

Peter: Real estate, if purchased well continues to be the single best investment one can make. Welcome to Income Property Investment Talk, a program dedicated to providing investors, eager to invest well in real estate, with the knowledge, the resources and the tools to generate increased wealth. Each week we bring the powerhouses of commercial and residential real estate to our program for you to learn from and to call at 1-866-472-5790. My name is Peter Mosca and my co-host just happens to be one of those commercial powerhouses, Dean Essa. Good morning Dean.

Dean: Good morning, Peter.

Peter: Dean, every Section 1031-exchange transaction is different. Part two of our ins and outs of 1031 tax-deferred exchanges is intended to answer general inquiries and specific questions from you, our listening audience. The application of these principles will depend on the specific facts of each transaction. We always recommend with this program that you consider and consult with a competent, qualified intermediary or Q. I., to determine how an exchange may best be structured to accomplish your investment objectives. For a short list of those QIs, you can always go to our website at www.incomepropertyinvestmenttalk.com, click resources, and you can see a short list of QIs that we know and we're comfortable with on our program. The good news is today we have one of those QIs with us to discuss the 1031 tax-deferred exchange. His name is William L. Exeter, president and chief executive officer of Exeter 1031 Exchange Services. He entered the 1031 exchange services industry in '86 and has written and lectured extensively on 1031 exchange transactions. Bill hosts his own talk show "The Exeter Group Real Estate Talk Radio Show" and is a frequent guest speaker, a guest expert on the "Financial Advisor's Money Talk Radio Show" in San Diego, "Inside

Business Radio” in San Diego, so Bill has experience not only with our topic of the day but also with radio. Bill, welcome to the program.

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

Peter: Bill, in a typical transaction the property owner is taxed on any gain realized from the sale. With a section 1031 exchange, the tax on that gain is deferred until some future date. Section 1031 of the Internal Revenue Code provides that "no gain or loss shall be recognized on the exchange of property held for productive use in a trade or business or foreign investment" and that's what we're talking about here today. What is a 1031 tax-deferred exchange and why is it so valuable?

Bill: Well, the key is if you sell an asset, and typically we're talking about real estate but it can certainly apply to personal property, if you sell an asset you're going to trigger a taxable event and with real estate it's typically going to be two things. One is depreciation recapture, over a period of time you had rental property you depreciate on a tax return and when you sell that rental property if you don't exchange it you're going to recognize that depreciation recapture. Then secondly, and hopefully if you've had real estate long enough you've got some appreciation in value, and the sale of that property will trigger a capital gain tax. So the 1031 exchange really allows you to sell that asset, do an exchange, buy replacement property, and defer all the taxes. The key there is you pay nothing, so we pay no federal taxes, we pay no state taxes and that allows us to keep all of our cash invested for us. It's working for us and it continues to grow for us. That's what the key is, we want to make sure we have the ability to trade up in value, buy larger properties, buy more units, and hopefully by doing that we are increasing our cash flow which increases our net worth and it's all tax-deferred. If we had to pay a third of our

capital gains and depreciation to Uncle Sam and whoever the state uncle is then that would really eliminate the ability to trade up in value. That's truly the key.

Peter: Yeah, let me cut in here for a minute. Do you find that the investors that you work with understand that the 1031, the like kind exchange under 1031 is tax-deferred and not tax-free, so when their replacement property is ultimately sold and moved into or leveraged into another exchange that that gain sometime in the future is going to have to be dealt with so to speak.

Bill: That's a good question. There are a lot of misconceptions out there. We find a lot of people when they ultimately sell are surprised that they have to pay tax on all of their prior gains as well. They almost look at it as if I bought a replacement property and I only have to pay the increased value going forward and it's really an accumulation of all the capital gains and all your depreciation recapture that you have deferred over the years and ultimately if you sell the property then you're going to pay tax on all of that.

Dean: Bill would you mind, before we get into some of the really intense technical issues regarding the 1031, would you mind giving our listening audience an overview of the 1031 process, you know the 45 day, the 180 day. I found that we speak to investors all over the country and typically about half the people in the room understand those time frames and how they dovetail.

