

INDUSTRY EXPERT OPINION REPORT

James Brennan on 1031 Exchanges

CALKAIN: WHAT ARE CLIENT'S CONSIDERATIONS WHEN SELECTING AN ENTITY TYPE TO HOLD TITLE TO REAL ESTATE?

BRENNAN: Clients unfortunately default to an LLC for entity choice simply because of asset protection. However, when co-investing a Joint Member LLC creates exit strategy concerns as it can hamper one investor's ability to properly structure a like-kind exchange. Clients need to carefully examine the structure that will house their real estate investment and contemplate the next investment assuming this investment is profitable.

CALKAIN: WHAT TYPE OF STRUCTURING DO YOU SEE AT THE ACQUISITION AND DISPOSITION STAGES?

BRENNAN: Often as a function of how real estate syndications are marketed, most General Partners or Developers use a GP/LP approach to structuring the laddered returns both for limited partners and general partners. This structure is fine for economics and often yields the intended result with a properly drafted operating agreement. However, partnership interests are not eligible for exchange, so limited partners need to focus on real estate interests that are "deed-able" to make the interest conducive to like-kind exchange treatment.

Clients do not need to seek out a commercially packaged Tenant-in-Common deal to achieve these results, clients simply have to select a well-versed Sponsor and a CPA/tax attorney that can craft a win-win structure for both the limited partners and the general partner.

CALKAIN: WHAT TYPE OF ESTATE PLANNING TECHNIQUES DO YOU SEE UTILIZED?

BRENNAN: The \$5 million and up net worth set gravitates mostly to a living trust at first as "Family Stewards" are looking to make managing assets easy for heirs, so a Revocable Living Trust gives the comfort that properties will funnel to the right place via contract and the Grantors (current property owners) do not have to sacrifice control of the assets currently.

In my opinion, clients do not pay adequate attention to estate taxes and how assets are titled. Real estate investors particularly tend to have a desire to control their investments; however, certain investments, such as triple net leases, lend themselves to estate planning and passivity.

Clients should really try to plan for both capital gains events and estate events. Unfortunately too much attention is put on deductions, current income, and economics of deals; however, clients face 25-50% in capital gains taxes upon disposition and upwards of 45-55% in estate taxes. This level of taxation will erode a substantial amount of the cash you will net from an investment when attempting to build real wealth.

CALKAIN: WHAT PROPERTY TYPES ARE BEING SWAPPED?

BRENNAN: Right now institutional investors and traditional buy-and-hold investors believe the market is improving- thus, why "sell in a soft market?". However, clients with low-basis property that have certain events (death, retirement, financial distress) are opting to conduct like-kind exchanges.

An example would be an apartment building investor retiring to Florida and swapping out of an Arlington Apartment building and buying a Walgreens NNN lease as replacement property. The client gets cashflow without the "toilets, tenants, and trash".

Another interesting and timely example are landowners selling to energy companies drilling on their property. This low-basis acreage with no depreciation benefits is great fuel for an income-producing commercial replacement property whether it be retail, industrial, or office. These clients often do not know that their land is "like-kind" with commercial real estate, and they do not know that passive real estate investments are out there that they do not have to actively manage.



These case studies exemplify the reasons client have conducted like-kind exchanges with Exchange Solutions Group in 2010. Many non-tax motivations such as geographic and asset class diversification supply the theme of exchanges; however, the real driver is often a problem or set of problems with existing relinquished property such as insufficient income, insufficient depreciation, lack of tenants, maximized value of relinquished property. Clients see the sale and exchange as an opportunity to seek out more suitable replacement property(ies) for their lifestyle with typically more passivity, more depreciation, more income, and better diversification.



CLOSED EXCHANGE CASE STUDIES IN 2010

- » \$1.2 Million Vacant Land into \$800k Unimprovement Property + \$400k Improvements [Improvement Exchange]
(Client General Contractor wanted to Build on Land an Affiliate Owned)
- » \$5.5 million dollar NN (Double-Net) Starbucks into a \$6 Million Dollar (Triple Net) CVS
(Client Desired Fully Triple Net Tenant, and saw Different Location as Better Opportunity for Appreciation)
- » \$40 Million dollar Undivided Fractional Interest in \$125 Million Office Building in DC.
(Client Traded Out of Partially Tenanted Office into Fully Leased Apartment Complex)
- » \$18 Million dollar Portfolio of Acreage in WV/PA to Major Energy Company, Replacement Properties- Apartments in VA
(Client Had Historical Basis Less than \$2 Million, Leveraged Proceeds into Substantial Apartment Portfolio with Strong Financing)
- » \$800k Rental Property in VA, Partial Exchange into \$400k Replacement Property in Arizona
(Client Retired from DC Area and wanted Real Estate Closer to Heirs)
- » \$5.5 Million Apartment Portfolio into \$8 Million Worth of Replacement Assets Using 200% Rule
(Client Diversified Replacement Properties into Land in North Carolina, NNN Drug Store, Syndicated TIC Deal, and Zero Cashflow Deal)

FOR MORE INFORMATION

WINSTON ORZECOWSKI

Research Analyst

Calkain Companies, Inc.

Tel. (703) 787-4714 | Fax (703) 787-4783

worzecowksi@calkain.com

James Brennan, Esq., LL.M

Managing Director/Corporate Counsel

Exchange Solutions Group, LLC

Tel. (703) 801-4178 | Fax (703) 663-9889

jbrennan@1031esgroup.com

CALKAIN
COMPANIES,
INC.

WASHINGTON, DC
FLORIDA
MARYLAND
DELAWARE