

Why should investors conduct a 1031 exchange?



What is the incentive?



Taxable sale

Transfers property for cash

v.



1031 exchange

Relinquishes investment property and acquires like-kind investment property


Since 1921, the tax code has provided taxpayers who own real property held for investment or use in a business a significant tax advantage – an IRC Section 1031 tax-deferred exchange, often referred to as a 1031 exchange.


A 1031 exchange allows taxpayers holding real property for investment or business purposes to potentially defer all taxes that would otherwise be incurred on a taxable sale of investment or business property.

1031 exchanges are a valuable investment strategy giving taxpayers the opportunity to defer taxes and build wealth in real estate.

More money in your pocket

For full tax deferral, a taxpayer must meet **two** requirements:

1.  **Reinvest all net exchange proceeds**

2.  **Acquire property with same or greater debt**

	Relinquished	Replacement	Boot
Value	\$9,000,000	\$12,000,000	
Debt	\$3,000,000	\$6,600,000	\$0
Cost of Sale	\$600,000		
Net Equity	\$5,400,000	\$540,000	\$0

The taxpayer acquired property of greater value, reinvesting all net equity and increasing the debt on the replacement property.

	Relinquished	Replacement	Boot
Value	\$9,000,000	\$7,000,000	
Debt	\$3,000,000	\$2,600,000	\$400,000
Cost of Sale	\$600,000		
Net Equity	\$5,400,000	\$4,400,000	\$1,000,000
Total Boot			\$1,400,000

The taxpayer acquired property of a lower value, keeps \$100,000 of the net equity and acquired a replacement property with \$40,000 less debt.

FOUR LEVELS OF TAXES

- 1 Depreciation Recapture (25%)
- 2 Remaining Federal Gain (15%/20% expected to double for HNW investors)
- 3 Net Investment Income Tax (3.8%)
- 4 State Taxes (0 - 13.3%)

