

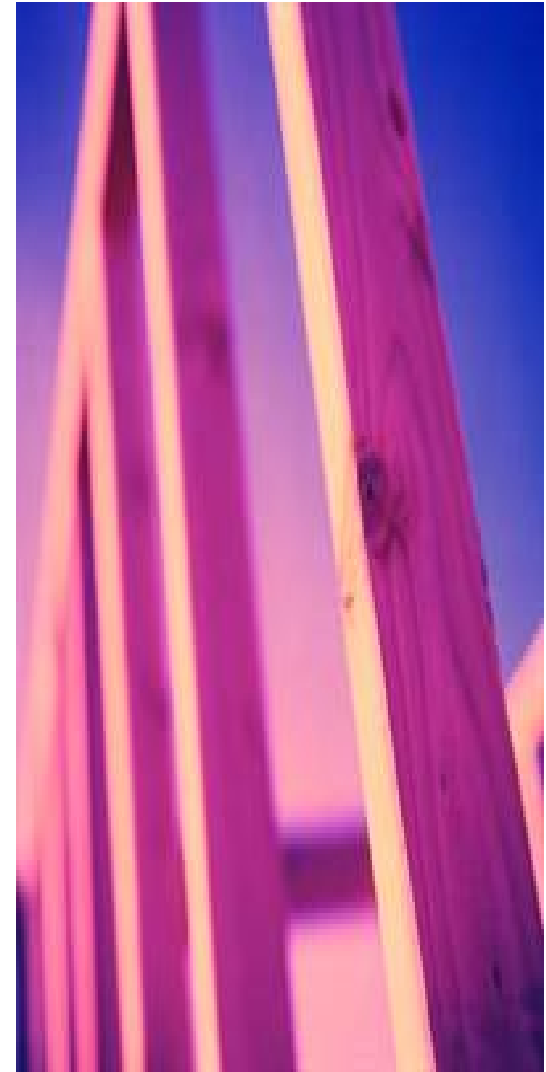
INTRODUCTION TO BUILD-TO-SUIT 1031 EXCHANGES

OVERVIEW

A Build-To-Suite Exchange – also referred to as a construction or improvement like-kind exchange transaction – allows the taxpayer to build, construct, or make capital improvements to a property before acquiring it as a replacement property. The taxpayer may use the exchange proceeds from the relinquished property to fund the construction or build-out, provided you follow the necessary 1031 exchange guidelines.

An Exchange Accommodation Titleholder (EAT) (for a definition of terms, see the Commercial Glossary on the Resources page of the Commercial section of CB Inside) may hold the property during the construction as part of a Parking Arrangement pursuant to Revenue Procedure 2000-37. The Qualified Intermediary (Accommodator) controls the exchange funds for the acquisition of the replacement property and the payment of the construction costs. By the end of the 180-day holding period for the exchange, the improved replacement property is transferred to the taxpayer to complete the tax-deferred exchange. The party constructing the improvements may not act as the taxpayer's agent.

Property to be produced may be constructed, built, installed, manufactured, developed, or improved. The taxpayer may build improvements on a vacant lot; add capital improvements to an existing improvement; or retrofit an existing improvement.



