

GREEN 1031 EXCHANGES

"INVESTORS GO GREEN, SAVE GREEN WITH 1031 EXCHANGES"



Compliments of

The "Green Movement" has gone from fad, to trend, to global initiative. As a result, commercial property owners are increasingly challenged to respond to demands for greater sustainability and social accountability. The U.S. Green Building Council's "Leadership in Energy and Environmental Design" (LEED) program sets standards intended to encourage and accelerate the adoption of sustainable building and development practices. Given rising energy costs, and public concerns about the environment, LEED certification has become a more significant criteria used by buyers and brokers evaluating commercial property. Of course, many of today's commercial buildings are far from "green". Replacement of outdated heating, ventilation and air conditioning systems can involve major capital expenditures and reduce cash flow during the renovation period. On the other hand, avoiding necessary environmental renovation has costs arising out of inefficient electrical systems, inadequate insulation, antiquated single pane windows, leaky pipes, asbestos, mold and compliance with future environmental regulations. But there is a third option that does not involve either a complicated and expensive renovation or slogging along with an outdated and inefficient commercial building. Some property owners are using a tax deferred exchange under Internal Revenue Code §1031 to sell a an environmentally outdated property in exchange for a modern, energy efficient property. Who knew §1031 was so "Green"?

"GREEN" CASES IN POINT

In 2007, an investment property owner discovered that his three single-family homes required a costly connection to municipal water and sewer services to mitigate problems relating to the septic system that served those properties. The owner used a tax deferred exchange to sell the three properties to a developer and rolled all of the profits into a recently completed shopping center. Another investor used an "improvement exchange" to relinquish a decaying hotel in exchange for an old "brownfield" that was improved as part of the exchange to create an updated and environmentally efficient property. In fact, the brownfield property was ultimately used as an executive retreat and conference lodge, but the improvements completed in the exchange involved a clean up of a polluted and muddy stream running through the parcel. Today, the brownfield property is a popular destination retreat where guests now catch brown trout in that stream - a great example of the "greening" of America.

The "green" building movement is still growing in the United States and green technologies are evolving rapidly. As a result, an investor seeking to capitalize on the green movement may be faced with construction and renovation issues. Fortunately, there are several tax deferred exchange variations under §1031 that permit an owner to develop or improve a property using a tax deferred exchange like in the case discussed in the above brownfield example. One strategy, known as a "reverse improvement exchange," permits an exchanger to acquire a replacement property to be improved before the sale of the relinquished property. Actually, the replacement property is acquired for the exchanger by an "exchange accommodation titleholder" or "EAT" (an entity created as part of the exchange that it owned by the exchanger's intermediary to facilitate the exchange). Once the EAT acquires the replacement property, the exchanger has 180 calendar days to complete the planned improvements, close the sale of the relinquished property and take ownership of the improved replacement property to complete the exchange. A reverse improvement exchange can be complex, but with proper planning an improvement exchange permits an investor to acquire a building that is in need of improvement (possibly from a seller unwilling to make those improvements) and to use the proceeds resulting from the sale of the property sold in the exchange to complete the improvements. There are other exchange variations that permit improvements to be completed on the replacement property acquired in the exchange that not only defer capital gains taxes, but also produce a greener America.



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