

What to Look For In a 1031 Exchange Facilitator  
Episode #20  
February 20, 2008

Dean: Welcome to another segment of Income Property Investment Talk. This is Dean Essa. This show brings you the powerhouses of commercial real estate week after week and today is no exception. Named after the IRS tax code that permits such transactions, 1031 exchanges allows investors to defer paying taxes on property they buy and sell as long as the transactions occur within 180 day time span and the funds are placed with an exchange facilitator or accommodator. Today's guest, Brendan C. Faber, president of First American Exchange Company, will discuss what to look for in an appropriate qualified intermediary and the critical role played by the qualified intermediary in accepting proceeds and holding them in escrow until the new acquisition closes. He will cover basic exchange issues, trading across or up in value and equity, and identification and timing issues. Without anything further, Brendan welcome to the show.

Brendan: Well thank you Dean. It's a pleasure to be on your show.

Dean: We are thrilled to talk about this subject because many thousands of listeners on this show do 1031 exchanges on a regular basis. We do 1031 exchanges on a regular basis and it seems like it's one of the subjects where I continue to learn something about it. It seems like you can never get to the end of the rainbow in it.

Brendan: There are so many topics that you can cover, traps for the unwary, just a number of different issues that we can cover in talking about exchange transactions.

Dean: Can we talk about just for starters before we get into the technicalities of the 1031, can we talk a little bit about why we should choose a certain qualified intermediary, and why is it important to know who it is we are going to go play with?

Brendan: It's important because you're going to be entrusting that company or person with holding your exchange funds. It's important to know what type of knowledge and

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experience the exchange company has. Are they qualified under the 1031 regulations?

What type of security do they have while they're holding or safeguarding your exchange funds?

Dean: Give us an example of that. When you say what type of security are you talking about what type of financial backing, what type of bonds, how is our money protected?

Brendan: Yeah, you'll hear in the industry people will, we have a certain level of coverage or fidelity coverage, that's only one measure you should be looking at. You should look at the financial backing of the company. What happens if the principles leave or use your money in a way that was not intended during the course of the exchange? The financial backing of the company, what do they do with the money? What kind of control do they have internally when they're holding your exchange funds?

Dean: Well let's talk about your company. Not to put you on the spot but First American Exchange Company has been doing exchanges for a long time. Tell us about your company in particular. What are your strengths?

Brendan: Well our strengths, we have 80 people throughout the country that just focus on exchange transactions. We are part of the First American Family of Companies, that's a New York stock traded company. We as part of a publicly traded company, we have to strictly adhere to the financial reporting and disclosure requirements of Sarbans Oxley which you'll hear. That adds another layer of reporting that we have to deal with internally that most customers won't see. What that means in actuality is for instance; we'll have a daily reconciliation of accounting for all of our exchange transactions throughout the country. We also have a treasury management team that will take those exchange funds and place those funds with a group of money centered banks throughout

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the country, but that control is removed from our exchange offices. So our exchange officer is really just can focus on servicing the client as opposed to trying to determine which bank they should use to hold those funds.

Dean: Across the country we have done workshops, Brendan. We always ask for a show of hands, these are typically investor workshops, we always ask for a show of hands who understands the 1031 process, whose done a 1031, and typically we get about 50% of the room. Now you would think that 100% of the room by now would clearly understand the process of a 1031. So with that said, would you mind for our listening audience, going through the 1031 process? Talk about the 45 days, talk about the 180 days, simplify it as much as you can about how the process works so, okay those of you who are listening if you own a property right now and you're thinking about selling the property, before you make a move on that property you really need to understand this process or at least know who to call. So, could you take it from there?

Brendan: I will thanks Dean. The real critical question you should ask is what type of tax savings am I getting in doing an exchange, and when you look at your entire tax situation does it really make sense to do a 1031. That's the first question. Assuming that the answer is yes, you're going to have a significant tax savings are transferring into a replacement property; you then look at some basic rules. You're trading from like kind property, which is, for real estate, its real estate for real estate and there's a very broad definition of what real estate is. You're also going to trade across or up in value and this is what we call the basic rule or the napkin test, when you do an exchange you want to trade across or up in value and across or up in equity.

Dean: What does that have to do with a napkin?