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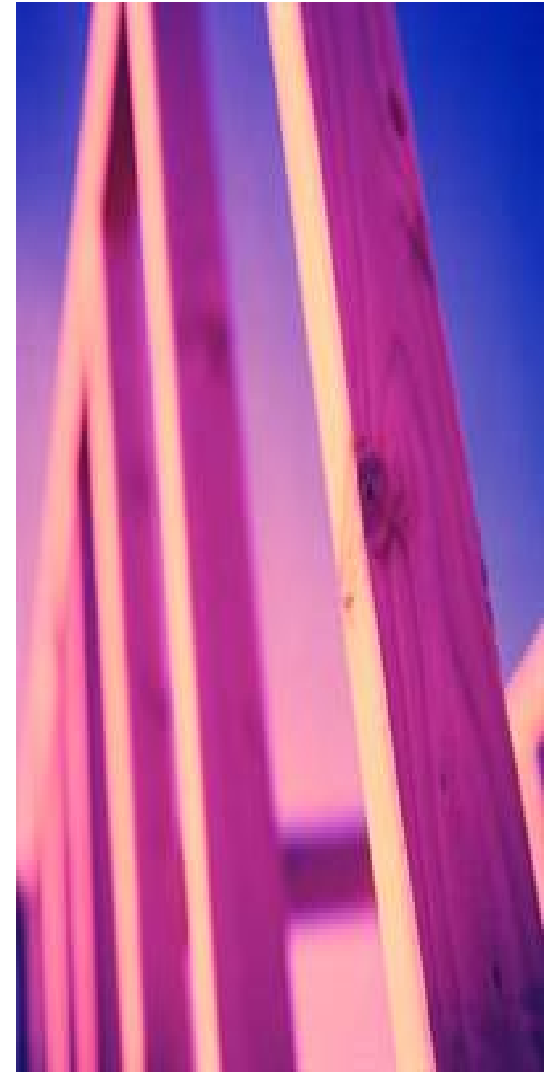
BUILDING A SUITABLE PROPERTY

Build-To-Suit Exchanges are excellent strategies if the taxpayer wants to customize a property or are having difficulties locating a suitable replacement property.

INCREASING VALUE

Structuring a Build-To-Suit Exchange may allow you to purchase a replacement of lower value without receiving cash and/or mortgage boot. By making capital improvements to the replacement property, you increase the value of the property and may avoid the recognition of capital gain tax liability.

(Note: To qualify for 100% tax deferral, the taxpayer must acquire a replacement property that is equal to or greater in value than the property that he/she relinquishes. The debt liability on the replacement property must be equal to or greater than the relinquished property debt. If the debt on the relinquished property is greater than the debt on the replacement property, the taxpayer may contribute cash to balance the exchange. The taxpayer must reinvest all of his/her net exchange proceeds from the relinquished property into the replacement property.



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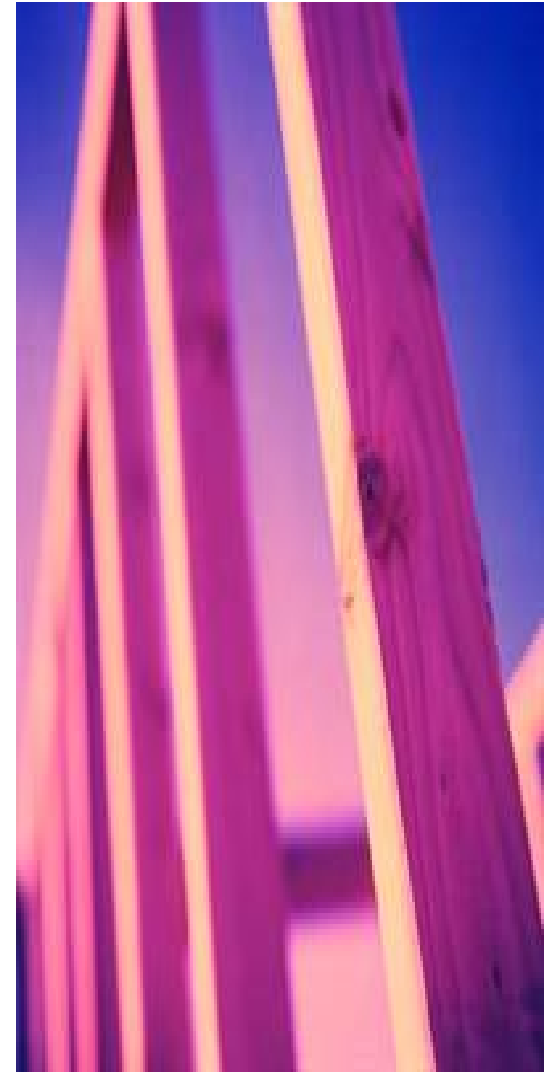
IDENTIFICATION OF REPLACEMENT PROPERTY

The taxpayer must abide by the 45-day identification period and the 180-day transfer requirements in a manner that is consistent with a traditional delayed exchange.