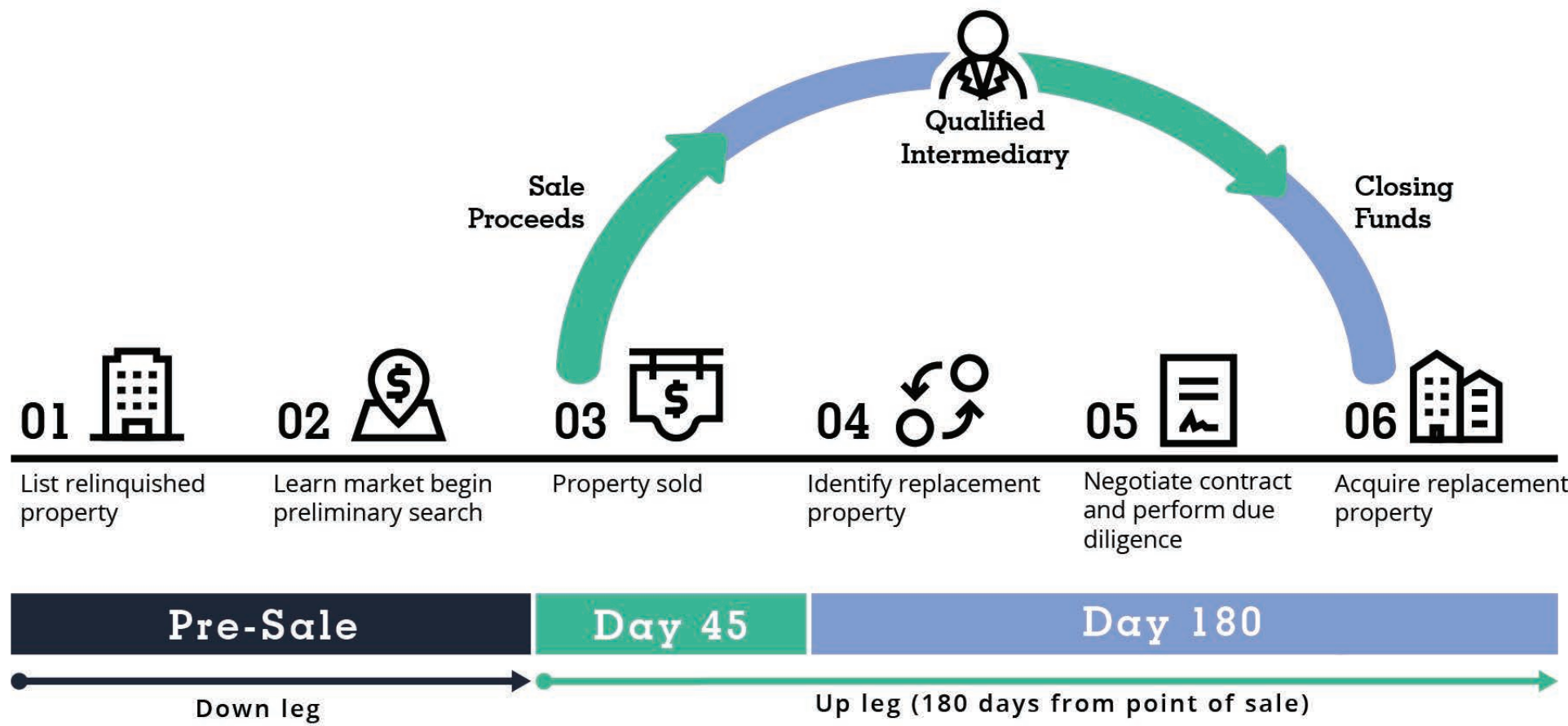
= TOTAL TAXES OWED



LOSS OF ANNUAL CASH FLOW

Acquiring a new property without a 1031, you'll lose out on cashflow. Had you just sold the \$9,000,000 (using the example to the left) property and not utilized a 1031 exchange you'd be left with \$5,400,000 of cash at closing, on which you'd need to pay upwards of \$1,800,000 in taxes leaving you with only \$3,600,000 to re-invest. Regardless of how you re-invest those after-tax proceeds, at any rate of return, you'll earn less than you would have had you been able to invest the whole \$5,400,000.

The 1031 exchange timeline



Rules of an exchange

Like-kind property

Like kind properties are real estate assets that qualify under Section 1031 of the Internal Revenue Code for exchange and for the deferment of capital gains taxes. Like kind properties must be held for business or investment purposes only, not for private use. They do not need to be of similar grade or quality to qualify.

Generally, any real estate asset counts as “like-kind” to any other, so long as both are held for business, productive use in a trade, or investment.

Qualified intermediary

A **Qualified Intermediary** (QI) is the professional provider of the mandatory mechanics of an exchange. The use of a QI, as an independent party to facilitate a tax-deferred exchange, is a safe harbor established by the Treasury Regulations.

The qualified intermediary’s exchange agreement and all exchange documents must be executed prior to closing on the sale of the relinquished property.

Time requirements

45 Days

Once the sale of your property occurs, the intermediary will receive the cash. Within 45 days of the sale of your property, you must designate the replacement property in writing to the intermediary, specifying the property that you want to acquire.

180 Days

You must close on the new property within 180 days of the sale of the old property.

Identification rules

The taxpayer must identify the replacement property to be acquired in accordance with the Rules of Identification and within 45 calendar days.