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Brendan: So the napkin is just trade across or up in value, you can write it on a napkin, and it's just a basic rule. If you want to have a tax-deferred exchange, you trade across or up in value and across or up in equity. And that's the napkin test.

Dean: Okay.

Brendan: Now, it can get much more complicated than that but here is an example. A taxpayer sells a property worth \$100,000. They want to buy a replacement property at least \$100,000 or exchange into that. Now if they had debt or if they pay off a debt of 50, they have 50 left over. They are going to use that 50 to buy that replacement property at a hundred. So effectively they've traded across or up in value and across or up in equity. The whole idea is the IRS wants you to have a continuation of your investment. So at the end of the exchange you don't want to be holding any cash in your hands or you don't want to have any debt relief.

Dean: There's a word for that isn't it?

Brendan: There's a word for either cash or debt is what we call boot. When you look at the IRS code, you won't see the word boot but boot just means something that's not like kind or taxable. Now the timing, once you sell that relinquished property, or the old property, you're going to have a 45 day time frame to identify potential replacement properties and there are some rules that we can get into about identification and from that original sale date you're going to have a full 180 days to acquire that replacement property. Now here's the trick, especially later in the year, typically after October 17, that 180 day time frame can be abbreviated by the due date of your tax return and there is case log where someone sold say in December and their CPA filed their tax return on April

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15. They had not yet closed on their replacement property, so that effectively closed their exchange once they file their tax return.

Dean: So this is really critical to be able to both coordinate with your 1031 qualified intermediary and also include your CPA in the transaction.

Brendan: Absolutely. Whether you're using your agent or your CPA or your tax attorney, it's really important to have that because the exchange Company cannot provide that specific tax advice to the client or they become a disqualified party.

Dean: Okay. So say, take your example, you're sitting on the relinquished property, you sold it, and now you have 45 days, we don't want to get into the details of the identification because we could take the whole hour on it, let's just say for specification purposes that they need to identify three properties. Say they identified three properties, what do they do, do they actually send those properties in to the IRS, do they actually send the actual addresses, legal descriptions of those three properties then?

Brendan: They don't have to send it to the IRS. What they're doing is, they're merely identifying it. The way to identify that is to put it in a writing and sign that letter and then send that to someone who's involved in the exchange. We typically have those identification forms sent to us and our company will provide the client with sample identification forms that they can use to identify.

Dean: Now what we've done in the past is a lot of times we're in a situation with clients where they will identify their three properties and they get in trouble because they end up not closing on any one of the three and losing their exchange because they come to find out in the process of due diligence that neither one of the properties work. What we've done with clients is, we've had them identify two properties and then the third one we've

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kind of put them as a safety net into a tenant in common type property so at least they know they're not going to blow their exchange, especially after looking at a large tax consequence. Have you ever seen that happen with clients?

Brendan: That comes up all the time and one advantage that you hear on the tenant in common options is to just have it as a safety net. We had this issue come up last week where a client had effectively identified more than three properties and again not getting into all of the technicalities, decided before the 45th day that she needed to modify her identification and identify essentially a fourth tenant in common investment just as a safety net. She was OK in terms of value so it wasn't a problem as far as identification, but that's essentially what she did.

Dean: This 45 day thing is critical. From what I understand you cannot extend that, you cannot extend that 45 days, it is what it is.

Brendan: It is what it is; it's one of the hard and fast rules in 1031. There's no way to extend that and so our advice is if you know you're going to do an exchange, even before that old property, or that relinquished property, transfers start looking.

Dean: I cannot tell you the workshops we've done across the country where we get excited about investing, we talk about, we introduce our 1031 person there at the workshop, and then I cannot tell you on the break how many people come up to us and say "Yes I am 44 days into my 45th day identification process, could you please find me a property."

Brendan: We'll see that come up, periodically. The 45 days goes by very quickly.

Dean: It really, really does. It just creeps up on you.

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Brendan: It's important especially, to retain an agent who is familiar with exchanges, who can start looking in a broad area as to possible replacement properties. That's where a tenant in common can be helpful.