For purposes of the 200% identification rule, fair market value of the replacement property that is to be produced is its estimated fair market value as of the date the taxpayer expects to receive it.

The description of the property should contain as much detail as is practical at the time of the identification. In a Build-To-Suit Exchange, the taxpayer should consider submitting construction plans and/or blueprints as identification. As in a Forward Exchange, the street address should also be included or a legal description of the property.

As in a traditional, tax-deferred 1031 exchange, the property transferred must be substantially the same as the property identified in a Build-To-Suit Exchange. Customary “course of construction” changes are acceptable. However, substantial changes do not comply with this rule.



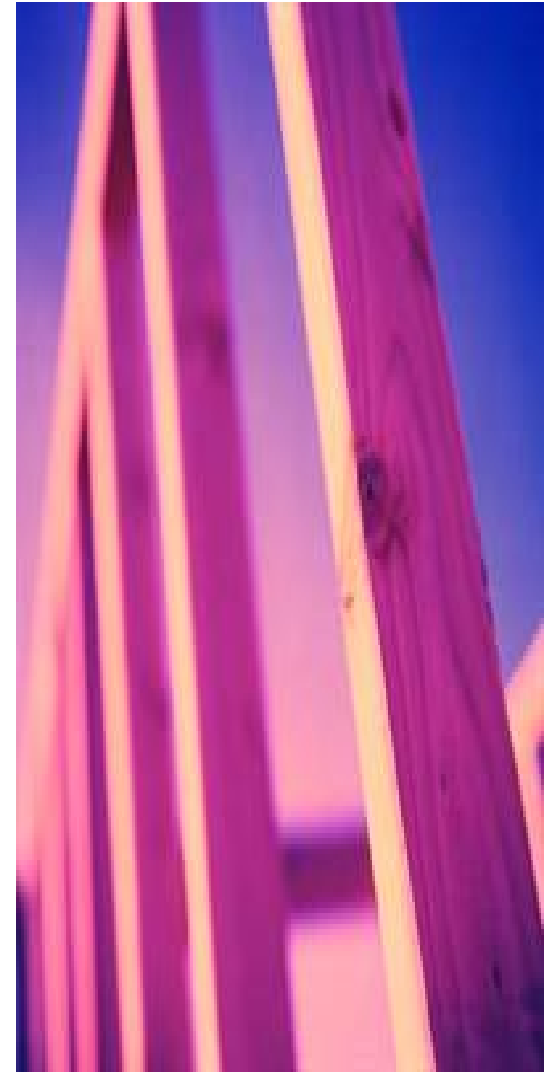
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COMPLETION

In a real property build-to-suit 1031 exchange, the entire build-to-suit project does not have to be completed by the 180th calendar day exchange period. Only the portion or value needed to satisfy the 1031 exchange value requirements must be completed within the 180-day period.

Funds disbursed to a contractor, builder or developer during the 180-day exchange period for work or services to be performed in the future after the 180-day exchange period has expired will not qualify for 1031 exchange treatment. The actual construction must be completed – in addition to being paid for – in order for the work to qualify as like-kind real property and for 1031 exchange treatment.