Bill: Boy, that's really true. The first thing is, like you mentioned, you have to have a qualified intermediary and the industry also refers to us as an accommodator, they're really one and the same thing. You have to have that entity assigned into your transaction before the closing. That's really the key. If you don't have an accommodator assigned into the transaction, then at the closing of your sale transaction you as the taxpayer have the

right to the funds and that triggers your taxable event. So you want to make sure you have your accommodator assigned into the transaction before closing. Once the closing occurs you have a 45 day window, 45 calendar days to identify potential like kind replacement property and you have a total of 180 days, so you have your original 45 days to identify potential property, another 135 days to complete your exchange for a total of 180 days. So the 180 days is really not that big of a deal, it's the 45 days that's pretty tricky. It runs very, very quickly. That's really what you want to watch out for. There's qualified use requirements so all of the properties that are involved in the exchange, both what you're selling and what you're purchasing have to be qualified use. That means they're held for rental, investment, or use in your business. Held for investment could mean you bought vacant land and held it for capital gains or appreciation, so it doesn't have to produce income it just has to be held for investment purposes.

Dean: Speaking of the 45 days, I can't tell you as I mentioned, we speak to investors all over the country, and we always have a 1031 speaker there, and I cannot tell you the people who have come up to us on the 44th day and tell us that they really need to go ahead and within 24 hours find three properties. Have you ever found people come to you at the last minute?

Bill: Yes, the panic attack. I'll tell you in 24 hours it's pretty tough to find property.

Peter: Well I'll tell you what, that's where I can do a quick 30-second commercial for the sponsor of the program RealSource. I mean that's the power of what that company can do for investors, not that they want you to wait until the 24th hour left in the 45 day period but a company like that is able to identify those properties for investors. When we do workshops across the country for them that's one of the reasons why an investor would

move forward with them automatically because of that 45-day time constraint and I'm glad you brought that up, Bill because I'm not sure that's sinking in to the general population.

Bill: That's very, very true. It is amazing how fast 45 days flies by. In fact, when you look at it it's really about six weekends and that's really the time you have to go out and look for property. So if you've got somebody like RealSource who can really sit down and help you quickly identify and narrow down properties, it's a huge, huge plus.

Peter: Bill, let's talk more about, like Dean had brought up, about the QI, the qualified intermediary, because if there's one thing that makes me ill is the number of stories that you hear of 1031 exchange services absconding with investor/client money. What we both know is that if I wanted to at the end of this program, I could put up a shingle outside my home, I work out of my house, and say that I'm a 1031 exchanger, I'm a QI. There's really very little in terms of regulation involved. There are differences between QIs and QIs and I think we can agree with that. Talk to us about, I know because we have relationships with other QIs on this program, last week we had a gentleman on from First American Exchange Company, Brendan Faber, who you probably know, we know Teresa Moss, Mary Cunningham from Chicago Deferred, and I know Chicago Deferred Exchange Corporation does a great job in terms of working with investors/clients monies, putting it separately, so talk a little bit about that process and how important that is.

Bill: That's an excellent question. It amazes me that I would say 80, 90% of investors don't realize that QIs are not regulated, they are not licensed, and they're not required to be bonded. It's essentially a completely unregulated industry. That's probably going to change and is beginning to change over the next couple of years. There's currently five

states that are looking at somehow regulating accommodators. In my opinion, most of the regulations that are currently pending need to have more teeth put into them but at least we're going down the right path. At this point there's really no regulation of the industry. You have to know what to look for and what questions to ask etc. when you're evaluating and selecting your qualified intermediary. I'm going to kind of turn the tables a little bit. I've been doing exchanges for 23 years and the biggest area that I've seen losses and is not necessarily the embezzlement of the funds, it's just the accidental loss where the accommodator should've caught something that was in the purchase and sale agreement, or the preliminary title report, or the escrow instructions and whatnot, that potentially disqualifies the transaction from 1031 exchange treatment and they don't.

Peter: That's a great point because on this program we've been talking about how important it is, a lot of us today in America we like to do things ourselves, do it yourself, that's why cable television is able to fill its programming because there's do-it-yourself programs for almost anything you can possibly think of and what we say on this program, Dean and I, we say listen if you are going to invest your money, make sure you reach out to the very best professionals you can. You bring up a great point Bill because a professional like you pick up on those types of things where as a do-it-yourselfer would more than likely miss that.