Dean: Well, what we're going to do is we're going to take our first break and after the break I want to expand a little bit more on what you can exchange and what you can't. I know the more I read about it, the more I'm shocked about things that I can exchange that I didn't know. I was told recently that I could exchange the office in my home if I wanted to depending upon which IRS exemption you wanted to take advantage of. You can exchange equipment; you can exchange cattle, all these different things. So when we get back I'd like to expand on that if that's okay with you.

Brendan: That would be great.

**BREAK**

Thanks for tuning in today to Income Property Investment Talk. If you have a question for Peter or Dean call now, listener lines are open. The toll free number is 1-866-472-5790. That number again is 1-866-472-5790. Now back to Peter and Dean.

Dean: This is Dean Essa and you're on the air with Brendan C. Faber, president of First American Exchange Company. We had a great first segment talking about 1031 exchanges, talking about the process of the 45 day and 180 day and we wanted to now start touching a little bit, Brendan on, what you can exchange and maybe perhaps a little bit about what you can't exchange. The more I get into this, the more I realize that there are some things that we can exchange that I never knew that we could.

Brendan: There is a to use a big word, a plethora of exchange items. For instance, we will handle a lot of real estate, but you will see personal property, you'll see jets, you'll see

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vessels. We've done cattle exchanges, radio station exchanges, mass asset, or companies will sell their building with all the personal property.

Dean: Do you do two separate exchanges when you sell a building with a lot of personal property? Do you exchange on the building itself and then another exchange on the contents?

Brendan: You separate them out so that you have the real property is treated as one because the rules are a little different as far as it like kind treatment on replacement property and then the personal property has a more strict like kind rule. You effectively separate them out even though they can be included in one exchange.

Dean: Now, what about, tell me if this is true and this may be more of a question for a CPA but I was told that with tenants in common transactions, which are very popular these days, you know when people pull their funds and each get first position on a large multifamily project or an industrial or retail project, I was told that tenants in common is the only way that they could hold title on a large transaction like that and be able to take advantage of each individual 1031 exchanges. So say for example, there are 22 tenant in common, with each individual LLC's, is that true that that's the only way you can take advantage of a 1031 for each individual, like say they hold it in a general and a limited they couldn't do that?

Brendan: That goes to the ownership test and really what you want to have is the same taxpayer that is selling the old property and exchanging into the new property. What you'll see with the tenant in common is you'll see a husband and wife who are selling a property and their trading into a tenant in common, they will most likely be split up into single-member limited liability companies that are disregarded for tax purposes; that

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they're pass through entities. So it effectively treats, that even though they're buying an LLC, if it is single-member that's disregarded for tax purposes or pass through, it's still treated as the individual for tax purposes. The rule is to have the same taxpayer on both sides of the exchange.

Dean: So let's say this, say there's 10 investors, all 10 are going into a tenant in common property, and each one has his own individual LLC. Then three years down the road they sell the property. Now, can each one of those 10 investors then either continue on with the next project and just roll their money across or up into the next property or can they take their portion of those proceeds and go buy another property and do an individual 1031?

Brendan: Presuming that those tenant in common investors are not construed as a partnership and it's important to remember that partnership interest cannot be exchanged under section 1031, which is why it's important on a TIC structure to not have a construed as a partnership.

Dean: So that's the very reason why the general partnership if you will, and limited partnership if you will, are excluded but the tenant in common can be included in there if it's set up properly.

Brendan: That's exactly correct. So each of the investors or the tenant in common owners, provided that they're not construed as a partnership, can then do if they are selling the property, they are taking their portion that's attributable to them and trading it, as they want to.

Dean: Oh that's fantastic. Tell us about, how can someone reach you if they want to do a 1031? So two questions I'd want you to expand upon if you can, at what point should

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they call you in their transaction and how do they reach you if they want to do a 1031 exchange?

Brendan: We get involved; typically it's a shorter time period before the sale of the relinquished property. We want as much time as possible so we can cover all the issues and we have a whole schedule of questions that we can go through when someone sets up their exchange transaction. We can do it the same day that they're transferring the relinquished property although we recommend more time just so that we can get all of the exchange documents in place. If they want to reach us, they can reach us on the web at [www.firstexchange.com](http://www.firstexchange.com).

Dean: And if anyone would like to ask Brendan a question please feel free to call in toll-free to 1-866-472-5790 here on Income Property Investment Talk on VoiceAmerica.