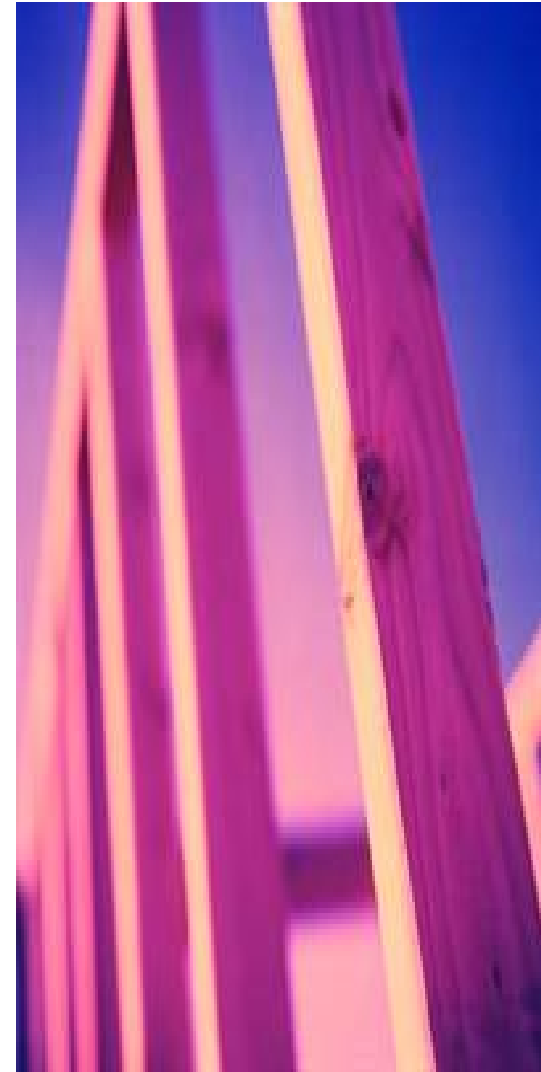
Once the exchange value requirements have been satisfied and the 1031 exchange completed, the taxpayer can receive title to the replacement property, continue making improvements and defer all of the gain on the portion of the property that was completed during the exchange period. Improvements constructed subsequent to closing will not qualify for 1031 exchange treatment and will incur tax liability.



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IMPLEMENTING A BUILD-TO-SUIT EXCHANGE

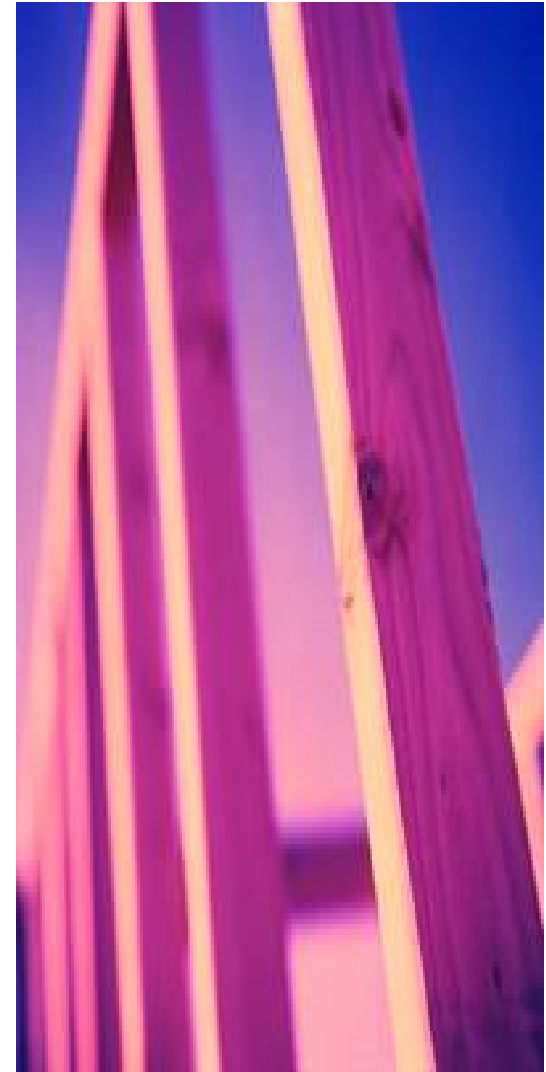
- Exchange proceeds from the relinquished property are transferred from the closing agent for the relinquished property to the Qualified Intermediary
- Within 45 calendar days after settlement on the relinquished property, the taxpayer must identify a replacement property, including improvements to be constructed
- The Sales Agreement for the replacement property is assigned to the Qualified Intermediary and the seller is provided with written notification
- The Qualified Intermediary and the EAT execute an agreement authorizing the EAT to acquire a fee interest in the replacement property and to complete the identified improvements
- Hazard and liability insurance is obtained naming the EAT as an insured or additional insured for the amount of the liability coverage specified by the Qualified Intermediary
- At settlement, the Qualified Intermediary will disburse some or all of the exchange funds to closing agent; the closing agent will disburse the funds to the seller of the replacement property
- The EAT assigns into the Construction Agreement
- The EAT and the taxpayer execute a Project Management Agreement, allowing the taxpayer or his/he designee to supervise the construction on behalf of the EAT