Bill: Absolutely, because when you look at the 1031 code it's fairly brief and if you look at the regulations there is a lot more teeth there but then when you get into the rulings and the pronouncements that have come out over the years, then it gets a lot more complicated. So what should be a really simple transaction is not. You don't always know what to look for and I find to a lot of qualified intermediaries are concerned about

liability, they're concerned about giving wrong advice, so most of them will take the position of we process the transaction, we will refer you to your accountant or your attorney and they'll give you advice, but most accountants and attorneys don't deal with 1031 exchanges very often so they don't necessarily know all the different twists and turns that are out there. You really need an accommodator who's got the experience and the expertise and the years in the business to really look at all the documents, catch potential problems, point them out, and probably more critically is to be able and willing and not afraid of liability to give the advice, give the structure, give the guidance, that the taxpayer really needs. That's really the area I've seen the most losses in. I've done a lot of expert witness work and that tends to be the biggest problem, an accommodator doesn't necessarily make the mistake but they should've caught it and didn't, so then of course they get sued. That's really the top one. The second one is related to that, where that's where the accommodator does make a mistake. We're all human, we're all going to make mistakes, and you want to make sure that your accommodator can stand behind that. That's making sure that they have errors and omissions insurance. A lot of the accommodator's, especially the small mom and pop shops either can't qualify or can't afford E and O insurance. If an accommodator screws up on your transaction that means it's probably going to be disqualified and you're going to recognize your tax liability, so that could be a huge hit.

Peter: We're talking with Bill Exeter, president and chief executive officer of Exeter 1031 Exchange Services. We're going to take a short break, but we'll be right back to discuss QIs and more on Income Property Investment Talk.

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.

Peter: Welcome back. We're here with Bill Exeter, president and chief executive officer of Exeter 1031 Exchange Services. Bill before we left for break you were talking about what to look for in a QI, a qualified intermediary/accommodator. One of the things that we should talk about, I believe, is what happens when an investor says okay Bill here's my money, what do you do with it, what happens to it?

Bill: Absolutely, good questions. In fact, the first thing that you want to ask for is where do they put the money, is it a local, regional bank, a community bank, is it a large institutional bank, etc. There's a lot of reasons why they might put their funds in a certain place and we want to make sure they're not putting their funds in a really small institution just to get referral business back to them. You want to make sure the solid institution that your comfortable with, that you've heard of, et cetera. The other thing you want to look at is their internal controls. I would ask questions specifically like when the money gets to you, how do you handle the funds? A lot of accommodator's don't have a sophisticated back office and that would be a critical issue for me. We reconcile our accounts every single day and we balance down to the penny, so we know if we're ever out of balance we can find it immediately. That's a critical component because boy your back office can get out of control so fast it's just an amazing thing.

Dean: Some people don't even have a back office. Sometimes you walk in the back door and you're out in the parking lot.

Bill: That's very true. That's really a critical, critical issue and part of checking that out too is making sure that they have fidelity bond coverage because we talked about the errors and the omissions but obviously, fidelity bond coverage is crime insurance and that's very important. Ultimately, after 23 years I've never had an employee embezzle funds but at some point they're going to get you and you have to make sure you're covered for that in case that should come up. You also want to make sure exactly how do they hold the account. Is it in their individual name? The account should be under the control of the accommodator, it should not be in the taxpayer's name because if the taxpayer has control over the funds during the 1031 exchange, it's what they call constructive receipt and its taxable. That will invalidate their 1031 exchange transaction.

Dean: What about these, in the last few years we've heard about somebody being absconded. Would you mind touching briefly on what happened there, and what our listeners should watch out for?

Bill: Absolutely. There's two that happened last year, one was essentially on the West Coast, which was the Southwest 1031 Exchange and one was primarily on the East Coast, so they had quite a number of operations and the one on the East Coast was 1031 Tax Group. A number of things happened there. First of all, they were both done by two different individuals but the fact patterns were almost identical. They both got into the industry about two years ago specifically to buy accommodators to use the funds for other purposes. So you want to look at the accommodator, the length of time they've been in business, who's the management team, who's the ownership team, and has there been any change in management or any change in the stockholders or investors etc. in the last

couple of years. If there are, that doesn't mean it's necessarily a bad thing, it just means it's one more thing to kind of dig deeper into.

Peter: Bill, are there other companies out there besides going to the smaller financial institutions like you talked about, what are the ways are they investing the investors money? How else do they invest that money or can they invest that money?

Bill: They can certainly choose to invest it virtually any way they want, so that's a good question. You want to know exactly how they're doing that. Especially the larger institutions, they're probably going to pool their funds, they're going to have professional money managers, they're going to use probably treasure bills, treasure bonds, very short-term government instruments, and those are perfectly okay. You want to make sure that's what they're limiting it to. We've had some accommodators historically, there was one that invested in first trust deeds and second trust deeds. Those things are just not prudent investments for a 1031 exchange activity. You shouldn't focus on how much interest you get; this is really a tax deferral strategy. Our average hold period right now is about 37 days so for 37 days you're not going to have that much in the way of interest income.