Now regarding the exchange itself, pricing, I know that it probably varies case to case, varies probably on the size of the project, varies on what type of exchange you're doing, actually let's not even go there yet. Before that, lets back up and talk about what are the different types of exchanges. I understand that there is a regular exchange, there is a forward exchange, there is a reverse exchange, there is a construction exchange, give us the different categories of exchanges, a little brief synopsis of each one, and what they mean.

Brendan: The regular, or what we would call the deferred exchange, is where you're disposing of an old or relinquished property, trading into a replacement property. We also get involved in reverse exchanges. The idea is to still always sell your old property and exchange into replacement property and defer the taxes, that's always the goal. With the reverse exchange what happens is you've typically identified a replacement property that

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you want to acquire but you have not yet sold the relinquished property. In that case, there's what they call a revenue procedure in which the IRS spells out the process to do that reverse exchange. It's much more costly than a deferred exchange and the reason for that is the exchange company will typically form again a single-member pass-through entity that's sole purpose is to hold that replacement property. So we actually go through the due diligence process with the client and we acquire that replacement property in an entity that's separate and apart from everything else that we do. We hold that property until the taxpayer is ready to sell their relinquished property.

Dean: So would you say that a very good reason to do a reverse exchange, and this is what I've come across personally, whereas I have a client that goes out there and finds the property that is just unbelievable, just one of those ones you have to have and you haven't sold your property yet. You do need the funds from the property that you have not sold yet in order to buy that property. You don't have the luxury of time of sitting on the market for six months or so while your property sells in order to acquire that property. So, would that be a time to do a reverse exchange because you know that there's going to be, it's the type of property that's priced so well that you know somebody's going to buy it quickly if you don't just because you know the markets, you've run the comparables. Would that be a situation where the reverse exchange would come into play? Where you really want to have that property and so you acquire it and then you kind of do everything in reverse in the sense that now you have the same time frames that apply, the 45-day, and the 180-day, but you do it in reverse. You have 180 days to sell the relinquished property.

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Brendan: That's a good point. It's important to remember you're still have this 180 day timeframe but the question with the reverse exchange is how are you going to finance the acquisition if you need to use the proceeds out of the relinquished property and that's where you'll need to get a lender involved that can loan to you those funds. We deal with lenders daily on this type of structure. They're comfortable with us forming a single purpose entity that's going to hold that replacement property. We take the property nonrecourse, so the client is going to have to guarantee that loan to acquire it. What happens is when they sell the relinquished property they'll then use those proceeds to pay down that debt or retired that debt. So it works but it always is a funding question for the client.

Dean: We have a call from Jennifer from Nevada. Jennifer welcome to the show.

Jennifer: Hello. I have a question. With some large accommodator's shutting down recently and investors losing their money, what makes First American different?

Brendan: The difference with First American, and what Jennifer is referring to is a point where there was an independent exchange company in Nevada that there were no safeguards in place as far as the use of that money while the exchange company held it and what happened is that that exchange company that was owned by a principle, an individual, used that money without any kind of control or safeguard for other purposes. So, the money dissipates and it's a double whammy for the client because one their exchange funds are not there and two they're going to have a tax bill. So the difference for us is a whole bunch of controls that are in place internally as well as with the Sarbanes-Oxley requirements and our whole parent corporation that keeps us so we don't have those kinds of issues.

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Dean: Can you go through just a few of those for our listener? Go through a few of those security measures that you have in place in particular.

Brendan: Yes, you want to know who are the principles, what happens if a principle passes away? Let's say I finish this call and I walked out and I get hit by a truck, no one's exchange is going to be at risk. I don't have or the exchange offices that are part of First American don't have control over those monies. We have a separate treasury management group, separate and apart from our exchange company that controls those deposits. So you wouldn't have something like what's called the Southwest Exchange Company in Nevada, you wouldn't have that kind of an issue come up.

Dean: Excellent. Any other questions, Jennifer for him?

Jennifer: No, that's it.

Dean: Thank you so much caller. Have you ever heard that song by Pink Floyd called "Money"?

Brendan: Many times.