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- The Qualified Intermediary receives all invoices for the construction; the Qualified Intermediary disburses funds to the EAT, who cuts and distributes checks
- At the earlier of: 1) the end of the 1-80day exchange period; or 2) when the construction is completed, the EAT transfers the replacement property to the taxpayer



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FINANCING

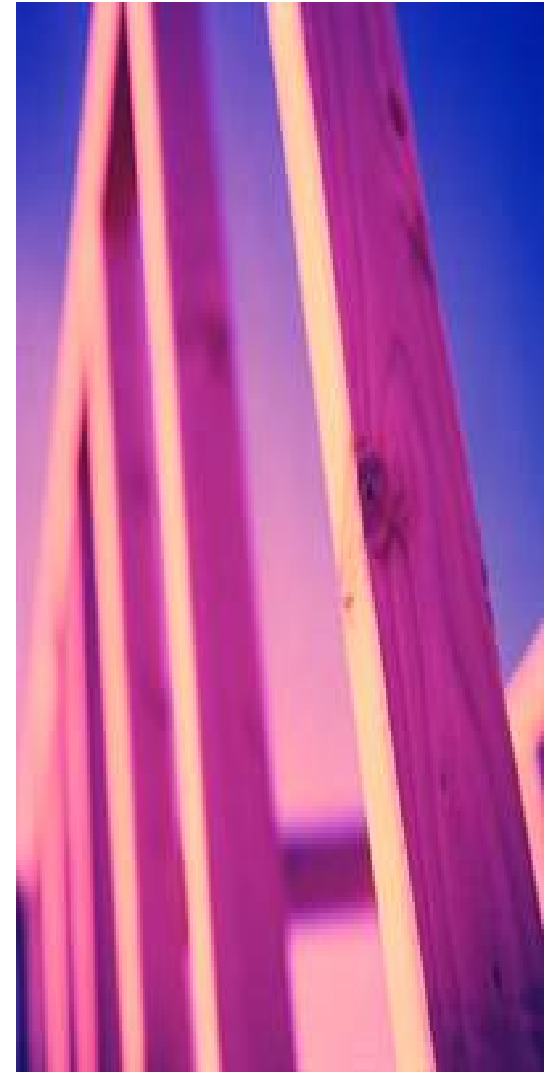
Institutional financing is often difficult to obtain on a Build-To-Suit 1031 Exchange. This is due to the fact that the lender requires the titleholder of the property to appear on the loan. A lender may be reluctant to lending to an EAT. The EAT will typically be the borrower only on a non-recourse construction loan and deed of trust or mortgage. In a Build-To-Suit Exchange, it may be necessary for taxpayers to contribute cash and/or finance the property acquisition and/or construction with seller carryback financing.

CONSTRUCTION CONTRACT

The Construction Contract should be in the name of the EAT. Contractors and sub-contractors performing work on the property must be licensed and hold appropriate insurance and bonding.

FEES

1031 exchange fees on Build-To-Suit Exchanges are typically higher than those for traditional forward exchanges due to the complexity and risky nature of these transactions.



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ALTERNATIVE STRATEGIES AND MISCELLANEOUS ITEMS

The taxpayer can contract with a builder or developer to purchase the property and perform the improvements. After the completion of the improvements, the taxpayer can acquire the property as a replacement property.

The taxpayer can also contract with a third-party to acquire the property and be responsible for completing the improvements.

The seller may also agree to complete the improvements.

All of the above scenarios are risky, if the owner incurs legal or financial difficulties. Cash holdback escrows are not permitted in Build-To-Suit 1031 Exchanges.

REVERSE AND BUILD-TO-SUIT 1031 EXCHANGES

In a combination Reverse and Build-To-Suit 1031 Exchange, the EAT makes improvements to the replacement property before the relinquished property is sold. When a buyer is found for the relinquished property, the Qualified Intermediary sells the relinquished property and simultaneously transfers the replacement property to the taxpayer.