3 Property Rule

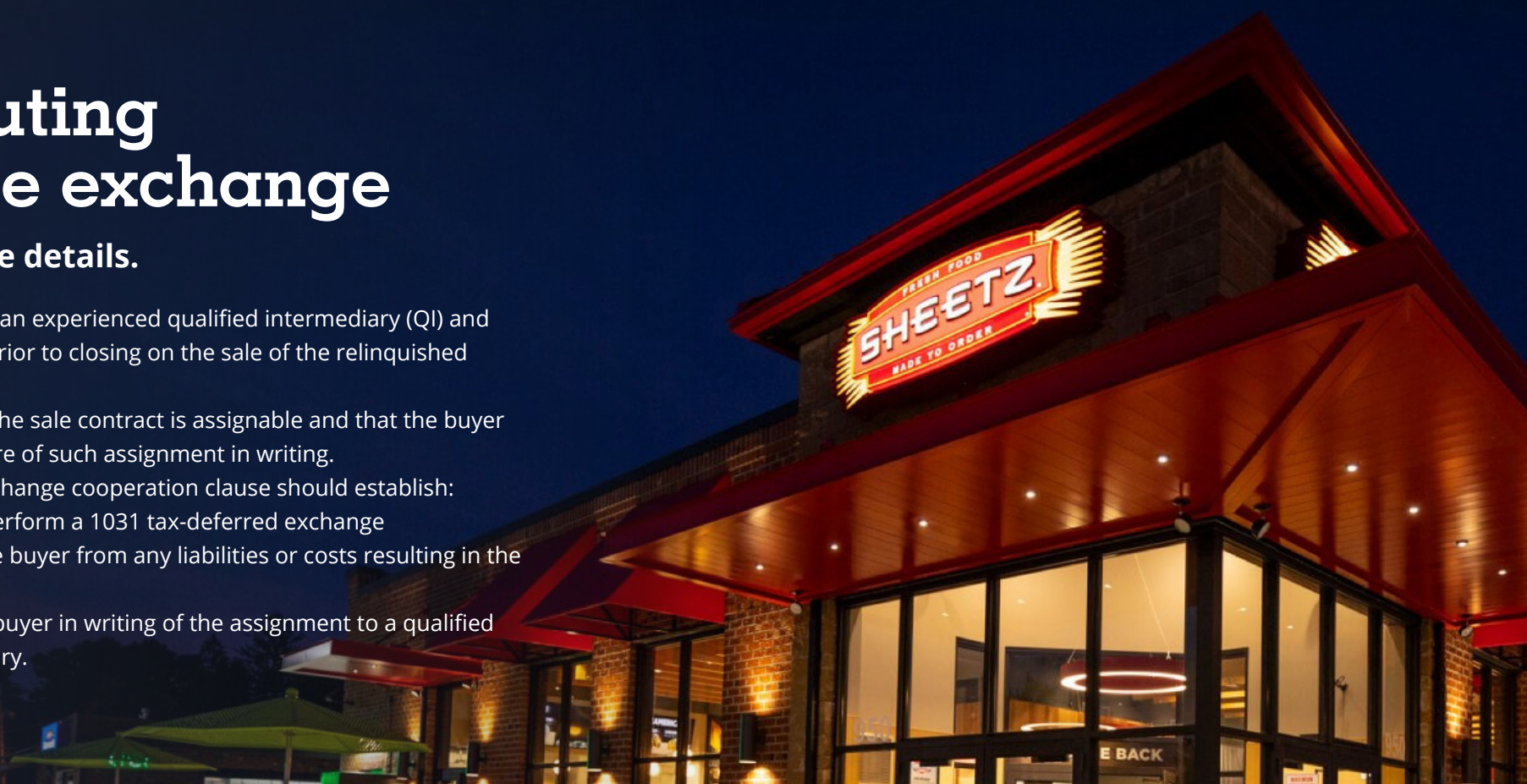
200% Rule

95% Rule

Executing the exchange

It's all in the details.

- Consult with an experienced qualified intermediary (QI) and tax advisor prior to closing on the sale of the relinquished property.
- Ensure that the sale contract is assignable and that the buyer is made aware of such assignment in writing.
- The 1031 exchange cooperation clause should establish:
 - Intent to perform a 1031 tax-deferred exchange
 - Release the buyer from any liabilities or costs resulting in the exchange.
 - Notify the buyer in writing of the assignment to a qualified intermediary.



