# 1031 Exchange Basics

Moody
SECURITIES, LLC

FOR SALE

**1**
Seller/"Exchanger" decides to sell investment property and engages a Qualified Intermediary (QI) before the close of the property

**2**
Proceeds from the sale are transferred directly to the QI from the title company

**3**
Exchanger identifies Replacement Property(ies) within 45 days of sale and notifies QI.

**4**
Funds are transferred to the seller of the Replacement Property(ies). Exchanger has 180 days to close on new Property(ies).

Exchanger has 45 days to identify replacement property(ies).

Replacement property(ies) must be closed within 180 days of the closing date of relinquished property.

DAY 0

DAY 45

DAY 180

A 1031 exchange is a unique real estate transaction that may offer multiple potential benefits:

1. Defers capital gains tax
2. Preserves capital
3. Opportunity to diversify portfolio
4. Facilitates estate planning

Basic 1031 Process:

1. Seller (exchanger) determines they want to sell their relinquished property, and engages with a Qualified Intermediary ("QI") prior to the date of closing.
2. Following the closing, all sale proceeds from the sale are transferred directly to the QI from the Title Company.
3. Investor identifies like kind replacement property or properties.
4. QI transfers seller's funds to purchase the replacement property or properties.

*Like-kind* refers to the type of property being exchanged. Commercial real estate is like-kind real estate. You can exchange any investment real estate for any other type of investment real estate. In most cases, you may exchange one rental property into multiple properties (most typically, up to 3 separate properties.)

1031 Exchange Rule of Thumb - "Exchange Up"

- Exchange => in value
- Exchange => in equity
- Exchange => in debt

*"Swap 'til you drop"*
A 1031 exchange, when properly structured, may be done an unlimited number of times allowing for continual deferral of gains.

# Potential Benefits to Utilizing Delaware Statutory Trusts in a 1031 Exchange Situation:

1. NO INDIVIDUAL GUARANTY - The Delaware Statutory Trust "DST" is the single owner of the real estate and borrower under the loan secured by the real estate; the lender usually underwrites the DST (and the sponsor of the DST) and not each individual investor. The loan is typically non-recourse to the investor (the investor is not required to sign on guarantees for non-recourse carve-outs on the loan and there are no credit requirements). However, each individual investor must be an accredited investor under applicable securities laws.
2. REDUCED PAPERWORK - Investor owns beneficial interests in the DST rather than a direct real property interest, which would require deeds, etc., providing for a simpler paperwork process.
3. SMALL MINIMUMS - The typical $100k minimum investment allows more flexibility for investors to not only purchase interests in larger commercial real estate, which would otherwise require more capital, but also diversify their exchange into several properties.
4. BACK-UP IDENTIFICATION - Considering a DST in a 1031 exchange situation is a great way to save an exchange when used as a backup to another potential property that falls through and/or taxable boot situation.
5. PASSIVE INVESTMENT - The Trustee/Administrative Manager of the DST is responsible for the day-to-day management, relieving the active management burden from the investor
6. OPTIONS - DST offerings may vary by:
   a. Locations
   b. Property types
   c. Debt Options - Choose from highly leveraged, moderately leveraged, or no leverage offerings
   d. Single asset or Portfolio offerings

## Example*

*The tax benefits available under any transaction will vary depending on your individual circumstances. You should consult your own tax advisor to review any potential tax benefits available for your personal circumstances.

| Sale *without* 1031 exchange | |
|---|---|
| Sales Proceeds | $1,000,000 |
| Less Mortgage Balance: | 0 |
| Net Sales Proceeds: | $1,000,000 |
| Original Cost: | $100,000 |
| Capital Gain: | $900,000 |
| Fed Tax on Gain @ 20% | ($180,000) |
| State Tax on Gain @ 6.1% | ($55,000) |
| Net Investment Income Tax @ 3.8% | ($34,000) |
| *Funds Available for Reinvestment:* | **$731,000** |

| Sale *with* 1031 exchange | |
|---|---|
| Sales Proceeds | $1,000,000 |
| Less Mortgage Balance: | 0 |
| Net Sales Proceeds: | $1,000,000 |
| Original Cost: | $100,000 |
| Capital Gain: | $900,000 |
| Fed Tax on Gain @ 20% | ($0) |
| State Tax on Gain @ 6.1% | ($0) |
| Net Investment Income Tax @ 3.8% | ($0) |
| *Funds Available for Reinvestment:* | **$1,000,000** |



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