Dean: I think it's about time that we played that song again because it's one of my favorite songs. Go for it. That music there indicates our Mortgage Minute with Stan Hanks from RealSource Financial. Stan welcome to the show.

Stan: Thank you, it's great to be on again.

Dean: And you can say hi to Brendan Faber, president of First American Exchange Company. I don't know if you've been listening or not.

Stan: I caught the last few minutes and it's nice to hear him and look forward to at some point meeting him.

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Dean: Well we love to have Mortgage Minute on every week where we discuss the commercial lending arena, what's hot, what's new, what's fresh. Stan, what's hot?

Stan: I'll tell you what's hot and I'll tell you what's not. What we have is, there are loans that are accessible for, we specialize in commercial loans, that's anything five units and above as well as self-storage, retail, office, and those deals. There are loans out there as I've mentioned every week. There is money to be had, it used to be that you could open your door and there was a flood of money, now you open the door and you have to look around a little. Let me just throw out some examples to your listeners so that they can get a feel. If you were trying to buy million-dollar apartment and you're going to hold it for three years, you could get a rate at about 5.86% today. A 5-year rate would be 6.12% so the rates are still really good you just have to be a little more selective in where you're looking and that's what RealSource Commercial can do for you.

Dean: So when you say a little selective in where you're looking you're referring to both the market that you're purchasing and also the actual strength of the deal itself?

Stan: Yeah, the underwriting criteria used to be that if you had an apartment and you wanted to buy and you had 10 or 15% down, you pretty much could buy. Now, you need to be able to put down 20% and sometimes 25%, the deal needs to cash flow and if you get those criteria, generally you'll be able to get a good loan with a good rate and good terms on a 30 year amortization.

Dean: Well, that's fantastic. I know that you're always at the cutting edge and I know that one of the things that our listeners need to understand, those who have only dealt with residential lenders and have not dealt in the commercial lending arena, that you can't just wake up one day and become a commercial lender and expect to have all the relationship

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in the banking industry. As a commercial lender, don't you have to pay the price to establish those relationships before a lender will take you on as a, I don't know is there a word for that, a preferred, or what's the word to use when you are...

Stan: Well there is a term in the industry and its used often, and it's correspondent lender.

Dean: Correspondent lender, that's the word I was trying to get at. ... some correspondent lender with some of these large institutions that actually have some of the best money available.

Stan: That's true and the other thing that happened, if we compare today to a year ago there's approximately 70% less lenders today than there were a year ago. It's important to make sure you're working with when you're buying a property those who have been able to kind of muddle through these challenges. Most of them have been bought up, Bank of America has gone out and bought up a couple really key lenders that many commercial brokers used and fortunately we have relationships with still those key lenders that are existing out there. That's just one of the nuances but the key for anyone listening is that most people when they buy property they just want a loan and they need to find someone who can make sure that happens and they shouldn't be nervous about the recession that may or may not be coming, they shouldn't be nervous about the sub prime loans and the housing market and how that's impacted. What they should be doing is finding properties that you can help find for them, Dean, and you can make sure that these things cash flow and then they'll get a loan.

Dean: That is fantastic. Stan, one more time, what are those interest rates and can we get interest only these days or is that gone?

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Stan: No, we can get interest only. You pay a little more but I'm working on a deal where there's going to be probably 15 tenant in commons, it's a small deal, around \$3 million loan size, and I'm going to have three years of interest only. That rates going to be sitting probably around 6 1/4. That's a real example today of what exists out there.

Dean: That is fantastic. Stan, how do they reach you?

Stan: Well two things they can do, one is they can always call our 800-number, 800-929-2150 extension 2710 or just ask for the mortgage department or ask for Stan Hanks, very simple. The other is go to our website, RealSource.net, click on commercial loans, we have our rate sheet right there that they can take a look at.

Dean: That is fantastic. Stan thank you so much and I appreciate it. I hope you come on the air with us next week.

Stan: I look forward to it. Thanks very much.

Dean: Before we take our break, Brendan, and then we're going to be bringing on H. Blaine Walker who is the chairman of NAR/TIC workgroup and the 2007 chair of NAR Realtor's Commercial Alliance Legislative and Regulatory Subcommittee. This is going to be a fantastic segment as well talking about a way that realtors depending on how they qualify can actually go ahead and start receiving commissions or some type of fee structure for actually bringing people on to tenant in common agreements which we haven't been able to do in the past. This legislation is hopefully going to pass here very shortly. So anyway, we're really excited to have Blaine on. Any one last thought you like leave with our listening audience Brendan regarding 1031 exchanges before we go into this break?

