

SECTION 1031 EXCHANGES FOR THE REAL ESTATE PROFESSIONAL

A Multiple 1031 Strategy Can Have Dramatic Effects on Investment Portfolio

These are some helpful tips and investment strategies using 1031 exchanges along with other 1031 "basics" that you should know about. The 1031 tax-deferred exchange is much more than selling a rental house and then buying another rental house. It requires a dedicated focus and guidance from a knowledgeable real estate professional. Today's sophisticated real estate investor can impact their portfolio dramatically by employing a variety of 1031 exchange techniques.

Why do a 1031 Exchange? No matter how nice your rental is, no matter how well built, if it's a 65-year-old home with three bedrooms and two full baths, its closets are probably too small and the kitchen is still decorated in the "I Love Lucy" era fashion. There's no great room, and no cathedral ceiling. In an era when people eat out or eat quickly, a great dining room has less appeal than in the past. Simply put, a lot of renters are interested in features not found in this type home.

On a personal level none of this bothers us. But in the contest for good renters -- folks who will be caring stewards of the property and pay their rent in full and on a timely basis -- newer properties seem consistently more attractive.

Those savvy about 1031s can start thinking creatively. For instance, one way to ensure that you see your college-attending child from time-to-time is to purchase a property in the college town and hold it as a rental, and do a 1031 exchange after graduation. Getting tired of collecting rent and watching your residential investment property deteriorate from uncaring tenants? Are you afraid to sell after making such huge gains in the market? 1031 exchange will allow you to exchange a residential property for a business, or office rentals with a better paying clientele.

Exit Strategy: The lifecycle of a real estate investor tends to evolve to the point that one day; the investor would like to slow down, cash out, or retire. Whether the investor owns rental houses, warehouses, land, office buildings, or apartment complexes, a potential replacement property could be a well-located, residential property in a resort community in an attractive setting - such as a beach resort or mountain property.

To qualify for tax-deferred status, if those properties are purchased through a 1031 exchange transaction, they must be held for investment. To demonstrate the intent to hold for investment, most investors simply put those properties on a rental program with a management company or manage the property rentals themselves. However, at some point in the future, that same investor has the opportunity to employ a very powerful tool known as conversion.

Suppose several years after completing the 1031 exchange, the investor elects to move or retire full-time to the beach (or the mountains, lake, or golf community.) At the time the investor moves into the previously rented investment property, no tax obligations are due. The investor simply converts a property held for investment into his or her primary residence. The ultimate opportunity comes several years down the road, if and when the investor decides to sell the newly converted residence. At the time of that sale if the homeowner meets the residence requirements of ownership, occupies the property for at least two years, and held that previously 1031 exchanged property for at least five years, he will qualify for the \$250,000 or \$500,000 residential sale exclusion.