Peter: So there's a balancing act there so to speak.

Bill: Exactly. It has to be an investment where you can have immediate access to your funds; it's completely liquid, there's no risk to principal, et cetera.

Peter: Okay, when we were discussing the show on break, you were talking about something that really, the light bulb in my head went off, when you talked about the modifying of the exchange agreements and how important it is for an investor to read the documents from start to finish. Can you talk a little bit about that because that really was something that caught me off guard? I never heard that before.

Bill: One of the QIs had actually modified their like kind exchange agreement with one of the companies they had acquired and the agreement actually permitted them to borrow the funds from the 1031 exchange account or 1031 exchange funds for other uses and they were redirecting that into other real estate investments they were going into. Now the issue is were the funds actually stolen or embezzled in that particular case? It's a legal issue that's going to have to go through the court system at this point in time. So it's critical that investors read the exchange agreement because that's going to spell out what the QI is limited to in terms of investing the funds and how to hold the funds. That's a big, big issue.

Peter: No doubt about that because if the company then does use those funds they can't say hey the company absconded with my money.

Bill: Exactly. Right now they're just claiming basically that we had a liquidity crisis and we don't have the funds to provide to finish your 1031 exchange transaction.

Dean: You mentioned like kind. I know that there are different types of exchange, I know there is a regular exchange, there is a reverse exchange, and there is construction exchange. Can you talk a little bit about, just a brief overview about what type of exchanges are there so our listening audience can say maybe I fit into one of those categories?

Bill: Sure I'd be happy to. The regular exchange is known by many different terms. We call them a forward exchange because you're selling first then you have 45 days to identify what you're going to buy and 180 days total to buy it. You're going to hear them referred to as a starker exchange, a 1031 exchange, a regular exchange, a deferred exchange, and a delayed exchange. They all really mean the same thing. You either close

them simultaneously or you close them on a delayed basis. So that's where you're selling first, buying later. Then you have the reverse exchange, which is becoming more and more popular. The ruling came out in the year 2000, so we've got 7, 8 years of experience with them now and that's when you can buy your property first and then sell your existing property later within that 180-day window. Then you also have what they call improvement exchanges, or you'll hear them referred to as build to suit exchanges, or construction exchanges, where you can identify, acquire replacement property and also use your excess or leftover exchange funds to build or improve or construct whatever you bought. Those are really your three categories.

Peter: Based on what you just mentioned there Bill, we can tell, and everybody should recognize and understand that there are countless rules and regulations that go into or are a part of conducting this 1031 exchange. Let's face it; it is the IRS that is responsible for it. The IRS rules and regulations are important, obviously. They're looking out for the American public. One aspect of the 1031 is identifying what a qualifying property is. Is that something we should look into right now, talking about what that is? I mean in general, if the property is not specifically excluded it can qualify for a tax-deferred treatment. Can you talk about what excluded means in and around the qualifying property?

Bill: Sure. In fact, there are specific types of property that are excluded from 1031-exchange treatment. Most of it's fairly basic and common sense with what doesn't work like cash, stocks, bonds, mutual funds etc. I mean you're selling real estate, so you have to buy real estate. Some get a little more complicated, like partnership interests, and that's probably one of the biggest areas or problem areas we've seen in the industry today. In

the 60s, the 70s, and the early 80s the entity of choice was to set up a partnership when you bought real estate. Today we are to the point where the baby boomers are getting into retirement, they want to split up the partnership and all go their separate directions. The problem is the individual investors don't own real estate, they own an interest in a partnership and so when they sell what they're getting is a cash distribution, so you can't exchange a partnership interest. So the partnership at the partnership level could certainly do an exchange, but the individual investors can't. You have to really look at what are you selling, what are you buying, and it has to be a real property interest on both sides of the equation in order to qualify.

Peter: Now, when you're talking about partnerships are you talking about the tenant in common type investment?

Bill: No, in fact it would be something set up and structured specifically as a partnership.

Typically there's a partnership agreement, you file a 1065 partnership tax return etc.

That's an excellent point because if you're not careful the way you to set up your tenants in common arrangements, it could be construed to be a partnership. So you have to make sure that you're not operating like partnership. A lot of people will sell property and then when they go to buy replacement property, the lender says look you have to have an LLC set up or we're not going to loan the money to you, so they're really buying into an LLC because they're going to have multiple members in an LLC. They need to make sure they structure that not with one LLC, which becomes a partnership, but as a true tenants in common relationship where they really do have an individual direct ownership in the property and they actually own the recorded deed and title.

