

EXCHANGING SEMINAR

Albuquerque Real Estate Exchange

March 29, 1984

I. The Exchangor's Meeting or Marketing Session

- A. Typically commercial/investment property
 - 1. Maybe sale only
 - 2. Go thru --- third leg
- B. House people afraid --- come observe
- C. Problem properties are offered or "pitched"
 - 1. Brief listing sheet, standard form, "package"
 - 2. Back-up info, photos, plats, etc.
 - 3. Motivation/problem of seller
 - 4. Mini-binders --- not firm contracts
- D. Two types
 - 1. Tax reasons --- major court cases
 - 2. Benefits Help clients/customers
 - 3. "Don't wanters" Maybe a new idea

II. The Tax Aspects

- A. Capital gains tax
 - 1. Buy 4-plex for \$75,000.00
 - 2. Later sell for \$125,000.00
 - 3. Profit is \$50,000.00
 - 4. Not necessarily the gain or a good deal
 - a) IRS bookkeeping
 - b) Holding period
 - c) Cash invested, sales costs
 - 5. Capital gain = net sale proceeds less adjusted basis
(loss)
- B. Exchanging involves income taxes.
- C. Basis/Adjusted Basis: Is original cost plus capital improvements, if any; less depreciation taken, if any; less partial sales, if any.
 - 1. Partial sale

2. Capital improvements
 - a) Increase value, prolong life
 - b) Paint trim, add new wing, grey areas
- D. Depreciation is more complex
1. Net spendable, after-tax, tax-paid
 2. Grocery, department store, or SAVE
 3. Basis is bought with after-tax dollars
 - a) 4-plex for \$75,000.00
 - b) All cash or some cash & loan
 - c) Interest is deductible --- not principal portion
 - d) Sell at profit --- excess not yet taxed
 4. Cannot depreciate land or principle residence
 5. Can depreciate office buildings, warehouses, apartments
 6. Any improvement is wearing out
 - a) Accelerated Cost Recovery System (ACRS)
 - b) 15 years or 6.67% per year
 - c) Even faster with residential rental
 - d) Caution --- RECAPTURE
 7. Allowable expense --- no check
 - a) Deduct from income
 - b) Reduce basis
 - c) Some tax-paid being returned

III. Basis Can Change

- A. Affects capital gain
 1. Long term
 2. Short term
 3. More than a year
- B. Special tax treatment for long term
 1. 60% excluded
 2. 40% taxed at ordinary rates
- C. Example: A taxpayer is in the 30% bracket on his other taxable income. In the year, he also has

a \$10,000.00 long term capital gain. If we assume the gain does not increase his bracket, his tax on the gain will be \$1,200.00 (see below)

\$10,000.00	Gain
\$6,000.00	60% exclusion
\$4,000.00	40% to tax
\$4,000.00	X 30% = \$1,200.00

D. Example (50% bracket)

1. \$10,000.00 more regular income --- \$5,000.00 tax
2. \$10,000.00 gain, \$4,000.00 taxable, \$2,000.00 tax
3. 20% tops
4. If depreciation reduced basis, now increases gain
5. Reduced income @ 50% now taxed @ 20%

IV. The Theory of Exchanging

- A. I.R.S. Code Section #1031
- B. True exchange is not a sale
 1. Continuing investment
 2. No gain to recognize
 3. Realize vs Recognize
- C. Example: Ten years ago Mr. Black bought a commercial lot for \$15,000.00. Today the net FMV is \$50,000.00. If he sells, he must "recognize" the gain and pay some tax. If he exchanges for a \$50,000.00 equity in another property, he can "realize" the gain without having to "recognize" it. He can use the full \$35,000.00 of profit/increment without any tax at the time. His basis in the new property will be less because of the deferment. At a future sale, he will have to pay the gain's tax, but for the present, he keeps and uses this tax money.
- D. #1031 Exchanges must be like-for-like
 1. Investment/income for investment/income
 2. Trade or business property qualifies
 3. Realty for Realty
 - a) Mortgaged for free & clear, ranch for office
 - b) Personalty for personalty
 4. Unlike is called "boot" CASH
 5. In realty a used pickup

6. One party may qualify --- other not
 7. Not your home (principle residence)
- E. Basis moves with the taxpayer
1. A continuing investment
 2. Similar to "rollover" in homes
 3. Plus/minus unlike
 4. Plus/minus mortgages
 5. May recognize some gain and defer some
- F. Few exchanges have equal equities
1. Some "boot" is involved
 2. Cash or other unlike property
- G. A LOSS cannot be 'recognized' in an exchange. It will carry forward as increased basis.
- H. Class Problem: Black and White

Let's go back to Mr. Black who owned the free and clear vacant lot. It cost him \$15,000.00 and is now worth \$50,000.00. He is tired of having his money tied up with no income and paying property taxes, standby charges, etc., every year. He wants an income holding with some depreciation. He does not want to sell and have a \$35,000.00 gain.

