an LLC may not offer any more protection from outside lawsuits than a properly formed corporation or partnership, it does offer many other advantages that make it the most desirable form of entity in many cases, particularly with respect to real estate holding companies. This is the kind of seemingly minor difference that Jane, and other investors like her, might want to keep in mind, if they want their "mailbox money" to be incoming, rather than outgoing.

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