Dean: What about this new vacation home ruling? Do you know anything about that?

Bill: There's a new ruling that came out, it's Revenue Procedure 2008-16, and that kind of cleared up a lot of ambiguity out there. What happened is, the question comes up is vacation property or is a second home considered investment property also. We had a private letter ruling way back in '81 that said basically yes, we had the regulations that came out that said no it has to be investment property, but it really didn't address the issue it just left us to guessing. A lot of us were saying if you're not truly holding it as a rental or investment property and you're using it for personal use, it's not going to qualify for 1031 exchange treatment. This ruling that came out was really favorable to the taxpayer. I was really surprised that it was this flexible and essentially what it says is you have to hold it as investment property 24 months prior to your exchange and 24 months after your exchange, but the requirement is you have to rent the property for at least 14 days or more and that's nothing really. You have to limit your personal use to 14 days or 10% of the number of days that you actually rent it out. So if you rented for 300 days out of the year, you can actually use it personally for 30 days out of the year. Now we have some guidelines that really tell us yes we can exchange vacation property provided you follow the rules.

Peter: Okay, were speaking with Bill Exeter. Bill is talking about the 1031 tax-deferred exchange, talking about the vacation guideline that just came out and we will have that up on our website at www.incomepropertyinvestmenttalk.com. When we get back from the short break, we are going to talk to Bill more about the 1031 tax-deferred exchange, how investors can take advantage of this particular guideline that the IRS provides for you.

Please stay tuned.

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.

Peter: Welcome back to Income Property Investment Talk, we're here with Bill Exeter. Bill, one of the things we want talk about as we make our way through the rest of the hour and we're encouraging you, the listener to give us a call. Some of you might be in particular situations that Bill, Dean, or I can help you with. Give us a buzz, 1-866-472-5790. If you have any questions that come up in the future you can go to our website@incomepropertyinvestmenttalk.com, click on the ask a question button and we'll have a real estate investment advisor get that answer to you. Now, some of the things we want to talk about are some stories and things that have been happening in our lives. Bill, if we can. Dean you had something that you wanted to talk to Bill about.

Dean: It just happened yesterday actually. I got an e-mail from an investor, he's in tenants in common with two other investors and they bought a pretty good-sized office building in Scottsdale. This one particular partner wants to sell his ownership interest. He kind of ran out of money, ran into a little bit of a problem, and he wanted to know if we could help him market his interest and how would that affect an exchange both either for him or for the person who would assume his partnership interest. I'm sorry not partnership interest, tenant in common interest. I wonder if you have any thoughts at all on that Bill? I had a couple things I wanted to tell him, but I'm not a CPA nor am I a real estate attorney and I thought maybe you could give some guidance.

Bill: Sure, in fact the way you describe it is really exactly the way that taxpayers call us and describe it which is a mention tenants in common, but they refer to themselves as a

partner. So the first thing we want to do is flush that out and make sure that it truly is a tenancy in common arrangement and in a lot of cases they'll call it a tenant in common but they've actually set up a formal partnership agreement, they file a 1065 partnership tax return, and then they turn around and give each of the two partners a K1 and they report on their individual tax return. In that case it is actually is going to be a partnership and if he were to turn around and just sell his particular interest in that partnership to somebody else it wouldn't qualify. In most cases, it truly is a tenancy in common arrangement. They are on individual titles so they each have an undivided, 50% interest to the property. We want to make sure there is no formal partnership agreement or any kind of agreement like that. We want to make sure they don't file a 1065 partnership tax return. We are really trying to make sure that they truly are holding title as individuals as tenants in common. Once we get to that point then the answer is absolutely yes that can be exchanged because they each have an undivided interest in that real property. It's a direct interest real estate.

Dean: Can I put that property, his interest, on the market?

Bill: Yes, absolutely.

Dean: Okay. Is it okay if I have them give you a call after the show?

Bill: Sure, I'd be happy to do that, absolutely.

Dean: Okay, thank you.

Bill: That's really the issue. If they truly are individuals as tenants in common than they have complete flexibility where they can actually sell that particular interest, whatever it is, 10%, 50%, and then do a 1031 exchange into another real estate interest. It may be

into another tenants in common. It may be into a property they take down 100% of, whatever they choose to do.