Mr. White owns a small apartment complex with a fair market value of \$200,000.00 and an assumeable loan of \$150,000.00. White paid \$180,000.00; he has taken \$10,000.00 of depreciation; his adjusted basis is \$170,000.00. He is sick of tenants and management; he wants a passive investment; he understands he may have to pay some tax.

The parties agree to an exchange. The equities are equal at \$50,000.00 each. For the present we will ignore transaction costs.

See next page for the basis adjustment and gain to be "recognized."

Exchange Basis Adjustment

Name Black & White Date 1984

Property Conveyed _____

Black

White

(3)

(4)

LINE NO		PROPERTY		PROPERTY		PROPERTY		PROPERTY	
1	Market Value of Property Conveyed		50,000		200,000				
2	Less Adjusted Basis		15,000		170,000				
3	Less Capitalized Transaction Costs		-		-				
4	INDICATED GAIN		35,000		30,000				
5	Equity Conveyed		50,000		50,000				
6	Equity Acquired		50,000		50,000				
7	Difference		-		-				
8	Cash or Boot Received		-		-				
9	Cash or Boot Paid		-		-				
10	Old Loans		-		150,000				
11	Less: New Loans		150,000		-				
12	NET LOAN RELIEF		-		150,000				
13	Less: Cash or Boot Paid (L9)		-		-				
14	Recognized Net Loan Relief		-		150,000				
15	Plus: Cash or Boot Received (L8)		-		-				
16	TOTAL UNLIKE PROPERTY RECEIVED		-		150,000				
17	Recognized Gain LESSER OF L4 or L16		-		30,000				

Transfer of Basis

LINE NO		PROPERTY		PROPERTY		PROPERTY		PROPERTY	
18	Adjusted Basis (L2) Plus (L3)		15,000		170,000				
19	Plus: New Loans (L11)		150,000		-				
20	Plus: Cash or Boot Paid (L9)		-		-				
21	Plus: Recognized Gain (L17)		-		30,000				
22	Total Additions		165,000		200,000				
23	Less Old Loans (L10)		-		150,000				
24	Less Cash or Boot Received (L8)		-		-				
25	NEW ADJUSTED BASIS		165,000		50,000				

New Allocation and Depreciation

LINE NO		PROPERTY		PROPERTY		PROPERTY		PROPERTY	
		PP	IMP	PP	IMP	PP	IMP	PP	IMP
26	Land Allocation								
27	Improvement Allocation								
28	Personal Property Allocation								
29	Estimated Useful Life in Years								
30	Depreciation Method								
31	ANNUAL DEPRECIATION IMPROVEMENTS								
32	ANNUAL DEPRECIATION PERSONAL PROPERTY								

V. Tips and Pitfalls for Brokers

- A. Clear understanding on commissions
1. All parties
 2. With other brokers
 3. Flat fee is best
 - a) Prices get altered
 - b) Affects gain
 - c) Equities are being transferred
 - d) Overall prices are not too relevant

B. Transaction Costs

1. NOTE: not saying 'sales costs'
2. Who pays and how
3. Other versions of Black and White --- time???

VI. More Complex Exchanges

A. The In-Lieu-Of Exchange

1. Not a firm deal --- may not fly
2. Like an option
3. Time limit 90 days, 6 months
4. Find suitable take-out

"I want your land; I understand you want cash and not not my apartment. Give me 90 days to find a cash buyer for the apartment, and then we'll have 3-way.