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Brendan: It's just important to know when you choose an exchange company, look at knowledge and experience, and are they qualified, and what type of security and safety do they have.

Dean: Fantastic. And would you like to stay on the air with us to the end of the show?

Brendan: I'm happy to stay on and I know Blaine well.

Dean: Oh excellent. We would love to have you on. Stay on and will bring Blaine on right after this break.

Brendan: Okay thank you.

Dean: You're welcome.

**BREAK**

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Dean: Welcome back to another segment of Income Property Investment Talk here on VoiceAmerica. In the previous segments, we have been on the air with Brendan C. Faber, president of the First American Exchange Company. He's been kind enough to stay on with us for the rest of the show. He happens to know our new guest, H. Blaine Walker, chairman of the NAR Tenants in Common Workgroup and 2007 chair of the NAR Realtor's Commercial Alliance Legislative and Regulatory Subcommittee. He's been a commercial broker for 30 years. He is also chairman of the Real Estate Commission in the state of Utah. Blaine, welcome to the show.

Blaine: Thank you Dean.

Dean: You might as well say hi to Brendan, since you know him.

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Blaine: Hi Brendan, how are you?

Brendan: I'm fine Blaine. How are you?

Blaine: I know Brendan well. He's actually handled a number of 1031 exchanges for me personally through First American Exchange. They do a great job, so it's an honor to be on with him.

Dean: That's fantastic. I would say probably 50% of our listening audience understands what a tenant in common transaction is. Maybe to further enlighten them and to completely educate the other half, would you mind going through a tenant in common transaction? Explain to us what it is.

Blaine: Of course, tenant in common is a way to take title to a piece of property, whether it's personal or real property, but let's just deal with the real property issue since we're talking about real estate. Tenancy in common is a form of ownership. You take it as a fractional interest in the property. You receive a deed for your fractional interest. In 2002, it was requested of the IRS to take a look at tenancy in common and how it's structured. If it's structured properly it would not be considered to be a partnership. So, in 2002 they issued a revenue procedure that if you followed a certain procedure and followed basically 15 points that that investment put together with tenants in common would not be considered a partnership or at least the chances of getting a letter stating that it isn't a partnership would be much greater. Most attorneys look at it and say if you follow those procedures you'd qualify for a 1031 exchange and it would not be a partnership. Hence, an individual could then buy a fractional interest in a property and use that for a 1031 exchange and as has been explained over the last half hour how an exchange works, as they sell their liquidated property or their down leg, as it's sometimes called, they could

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then take the proceeds from that and move it into a tenant in common vehicle and purchase up, meaning purchase a class A type property; retail, office, apartment complex, industrial property, something to that sort and have professional management. There are two types of ownership or two types of tenant in common offerings out there in the marketplace right now. One is known as a securitized tenant in common offering and the other is a pure real estate offering. There is a differentiation there and it's a very fine line and probably 90% of the offerings out there are securities. There are some pretty extensive legal opinions that have been given to some of the sponsors stating that they are doing them as pure real estate deals, but as mentioned most of them are done as securities.

Dean: Let me ask you two questions regarding that then. On those fractionalized first shares, is each one of the investors in first position? A fractionalized first position, like, if there's 10 investors in a tenants in common agreement is each one in first position together kind of collectively?

Blaine: When you say first position, the mortgage holder is in first position but I think what you're referring to do they receive a deed to their interest and do they have a fee simple interest in the property? The answer to that is yes. Their fee simple interest is the fractional interest, which they are entitled. So if there were three people in it and they each had one third, they would have a fractional interest as to one third and that would be fee simple subject to any liens or encumbrances that were in the property such as the underlying loan.

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Dean: Perfect. Now, the other question, you said, would you mind giving us maybe a little jewel or nugget in what differentiates the pure real estate transaction, tenants in common with the actual securitized.