Dean: You know what I'm impressed with, Bill, I remember hearing back to Peter's initial introduction about how you entered in '86, and you know '86 was the year of the trifecta, the tax revision and the oil crash and the savings and loan crash. Talk about baptism by fire, that's when people were buying office buildings and thinking about jumping off the top floor. Just the fact that you're standing here today after entering into this arena during that year, I've got to say that's pretty impressive.

Bill: It was a wild year and I can tell you that. We had the tax act there and the county recorders were open until 2,3,4 in the morning on New Year's Eve.

Dean: They couldn't keep up.

Bill: It was just an unbelievable year-end.

Peter: Bill, I just want back track a minute, just for my own edification and make sure I understand this. When you're talking about partnerships, can investors exchange partnership interest in the 1031 and does the partnership itself make the exchange?

Bill: Good question. The partnership itself at the partnership level or entity level would have to do the 1031 exchange transaction. So if I have ABC partnership, we have five partners, the partnership can sell real estate, identify property and buy into another real property interest as investment property. That's perfectly okay. There are solutions if the underlying partners all want to go different directions. We don't have enough time to talk about it but there are two really basic summaries. One is called swap and drop where the 1031 exchange is completed at the partnership level, they buy five different properties in the partnership as an exchange, than a year or two years later they drop one property out

to each underlying investor or partner, so that's what they called swap and drop. They do the swap of the partnership level and then later on distribute the property out. The more common structure, the reverse which is a drop and swap, you drop the property out of the partnership, so the partnership deeds the property out to the partners and now they hold it as tenants in common instead of a partnership issue. The key there is the individuals have to hold title long enough to prove they had the intent to hold for an investment. Then you can sell, and they can all make their own decisions and go separate directions. That holding period should be at least 12 months if not longer to be safe. That's in a perfect world. In the real world we typically have about two weeks. It gets very complicated but that's a very concise summary of how that works.

Dean: Peter, he's not talking about the double date you were on last weekend, swap and drop, he's talking about real estate, in case you're wondering.

Bill: But we do personal property exchanges, so you know.

Peter: Well after that one I might have to start discussing swap and drops and personal property. Thankfully I'm not in California but in New Jersey I think I might have to pay an awful lot too so.

Bill: Where do you take that one?

Peter: Dean, Vegas isn't the only place where you're supposed to keep things, you know. Earlier we talked about delayed exchanges, that has several different names and people exchange different names for it, but ultimately the delayed exchange is, I believe, the most popular exchange process, the one that most investors are familiar with. You talked about the basic approach, you talked about the 45-day rule, you talked about the three-property rule in terms of identifying three properties. One of the things that you didn't

touch on, I don't believe, and if you did I apologize but what is the 200% rule and how does that apply to the investor?

Bill: Typically the investors use the three property rule because they're selling one property and they want to trade up in value so they're going to identify three properties, each individual property will be a greater value than what they sold. They typically identify three with the intent to buy one. If you have an investor who really wants to diversify their portfolio, that three-property rule may not work for them. You may have an investor who wants to buy three or four properties and they really would prefer to identify more so they have options. If they want to identify 6, 7, or 8 properties, it's more than the three-property rule, that's when you would look at the 200% rule. It gets a little more complicated, but the 200% rule has no limit on the number of properties, the limit is on the total fair market value of all the properties you identify. It's 200% of whatever you sold. So if you sold \$2 million in property, 200% is 4 million, you can identify as many properties as you want as long as it doesn't exceed that \$4 million limit. So it's a great way to kind of add more in terms of how many properties you can identify and gives you more options to choose from. It's usually used when an investor is trying to diversify their portfolio don't make a play on it. We have found, I'm sure there's other circumstances that will lead somebody to do a reverse exchange, but in my personal experience that is the number one reason to do a reverse exchange. Do you have any thoughts on that?

Bill: Yes. That's one of the most popular reasons to do it, they just find an opportunity they can't say no to and they have to buy first and they probably haven't even listed their existing property. They're going to go ahead and buy, close, and then you've got be 180 days to list. Historically, it has not been an issue; of course, the market today is a little

more challenging than listing the property and selling. I always tell clients you can always sell property in today's market, the question is how much do you want to discount it. That's really the issue. The other thing we've seen quite a bit is we actually expected a decrease in reverse exchanges this year, and we've actually seen the opposite. We've seen an increase because a lot of the clients are trying to put their sale and their purchase properties into the transaction and trying to get it to close fairly close together, fairly close to being simultaneous. At the last minute when they go to close on their sale, the buyer can't complete their financing. Either the lender doesn't exist anymore, the loan program doesn't exist anymore, the underwriting requirements have changed, so the sale transaction either gets postponed or canceled altogether and same thing, they have to decide, do I want to buy on my purchase and go ahead and close or do I just walk away and let it go. Either way, if you have to buy first that's when the reverse exchange kicks in.