B. The Multi-Leg Exchange

1. Three or more properties
2. All 'into the hat'
3. Different owners
4. Able may get Baker's property, but Baker may get Charlies' parcel while Charlie gets Able's
5. Balancing equities can get complicated

C. The Open, Delayed, or Deferred Exchange

1. Cash sale is pending
2. Seller (exchangor) does not want cash

VII. In our 1st example of Mr. Black and Mr. White, we had no transaction costs and exactly equal equities. This is not real world. Let's change our facts a little.

<u>Black-Lot</u>		<u>White-Apt.</u>	
\$50,000.00	FMV	\$200,000.00	
15,000.00	Basis	170,000.00	
None	Mtge.	140,000.00	**
50,000.00	Equity	60,000.00	**
5,000.00	Costs	14,000.00	

** Note change from \$150,000.00

- A. In columns 1 and 2 next page re-run these changes
- B. In columns 3 and 4 do another re-run with White paying all \$19,000.00 in costs --- \$14,000.00 for himself plus \$5,000.00 for Black. Accordingly reduce Black's FMV to \$45,000.00 and thus his equity to \$45,000.00.

Exchange Basis Adjustment

Name _____ Date _____

Property Conveyed _____

LINE NO		(1)		(2)		(3)		(4)	
		PROPERTY		PROPERTY		PROPERTY		PROPERTY	
1	Market Value of Property Conveyed								
2	Less: Adjusted Basis								
3	Less: Capitalized Transaction Costs								
4	INDICATED GAIN								
5	Equity Conveyed								
6	Equity Acquired								
7	Difference								
8	Cash or Boot Received								
9	Cash or Boot Paid								
10	Old Loans								
11	Less: New Loans								
12	NET LOAN RELIEF								
13	Less: Cash or Boot Paid (L9)								
14	Recognized Net Loan Relief								
15	Plus: Cash or Boot Received (L8)								
16	TOTAL UNLIKE PROPERTY RECEIVED								
17	Recognized Gain LESSER OF L4 or L16								

Transfer of Basis

18	Adjusted Basis (L2) Plus (L3)								
19	Plus: New Loans (L11)								
20	Plus: Cash or Boot Paid (L9)								
21	Plus: Recognized Gain (L17)								
22	Total Additions								
23	Less Old Loans (L10)								
24	Less: Cash or Boot Received (L8)								
25	NEW ADJUSTED BASIS								

New Allocation and Depreciation

26	Land Allocation								
27	Improvement Allocation								
28	Personal Property Allocation								
		PP	IMP	PP	IMP	PP	IMP	PP	IMP
29	Estimated Useful Life in Years								
30	Depreciation Method								
31	ANNUAL DEPRECIATION IMPROVEMENTS								
32	ANNUAL DEPRECIATION PERSONAL PROPERTY								

Exchange Basis Adjustment

Name _____ Date _____

Property Conveyed _____

LINE NO		(1)		(2)		(3)		(4)	
		PROPERTY		PROPERTY		PROPERTY		PROPERTY	
1	Market Value of Property Conveyed								
2	Less Adjusted Basis								
3	Less Capitalized Transaction Costs								
4	INDICATED GAIN								
5	Equity Conveyed								
6	Equity Acquired								
7	Difference								
8	Cash or Boot Received								
9	Cash or Boot Paid								
10	Old Loans								
11	Less: New Loans								
12	NET LOAN RELIEF								
13	Less: Cash or Boot Paid (L9)								
14	Recognized Net Loan Relief								
15	Plus: Cash or Boot Received (L8)								
16	TOTAL UNLIKE PROPERTY RECEIVED								
17	Recognized Gain LESSER OF L4 or L16								

Transfer of Basis

18	Adjusted Basis (L2) Plus (L3)								
19	Plus: New Loans (L11)								
20	Plus: Cash or Boot Paid (L9)								
21	Plus: Recognized Gain (L17)								
22	Total Additions								
23	Less Old Loans (L10)								
24	Less Cash or Boot Received (L8)								
25	NEW ADJUSTED BASIS								

New Allocation and Depreciation

26	Land Allocation								
27	Improvement Allocation								
28	Personal Property Allocation								
		PP	IMP	PP	IMP	PP	IMP	PP	IMP
29	Estimated Useful Life in Years								
30	Depreciation Method								
31	ANNUAL DEPRECIATION IMPROVEMENTS								
32	ANNUAL DEPRECIATION PERSONAL PROPERTY								

ALBUQUERQUE EXCHANGORS

Listing Date 1982
Fee or Commission: \$6,600.00
Expiration Date 1982

Price \$110,000.00
Loan: 65,000.00
Equity: 45,000.00

Have: Apartment House (Give a few basic facts)

Have back-up package with real details for interested parties; don't waste paper with pages of info unnecessary for the 95% who are not interested.

