

THE PROPERTY REPORT

Building Value / *By Ray A. Smith*

Strong Market Boosts Appeal of Tax Strategy

BUY NOW, sell later. Last week, Apartment Investment & Management Co., a big publicly traded apartment owner, did just that, conducting what is known as a reverse exchange. Reverse exchanges are variations on 1031 exchanges, transactions in which owners defer gains on the sale of a property by effectively exchanging it for a "like-kind" property—tax-code language for a property of roughly equal value. By doing either traditional 1031 exchanges or reverse exchanges, sellers are able to put off paying capital-gains taxes.

Generally, investors have gravitated more toward the traditional 1031 exchanges, because reverse transactions tend to be more expensive and complicated. But that may be starting to change—among individual investors as well as institutional investors. Tax experts and others say the reverse exchanges tend to

offer advantages in a strong real-estate market, like the current one for commercial property.

In traditional 1031 exchanges, an investor sells a property, then buys another of similar value. The property the seller wants to buy to complete the exchange has to be identified within 45 calendar days of his sale and purchased within 180 days. In most cases, an independent third-party intermediary prepares the exchange agreement and handles the money.

In a reverse exchange, an investor purchases the like-kind property first, before completing the sale of the property he plans to exchange. He parks the property he is buying with an entity called an exchange accommodation titleholder, which holds the title to the property until the investor completes the sale of the exchange property. The Internal Revenue Service gave this type of transaction

its blessing in 2000.

Aimco's \$500 million transaction, in which it bought 10 apartment complexes in Rhode Island and Maine, is a big endorsement of this procedure.

"In a tight real-estate market, where there are other very strong buyers in the market, the reverse exchange solves the major dilemma of being able to acquire the replacement property within the 45-day to 180-day time frame," says Javier G. VandeSteege, president of Asset Preservation Inc., a Granite Bay, Calif.-based intermediary firm that handled the Aimco transaction.

In a traditional 1031 exchange, Mr. VandeSteege points out, buying a property

within the required time frame in a strong market "can be very difficult, because things get bought very quickly and prices can go up." But by doing a reverse exchange in an escalating market, "you can buy the property at today's price, and you have up to 180 days to sell, which gives you more time to get a potentially higher price for the property. It's the best of both worlds."

The extra expenses and paperwork involved in a reverse exchange may remain a barrier for some individuals, however, no matter how tight the real-estate market. On average, a reverse exchange can cost about \$7,000 in fees to intermediaries, while a traditional 1031 exchange might cost an investor \$1,200. What's more, in a traditional exchange, the investor has cash from the sale to put toward the subsequent purchase; in a reverse exchange, an investor without much spare cash would have to find financing to cover more, or

Putting Property on Layaway

In a reverse exchange, an investor can buy a replacement property before selling his exchange property. A traditional 1031 exchange works the opposite way.

There are two ways to conduct a reverse exchange:

- An exchange accommodation titleholder, or EAT, can acquire the replacement property while the investor continues to own the for-sale property. This is the most common in reverse exchanges.
- The investor can acquire the replacement property while the for-sale property is transferred to the EAT.

The EAT will often require the investor to:

- secure hazard and liability insurance
- get an environmental assessment of the property
- have an indemnity from any liability
- possibly get additional title insurance

For more information on reverse exchanges and other kinds of 1031 exchanges, contact the Federation of Exchange Accommodators at (916) 388-1031, or at fea1031@earthlink.net. The group's web site is www.1031.org.

Sources: tax lawyers and exchange accommodators



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all, of the purchase price.

"If you're a small investor whose major asset is what you're selling, it's hard for you to buy anything before you sell," says Louis S. Weller, a principal at Deloitte & Touche LLP's national real-estate tax services group in San Francisco. "You need to have the economic where-

withal to buy what will be the replacement asset in your exchange before you obtain the equity out of what you're selling, either by borrowing or having other funds available. Many people don't have either that ability to finance or money in their bank accounts" to make a reverse exchange work.