Peter: Well, you mentioned financing and we're going to have after our next break, Stan Hanks from RealSource Commercial talk to us about what's happening in the financial markets right now in terms of loans and things of that nature. Bill, one of the other things, quickly, I think we have one minute left and maybe I'm putting too much on you, but with the reverse exchange, I see that happening with the investor who wants a little time to make some improvements so that way they can take the money and upgrade into additional property. Do you see that happening as well?

Bill: Yes. Absolutely. It's a great way to get time to go out and find exactly what makes sense, upgrade, buy larger property, find exactly what suitable, buy that and you're going to combine that with the construction or build to suit exchange too. So you buy it, park

title with us, and you start building, making improvements while you're trying to sell your existing property.

Peter: Fantastic. We're coming up on our next break, but when we get back will be talking with Bill Exeter and Stan Hanks.

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.

Peter: Welcome back to Income Property Investment Talk. We're here with Bill Exeter, president and chief executive officer of Exeter 1031 Exchange Services and we're proud to bring on the program now Stan Hanks from RealSource Commercial. Stan joined us on the break and Stan you're on the air. There is that Pink Floyd music we all love and that indicates to us that it's time for the Mortgage Minute. Stan, I guess I sound like a parrot somewhat because I keep saying the same thing to you when I have the pleasure of speaking to you on the program, but you know what as long as this message continues to resonate, I saw Sam Zal, who's a Chicago real estate expert and an economist in his own right.

Dean: I was told that one of the reasons why they instituted that 200% rule was that before that investors, just to protect themselves, were cutting and pasting the whole multiple listings service and dropping it into their identification.

Bill: That's very true. We had one investor, this is back in the late '80s that sent us a letter and attach the MLS printout as their identification list. That's a little too unspecific.

Dean: Now what about the reverse exchange? I want to talk a little bit about that for a second. I know we touched on it. Is that basically the same as a forward exchange as far as the time frames go, but in reverse? 45 days and 180 days still apply but in reverse?

Bill: That's exactly right. When you acquire your property, you're acquiring that upfront. When you acquire it the accommodator has to take title to it or what the IRS calls park title to your property. From the date that we park title, that starts your 45 days and in this case you're identifying what you're going to sell. In most cases, the taxpayer already knows that so you just have to formally identify what you're selling. But in some cases you may do enough real estate transactions every month that you're not quite sure what you're going to pair that with. You have 45 days to figure out what you're going to sell, then you have a total of 180 days to actually sell it. You have to sell and close the transaction no later than that 180 days.

Dean: We've used it with our investors. A reverse exchange is sometimes an investor is placed in front of a property that he absolutely has to have or he's going to go take out a whole post office, it's such a great property, but yet he or she has not sold their property and so they know that it's a hot property, it's undervalued and they're going to lose it if they yesterday on MSNBC telling people now is the time to buy, there is money available, what say you? Is there money available out there and what type of money is available out there?

Stan: There is money available and I just saw a very interesting article, so I want to allay some people's fears, if you look at the foreclosure rate on commercial property and they actually base it on delinquencies, not foreclosures, but there is a .28% forecbsure at the end of '07 versus the double-digit foreclosures and delinquencies we're seeing in the

housing market. There is a significant difference and that's why the principles in commercial lending are still worth lending on. The principles that back property that cash flow are still going to get the loans. People are really concerned about these loans that have been securitized and I don't want to confuse the listeners, but 80% of the sub prime loans were securitized, which is what caused a problem. Only 28% of commercial mortgages have been securitized. Those are some of the differences. That's what's really key for your listeners is to realize commercial property, when I say commercial, I'm talking either office, self-storage, and multifamily, five units and above.

Dean: Stan, do you think that may have something to do with the fact they also look at the property itself, not just the investor for example, on the residential side?

Stan: No question. Day in and day out as I look at deals the first thing we look at is take the income, less the expenses, include in there the debt you're going to have on the property, and there should be cash left over. The cash to pay the debt comes from the property first and foremost. I think that's the key principle when you're buying something other than a residential home.

Dean: What type of debt service coverages are the lenders looking at these days? Is it very similar to what they looked at in the last 2, 3 years? Is that changed much?

