



IRC Section 1031 exchanges: Three considerations for successful real estate investors - by Valeria Kozhich and Ashley Charen

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The experience of owning and operating real estate in New York City has undergone major changes in recent decades. Property owners have seen a significant appreciation in the value of their assets while simultaneously needing to cope with an increase in the number of rules and regulations. For

many, the decision to transition from owning management-intensive property to a passive real estate investment may be appealing. After making the decision to sell a property and diversify holdings, the investor is left with one overarching question: "Now what?"

For those who wish to leave some capital in investment real estate, an IRC Section 1031 exchange may be the perfect answer. Addressing the following three considerations prior to entering into an exchange will help ensure a smooth and successful exchange process.

Consult with accountants and attorneys experienced in 1031 exchanges. Ideally this should be done two years prior to the intended sale. The attorney will review the existing property ownership structure early in the process, which allows time to correct any title mistakes. It also provides ample opportunity to determine whether the current ownership structure is an effective vehicle for the 1031 exchange and to restructure if needed. At a minimum, the accountant will work with the client to analyze the benefits of different exchange structures and calculate the adjusted cost basis of the sale property. Discussions can also be had to determine how the exchange will serve seller's long-term goals, which may involve comprehensive estate planning. These upfront actions will save a seller time and money during the sale and 1031 exchange process.

Look for replacement properties and begin due diligence. The earlier this happens, the smoother the execution of the 1031 exchange is likely to be. Meeting Internal Revenue Service timelines is vital to the 1031 exchange process; from the date of the sale closing, a seller has 45 days to identify their replacement properties and 180 days to close on the replacement properties. The seller's attorney and brokers will work together to facilitate the identification process prior to the sale of the relinquished property and negotiate relevant provisions in the letter of intent and contracts.

Estimate the net proceeds from the sale of the relinquished property that will be deposited with the qualified intermediary, who facilitates the 1031 exchange. This calculation should be done in conjunction with an experienced accountant and attorney. Establishing an approximate number for the net proceeds allows the investor and broker to determine the price range of the properties that can be acquired. With a reasonable estimate of available capital, the seller can also consider financing options. Financing the acquisition is a key consideration for sellers that had debt on their relinquished property.

Early action and a professional team experienced with 1031 exchanges are crucial to each of these considerations. Involving qualified professionals well in advance of the sale of an investment property is imperative for a smooth and successful exchange.

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