9 STEPS OF A SUCCESSFUL *Reverse Exchange*

Sometimes, a taxpayer will find investment property to purchase prior to selling the property that they intend to exchange. A Reverse Exchange is a tax-deferred exchange that enables the purchase of replacement property prior to the sale of relinquished property.

STEP 1 Taxpayer enters into a contract to purchase replacement property.

STEP 2 The IRS will not allow taxpayer to be in title to the replacement property and relinquished property concurrently. Cascade Exchange Services forms a special purpose LLC (an Exchange Accommodation Titleholder, or "EAT") to take title to the replacement property.

STEP 3 Taxpayer and/or lender loans money to EAT for the purchase of replacement property. *Tip: Many traditional lenders are unable to work with reverse exchanges. If a lender is involved, put us in contact with them early in the process to avoid delays in closing*!

STEP 4 At escrow closing, taxpayer assigns their interest in the replacement property to the EAT. EAT takes title to replacement property to begin reverse exchange.

STEP 5 From date of purchase, taxpayer has 45 days to identify relinquished property, and 180 days to sell identified relinquished property.

STEP 6 Taxpayer enters into a contract to sell identified relinquished property.

STEP 7 At escrow closing, Cascade Exchange Services receives all sales proceeds from the sale of relinquished property.

STEP 8 Cascade Exchange Services disburses sales proceeds and exchange funds as a payoff or pay down of loan on replacement property.

STEP 9 EAT transfers title of replacement property to taxpayer to complete reverse exchange.

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INTRODUCTION TO REVERSE EXCHANGES

Sometimes a taxpayer may find investment property to purchase before they have sold the property that they intend to exchange. The Revenue Procedure 2000-37 issued on September 15, 2000 gave taxpayers 1031 exchange treatment for reverse exchange transactions. A reverse exchange occurs when the purchase of replacement property must close before the sale property is relinquished.

When the exchangor is performing this type of exchange, the Qualified Intermediary creates an Exchange Accomodation Titleholder (EAT) to park title to property until the relinquished property is sold. The exchangor (or a lender) provides funds to purchase the replacement property, and a trust deed is recorded securing a note for the loan. After the sale of the relinquished property, the sale proceeds are deposited into the exchange value account, where they are then used to pay back the exchangor (or lender) for borrowed funds and reconvey the lien against the property. If the EAT acquired title to the relinquished property, a deed would be recorded from the EAT to the buyer. However, if the EAT acquired title to the replacement property, a deed would be recorded from the EAT to the exchangor.

Two Types of Reverse Exchanges

Relinquished property reverse exchange: For this type of reverse exchange, the EAT takes title to the relinquished property. However, this could result in the EAT acquiring the relinquished property subject to an existing mortgage. This may trigger the due-on-sale clause of that existing lien, and thus, is used less frequently than a replacement property reverse exchange.

Replacement property reverse exchange: For this type of reverse exchange, the EAT takes title to the replacement property. It is crucial that financing is in the name of the EAT, although the exchangor guarantees the loan, not the EAT. Portfolio lenders, cash to purchase, third party financing, or seller carry-back financing are used for this type of exchange.

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Typical Financing Arrangements
For Replacement Property Reverse Exchanges

- Exchangor provides cash to the EAT to finance the acquisition, which is paid off with exchange proceeds.

- Seller provides carry-back financing for all or a portion of the amount needed to acquire the replacement property.

- A third party provides financing for all or a portion of the amount needed to acquire the replacement property.

- Lender makes a long-term assumable loan to the EAT in the amount needed to finance the acquisition when the exchange is complete. The exchangor provides the balance in the form of a temporary 2nd loan to the EAT which is paid off with exchange proceeds.

- Lender makes a long-term assumable loan to the EAT in the amount needed to finance the acquisition when the exchange is complete. The same lender provides a temporary 2nd loan to the EAT secured by the property and the exchangor loans the balance to the EAT as a 3rd loan. The 2nd and 3rd loans are paid off with exchange proceeds.

- Lender makes a long-term assumable loan to the EAT in the amount needed to finance the acquisition when the exchange is completed. The same lender provides a temporary 2nd loan to the EAT secured by the property (100% financing) and cross collateralizes it with another property owned by the exchangor. The 2nd loan is paid off with exchange proceeds.

- Lender makes a long-term assumable loan to the EAT in the amount needed to finance the acquisition (100% financing) and cross collateralizes it with another property owned by the exchangor. The loan is paid down with exchange proceeds, and the original loan is modified, changing the grantor and the loan amount.

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