Cooperation Clause | Relinquished

"Buyer is aware that seller intends to perform an IRC Section 1031 tax-deferred exchange. Seller requests buyer's cooperation in such an exchange and agrees to hold buyer harmless from any and all claims, costs, liabilities, or delays in time resulting from such an exchange. Buyer agrees to an assignment of this contract to Asset Preservation, Inc. as a qualified intermediary (QI) by the seller."



Cooperation Clause | Replacement

"Seller is aware that buyer intends to perform an IRC Section 1031 tax-deferred exchange. Buyer requests seller's cooperation in such an exchange and agrees to hold seller harmless from any and all claims, costs, liabilities, or delays in time resulting from such an exchange. Seller agrees to an assignment of this contract to Asset Preservation, Inc. as a qualified intermediary (QI) by the buyer."

How a \$100 million portfolio might look



Potential Tenants

Representative deals and not actual deals on market.

PHARMACY

Tenant:	CVS Pharmacy
Price	\$8,000,000
Location	FL
NOI	\$500,000
Cap Rate	6.25%
Lse Yrs Rem	25
Rent Incr	None

MEDICAL

Tenant:	Childrens Hospital
Price	\$10,800,000
Location	PA
NOI	\$675,000
Cap Rate	6.25%
Lse Yrs Rem	15
Rent Incr	2% Annual

BIG BOX RETAIL

Tenant:	Home Depot
Price	\$30,769,231
Location	MA
NOI	\$2,000,000
Cap Rate	6.50%
Lse Yrs Rem	12
Rent Incr	5% per 5 Yrs

INDUSTRIAL

Tenant:	Amazon
Price	\$12,692,308
Location	NY
NOI	\$825,000
Cap Rate	6.50%
Lse Yrs Rem	7
Rent Incr	3.71% Annual

MEDICAL

Tenant:	Fresenius
Price	\$11,111,111
Location	NC
NOI	\$750,000
Cap Rate	6.75%
Lse Yrs Rem	10.1
Rent Incr	10% per 5 Yrs

CONVENIENCE STORE

Tenant:	Sheetz
Price	\$7,826,087
Location	VA
NOI	\$450,000
Cap Rate	5.75%
Lse Yrs Rem	18.8
Rent Incr	8% @ Yr 11

BIG BOX RETAIL

Tenant:	Walmart
Price	\$18,897,638
Location	SC
NOI	\$1,200,000
Cap Rate	6.35%
Lse Yrs Rem	11.2
Rent Incr	3% per 5 Yrs

Purchase Summary

Total Portfolio Cost	\$100,096,374
Less:	
Debt	(\$50,048,187)
Equity Required	\$50,048,187