Address: 2000 Park Ave.

Legal: w/f

Price: \$110,000.00

Loan(s): \$55,000.00 1st mortgage, 7%, \$600.00 per month
\$10,000.00 2nd TD, 8%, \$125.00 per mo.

Equity: \$45,000.00

Why Does Not Want: Tired of management

Want: Wants to exchange for management free property.
Prefers vacant commercial, free and clear.

Remarks: Substantial. Can add up to \$20,000.00 cash. Willing to recognize some gain to accomplish his goal. Does not want any future payments.

Owner: Mr. Redd

Broker: E. C. "Steve" Stevens
Walker-Hinkle Co.
505-268-4551

This information is from sources deemed to be reliable, but is not guaranteed by agent. Package is subject to prior sale, price change, correction or withdrawal.

PRELIMINARY EXCHANGE PROPOSAL
THE NATIONAL INSTITUTE OF REAL ESTATE BROKERS



15

National Marketing Session

To: White's Broker

Issued At: Albuquerque

Address: 123 Fourth St.

Date 1982

City Albq State N.M. Zip 87103

I hand you herewith a proposed exchange possibility and request that you give your immediate attention to this proposal.

MY CLIENT: Redd

Type of Property: Apartment House Address: 2000 Park Ave.

Subject to: \$ 55,000⁰⁰ 1st mtg
10,000⁰⁰ 2nd TD

YOUR CLIENT: White

Type of Property: Commercial Lot Address: 789 Tenth St

Subject to: \$10,000.00 land contract

TERMS AND CONDITIONS: Set with brokers for Blue and
Flag to arrange a 4-way

Note: Other data on properties outlined herein as per sheets attached and submitted herewith. Final terms and conditions, if any, to be in subsequent offer and/or escrow instructions.

This proposal is subject to prior disposition of the above properties, and shall expire on (date) _____

Both Brokers agree to direct their immediate attention to this proposal and submit any additional data requested by either broker.

Stevens
Submitting Broker

268-4551

Date

1/3/ White's Broker
Broker Receiving Offer

Date

Remarks

© 1969 by

Approved: _____

Approved: _____

Frank Weaver's Pony Express
Box 5906-San Jose, Ca. 95150

Date: _____

Date: _____

D

COMMISSION AGREEMENT

BROKER SPLIT

1982

Date

It is agreed by the undersigned that if the transaction described as Redd's apartment for White's lot with apartment going to Blue; Blue's vacant land to Flagg; Flagg adds cash and White gets cash is closed, the parties will contribute commission/fees as is outlined below:

<u>PRINCIPAL</u>	<u>FEE</u>
<u>Redd</u>	<u>\$ 6600⁰⁰</u>
<u>White</u>	<u>6000⁰⁰</u>
<u>Blue</u>	<u>20,000⁰⁰</u>

It is further agreed that the total sum of these fees is \$32,600⁰⁰ and this sum will be divided between the participating brokers in the following manner:

<u>Redd's Broker</u>	<u>\$8150⁰⁰</u>
<u>White's Broker</u>	<u>\$8150⁰⁰</u>
<u>Blue's Broker</u>	<u>\$8150⁰⁰</u>
<u>Flagg's Broker</u>	<u>\$8150⁰⁰</u>

As a participating broker, I agree to the above split.

<u>/s/</u>	<u>Stevens for Redd</u>
<u>/s/</u>	<u>White's Broker</u>
<u>/s/</u>	<u>Blue's Broker</u>
<u>/s/</u>	<u>Flagg's Broker</u>

C

EXCHANGE COMMISSION AGREEMENT

It is agreed by the undersigned that in the event an exchange of their property located at 2000 Park Ave. Apartment House

_____ is made for property located at Albuquerque Vacant commercial lot

_____ on terms stated in Exchange Agreement date 1982,

19____, or upon any other terms agreed upon, I, or we, will pay a commission to Broker Stevens

in the amount of \$ 6,600.00 plus normal closing costs

/s/ Redd

EXCHANGE COMMISSION AGREEMENT