Blaine: Basically that's going back to the Supreme Court decision, and it was a Howley case, and I don't know that we have time to go into the whole case but basically if there is money invested into it with the intent in receiving a profit which is the case in most any investment and the key element is that if the proceeds that you receive from it comes primarily or solely from the efforts of others and that's what really the securities industry hangs that on as they look at any investment, if it comes purely from the efforts of others then it's probably a security. The real estate sponsors tried to divest themselves of any type of management, they hire outside managers both property and asset managers and they divest themselves of any interest in the property. In that regard, the legal opinions that have been issued out there and of course I don't want to get into that but, if they divested the management aspects from it and that's done by someone else and the owners of the property have the opportunity to hire or fire that manager then it's probably a real estate deal. If the management is maintained by the sponsor, the sponsor's responsible for that management, hence, the efforts that they put into it are solely their efforts and not the efforts of the owners of the property then it's probably a security. We could go into it and a lot greater detail but...

Dean: No, but I appreciate that. That little differentiation makes all the sense in the world. It's a great litmus test. Let's get to the exciting part. Let's talk about this new SEC exemption that may allow commercial realtors to receive advisory fees on securitized tenant in common interest sales.

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Blaine: I think that's the key issue. We just talked a little bit about the securitized side and the pure real estate offering. In the pure real estate offering, the real estate broker has been able to receive a fee for putting their client into one of those transactions. In a securitized one, they obviously can't unless they have a securities license. What the exemption does is allows for, and there's a couple of key elements here, a commercial real estate professional, and the key is they have to be a commercial real estate professional, and basically what determines what a commercial real estate professional is we'll talk about in a second. But the commercial real estate professional, it would allow for them to opine on the real estate aspects of the transaction, not the securities issues, but purely on the real estate aspects of the transaction and receive an advisory fee for doing that. They are exempted then from having to have a securities license. That's the exemption and the key on the commercial part of that is they have to have at least five years and have to have sold at least \$3 million worth of commercial properties over the last five years or 10 million over the last 10 years or they have to have educational experience that is similar to the requirements to obtain a CCIM, an SIOR, or a land designation, those types of commercials. Those are not the only commercial ones but, or the equivalency of the education it requires to get those designations.

Dean: Is it kind of like, as far as how they regulate that, is it kind of like you just have to prove it up, if they ever challenged, like you can claim anything you want on your taxes but you better be prepared to back it up type thing?

Blaine: Yeah, I think that's a good analogy Dean, is that you've got to be able to prove that you've actually done those things. If you can't and you're dealing in these transactions then of course you fall outside the exemption and then you fall under the

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jurisdiction of the SEC and they can come after you for selling these interests without a securities license.

Dean: Now Brendan, on these tenants in common agreements, have you been successful at facilitating a substantial amount of 1031 exchanges for these tenant in common type transactions?

Brendan: That's correct, Dean. We've assisted our clients in doing TICs whether they're securitized or real estate. The question to remember at least from an exchange perspective is whether it qualifies as real estate or like kind property and not as construed as a partnership.

Blaine: That's a key element. That's the reason that the folks that started doing them as securities and have done most of them that way is that when the IRS gave the ruling that it's not a partnership and then the fact that you get a deed to actual real estate, you're not getting a securities form, you just get an actual deed to your fractional interest of the property. So then it becomes real estate for real estate and you have to comply with the exemption. There's two issues here. One is the exemption from the IRS's standpoint which has nothing to do with whether it's a security or a real estate form of a TIC but that it has to be real estate, so the IRS said in their revenue procedures, Reg. Proc 2002 -- 22 as it's commonly called, they said you need to meet these 15 points. So it's important for an investor to have their attorney and their tax consultant review that agreement and make certain that it qualifies for a 1031 exchange under the IRS rulings.

Dean: For all of you out there in our listening audience please feel free to call in especially if you're a commercial broker with a designation of ALC, or SIOR, or CCIM,

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or you have the equivalent, or you have had transacted over \$3 million worth of tenant in common agreements in the last five years or \$10 million worth in the last 10 years.

Blaine: That's not 10 million or 3 million in tenant in common; it's in commercial transactions.

Dean: Oh, that even makes it easier.