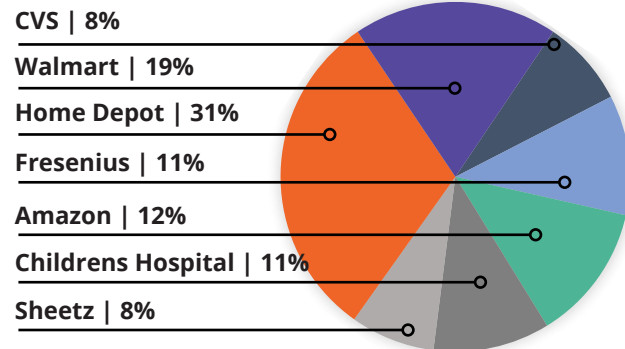
Debt Assumptions

LTV	50.00%
Int Rate	6.50%
Amort Years	25

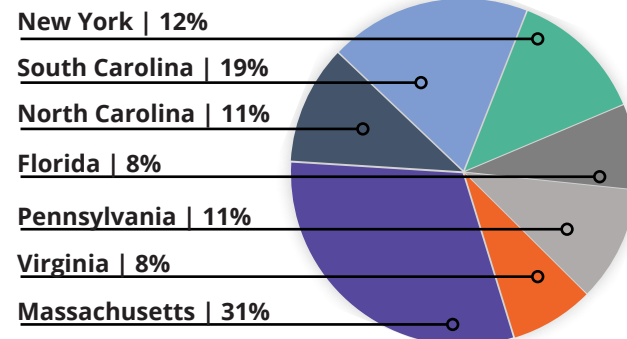
Purchase Summary

Net Operating Income	\$6,400,000
Less:	
Debt Service	(\$4,103,025)
Levered Cash Flow	\$2,296,975
Cash on Cash Return	4.59%
Portfolio DSCR	0.56
W.A.L.T. (Yrs)	10.78
Avg Going-In Cap Rate	6.39%

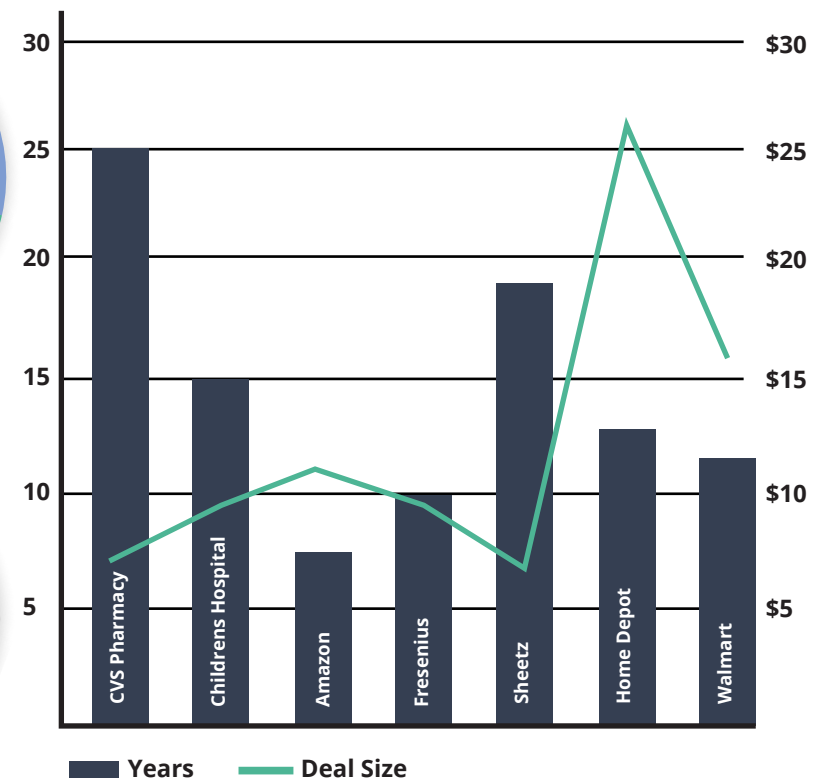
Tenant Risk Concentration



Geographic Risk Concentration



Lease Years Remaining v. Deal Size



Why hire an exclusive buyer broker?

Fiduciary Obligation to You

Properties for sale are represented by brokers working for Sellers, not you. In order to ensure that your interests are advanced it's important to be represented by your own broker.

Search

Having a dedicated team searching for properties that meet your criteria is essential. You should be in position to be making decisions on properties and leaving the search itself to professionals.

Cost

The Net Lease world works on co-brokering so the cost for you to work with a Buyer's Broker is deminimis or nothing at all.

Negotiating

When negotiating any sort of transaction, it's always better if you have a strong team negotiating on your behalf. You can be sure the Seller does.

Due Diligence and Closing

Particularly when buying multiple properties; coordinating the efforts of third parties for inspections and the like is something that a good Buyer's Broker will do. They are also focused on getting the deal across the finish line and making the transition to new ownership as seamless as possible.

Let's connect.

JONATHAN HIPPI

Principal

Head of U.S. Net Lease Group

C 571 926 2009

jonathan.hipp@avisonyoung.com

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avisonyoung.com/netlease

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2001 K Street NW, Suite 200 North, Washington, DC 20006

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