Stan: It hasn't changed a lot but what has changed, they're still at a 1.2 on average is the debt coverage ratio. Sometimes you get even better rates this year at a 1.3 or a 1.4, but you can still get a great loan and you can still get the price that you want as long as you have a 1.2 debt coverage ratio. Fortunately, because of who we are at RealSource and our relationships, I'm underwriting loans at 1.15. So we can still be aggressive. But here's the things that have changed, things have changed. We no longer get as much interest only as

we used to. We use to easily get 2, 3, 5 years of interest only. That's really, really tailored back and you may get one year but plan on no years of interest only. Plan on a straight amortized loan, but you should always underwrite at 30-year amortizations. If you're working with a lender that's giving you 20 years amortization, give us a call.

Peter: Stan, one of the other topics we were talking about today when we were talking 1031 exchanges, we were talking about partnerships, we were also talking about tenant in common type investments, and I know that's something that you are quite familiar with their at RealSource Commercial.

Stan: We do them day in and day out. A small tenant in common deal to us could be somewhere around \$1 million. We're working on a \$3 million tenant in common loan right now and the rates going to be below 6%, 5.85%. We are also looking at a \$20 plus million tenants in common project and we are going to be somewhere around six for three years, that's 6% and there will be 30 to 34 investors on that project and we're still going to get a great rate. We know what it takes to do a tenant in common deal. If there's multiple partners, please give us a call because we can make sure those things get funded.

Peter: Bill, your ears just perked up hearing those rates that Stan was talking about.

Bill: Those are pretty darn good rates.

Stan: Well, they are. We used to be able to get those rates from all over the place and we've had to struggle to find them, but we have them. The other thing that we just found out is with a meeting with Fannie Mae and Freddie Mac, it looks like they will also be starting to do some tenant in common deals which historically they have not. That's another option that's going to be out there, which will be a great option.

Dean: I know that Stan, with RealSource Financial a lot of people don't understand the difference between commercial financing and residential financing. In the commercial arena you have to have the relationships, you have to pay the price in order to become correspondent lenders with some of the best money that's available in this country. I know that you just can't wake up one day and have those correspondent relationships. You had to pay the price didn't you?

Stan: We did and that's an interesting point because when someone is trying to get a loan and they walk into their bank they will not get the terms than if they went to a seasoned correspondent lender, which is what we are. In fact, I sat in front of a really great lender just the other day and I said so when people walk in off the street what you tell them. He said we tell them to call you because we want them to go through someone like yourself to make sure to weed out those deals that really aren't deals.

Peter: Okay Stan. Very quickly, I know it's Stan@RealSource.net but what phone number can you give the listeners to call if they're interested in talking with that seasoned financial lender?

Stan: 800-929-2150. 800-929-2150 or go to our website RealSource.net.

Peter: 800-929-2150, you know me well I had to say it a third time.

Stan: Always Peter, always a pleasure. Thanks you guys.

Peter: Thank you Stan. Bill, we have about two minutes left in the program. I'm sure we didn't touch on everything we possibly can with the comprehensive subject matter like this, but give us that last golden nugget that you want to discuss with this last minute and a half that we have.

Bill: I would say when investors have a pending 1031 exchange to look for an accommodator who's really willing to sit down, evaluate the transaction, come up with some strategies, obviously accommodator's are not attorneys, they can't practice law but they can certainly give a variety of options. They can help give some advice, potentially give some structure, choices, and really say here's your options, here's your pros, here's your cons, here's your less risky, here's your more risky, and then working in conjunction with their advisers they can actually come to the best decision possible for the tax payer. Don't look for just someone who's a processor, you want to make sure you got somebody who's willing to really sit down and discuss the transaction with you.

Peter: And Bill how does one get a hold of you?

Bill: A couple ways, they can e-mail me at WExeter@ExeterCo.com, so it's wexeter@exeterco.com. They can call us at toll-free, 866-393-8370 that's 866-393-8370 or the website address is Exeter1031.com that's exeter1031.com.

Dean: I'm going to call you after the show, if it's okay Bill with that client on the line that I'm helping them through selling their tenant in common interest.

Bill: Sure I'd be happy to chat with them.

Peter: Bill Exeter, thank you so much for joining us on Income Property Investment Talk. Next week we will have Saul Klein from .2 Technology. Saul is a realtor technology guru. He's going to be talking to us about technology, the real estate transaction, and using technology in the investment process. Dean, have a great day today.