How To Make A 1031 Like Kind Exchange Succeed

An Owner's Perspective

Apr 5, 2010 | *By Rick Liljedahl, CRE* Net Lease Capital Advisors, Boston, MA

Like kind exchanges may provide significant deferral of taxes when selling a property. I have recently had the opportunity to lead a portfolio based like kind exchange, involving more than 28 partnerships relinquishing property at a point in time. This is an owner's perspective of some of the multiple events and decisions involved in the 1031 process.

The decision by an owner to utilize a like kind exchange requires consultation, investigation, thought and understanding. The first task is to clearly determine the tax situation of each individual partnership. Within each partnership, each partner will also have a distinct tax situation, all of which will determine if there is sufficient savings to warrant a 1031 exchange.

Once prospective 1031 partnerships are determined, the process of organizing a team begins. Certainly a large portfolio of 1031 deals will command more attention than a "one off" deal, but the required process and players are the same in both cases. 1031 is a specific niche and as such requires specialists. The owner must objectively assess its own knowledge of the 1031 process. Proper execution is critical; there is only one chance to execute properly. Our group understood this and also placed high importance as to the rewards; we chose to organize a team immediately and proceed on a very proactive basis.

The team of specialists may include an accounting firm, an attorney specializing in 1031 transactions, an advisor for structuring, a qualified intermediary (QI) and other consultants as needed (brokers, appraisers; environmental, etc.). It is critical that this group operate as a team, since each participant has an important contribution and is a necessary participant. Consistent communication was emphasized and our entire team participated in set conference calls frequently. Everyone heard the same information, as it is critical to gain consensus early on. The dominoes than began to fall into place.

The real trigger for the 1031 event is the sale date for the relinquished property. Expected dates in the real estate business are often fluid and this has a direct impact on finding, securing and executing replacement property. Once again, focus and flexibility are essential.

It is advisable to begin the search for replacement property immediately, before property is relinquished. We did this and it proved fruitful and interesting as in some cases it became necessary to convince the seller we were real buyers and would in fact close. We had several investment criteria, and as a development company, we also placed a very high emphasis upon traditional underwriting and "go dark" scenarios; we wanted inherent real estate value. Several deals were rejected due to "overimprovements," inferior locations or other real estate factors.

Following are the critical elements inherent in the 1031 process. The process is intense as many of the steps happen simultaneously.

1. Locate and secure appropriate deals, often taking into account particular partner preferences; keeping in mind the 45-day time window.

2. Formally identify property under the 200% or 3 property rule and aim for execution. Provide for an alternate plan should the identified deal fall apart.

3. Complete due diligence within a short time window; coordinate third party consultants.

4. Maintain intricate and highly fluid records which for each partnership as to buying and selling and the overall mix of properties and portfolio characteristics.

5. Consider and execute needed interim and or permanent financing.

6. Document all deals.

7. Execute! Keeping in mind the 180-day time window.

8. Celebrate the execution and success!

Conclusion: 1031 is a defined mixing of expertise and execution. A well thought out process and a proactive and creative team insures the probability of execution and ultimate success.