Blaine: It's also important to note Dean that this exemption is only for those practitioners that will do a tenant in common transaction occasionally, a securitized tenant in common transaction. What it does is it allows them to have one more; I like to use the term arrow in their quiver to present to their person. As you have mentioned that 45 day period comes up very quickly and so as you're looking for properties out there, a tenant in common offering may be something that would work for them. So this is not someone that's involved in securitized tenant in common offerings on a regular basis. If they're going to do that than they need to go get a securities license. This is for the real estate broker that will do maybe one or two a year and it just gives him the opportunity of another type of property to present his or her buyer.

Dean: That's fantastic. How would then a broker, say for example myself, I qualify. I happen be one of those ones that qualify for this, to be able to receive compensation. I could now, as a commercial practitioner, I could now introduce someone to a tenants in common agreement and get paid like say for example on the amount of capital that they invested? I could get paid perhaps a portion of that? If they invested a half \$1 million maybe I could get a percentage of that amount raised? I could get paid legally? Is that kind of what this is?

Blaine: That's correct.

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Dean: Fantastic. We've been waiting for this for years.

Blaine: The key element too is that you do have to have a prior existing relationship with the client, which is evidenced by a buyer agency agreement. They need to sign a buyer agency agreement with you which discloses what a securitized tenant in common offering is and in there you disclose that you are a commercial real estate professional i.e. you're representing that you have got the background and experience to be classified under that. There's also another consideration that they're looking at and that is to have the buyer acknowledge that they are an accredited investor.

Dean: Excellent. And we'll talk about that accreditation here after this caller. We have a caller Mike from Utah. Mike are you on the line?

Mike: I'm here.

Dean: Great, do you have a question for our guests?

Mike: Just a small point, so this means then I don't have too worry about being stiffed on my commission by a broker dealer who says it's not legal for me to give you a commission on that?

Blaine: Well, keep in mind the exemption has not been finalized yet Mike. It's in the process. I'm going through what the exemption, just touching on a few elements of the exemption request. That request has been issued by the NAR. It's been acknowledged by the SEC. They have put it on their website. They asked for input on that through the end of December and they are now evaluating the input that's been given and trying to answer any of the concerns and questions that have been raised. We anticipate the exemption will be approved, we don't know if that's going to be in the next couple of weeks or in the next

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couple of months. We're hoping that it's going to be done certainly during the first quarter of this year or by NAR's May meetings.

Mike: That's great.

Blaine: To your specific question, when you say stiff, if you qualify under the commercial area then you can opine strictly on the real estate aspects and you've entered into this agreement with the buyer, then yes, when you introduce that buyer to a broker dealer or rep, you also give them your buyer agency agreement, a copy of that, then you can be paid in the transaction.

Mike: At least then I'll have some recourse if they start yanking me around on my commission.

Blaine: I'm not sure what you mean by recourse but you would have a right to receive a fee and that fee is either paid by the buyer or client or by the sponsor. So it's not really paid by the rep.

Mike: I understand that. It's just that in the past without any protection, without the legality of purpose then there would be absolutely no recourse whatsoever to go back to enforce any kind of compensation.

Blaine: No, because it wasn't legal, you couldn't do it legally. Now this opens the ability to do it legally and the reason that NAR approached it was because they had the same questions put to them by a lot of the commercial members that had referred buyers through. I've been in that same situation and I referred it to a broker dealer because I had concerns for my client. I knew I couldn't get paid but I wanted to represent my client properly so I referred them to a broker.

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Dean: Well, we only have one minute left in the show. Mike please make sure you leave your information with the engineers so that we could send you some stuff on this legislation and thank you so much for calling in and Blaine and Brendan I can't thank you enough. Maybe in the last minute that we have remaining can you leave us with a little nugget, each one of you, with one nugget for our audience. We have 30 seconds.

Blaine: Well if anybody wants to reach me they can e-mail me direct at Blaine@BlaineWalker.com.

Dean: Blaine@BlaineWalker.com, what about you Brendan?

Brendan: We can be reached at First American Exchange at 800-556-2520 or on the web at [www.firstexchange.com](http://www.firstexchange.com).

Dean: Another great segment of Income Property Investment Talk here on VoiceAmerica. This is your host Dean Essa, Brendan Faber, and H. Blaine Walker. Thank you very much.