

2 Ways To Get the Custom-Built Property Of Your Dreams From Your 1031 Exchange

An essential truth regarding conducting a 1031 exchange is that you may not make use of the proceeds off the sale of your relinquished property to construct property you own already. This is a common stumbling block of unwary investors. To qualify for tax deferral, your replacement property must be of LIKE KIND with the property it is replacing. In this case, the property you purchase has to comprise real estate valued at or above the value of the property sold. A renovation that is not finished is considered a contract for service, which represents personal property but not real property. Because a replacement property has to be equivalent in type and value with the property sold upon closing, it is, at times, hard to find a property that fulfills these requirements and meets his or her specifications.

So, how can you get the property of your dreams out of a 1031 exchange? There are two main methods by which you can acquire a build to suit property that fits your structural specifications as well as complying with the accounting requirements necessary for a like-kind exchange under section 1031

The first option is to perform a 'poor man's Build-to-Suit,' in which you ask the seller to construct particular improvements on a piece of property to heighten its value prior to closing on the sale. For example, if you relinquished a piece of property with a value of one hundred thousand dollars, and you were looking at a replacement property valued at \$10,000, the seller could construct \$90,000 worth of improvements to raise the property value. The finished improvements would represent real estate, and you could then buy the piece of property for one hundred thousand dollars, complying with the requirement of equivalent value. Most sellers, however, will not be very enthusiastic to construct these improvements so that you may conduct a 1031 exchange.

In the 2nd, more likely scenario a qualified intermediary who holds the proceeds from the sale of the relinquished property can buy the replacement property and take title to it in a limited liability company owned by the intermediary. The intermediary would then use the remainder of the proceeds to make the necessary improvements on the piece of property. Upon completion, the intermediary returns the replacement property to you, which then permits you to complete the exchange .

Back to the ten thousand dollar replacement property: the intermediary who held your money would buy the property for the asking price and would construct the required improvements with what is left of the proceeds, transferring the replacement property to you when the property's value suffices to constitute a like kind exchange.

Although a build-to-suit exchange can help you acquire the replacement property that you really want, it is important to be attentive to the amount of time required for the improvements that you would like to build . You only have 180 days in which to bring your 1031 exchange to completion, so you must be conscious of what work can actually be finished in this period. Be mindful that an improvement represents real estate when it is completed, and so a renovation in the process of construction doesn't add to the value of the property. Although you may or may not be able to construct improvements as extensive as you might want, one hundred and eighty days is ample time to finish considerable remodeling and renovation, and to bring your replacement property that much closer to your ideal.

About the Author

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