



## THE STEPS IN A REVERSE EXCHANGE

The following describes the methods currently used to implement the “reverse” exchange process in compliance with Rev. Proc. 2000-37, which provides a “Safe Harbor” for “reverse” exchanges. Because of the many variations in the process, despite the appearance of these transactions being ‘plain vanilla’, they are actually considerably tailor-made, thus requiring a great deal of time, at the commencement of the transaction, to make sure that the agreements accurately reflect the arrangement. Attention to these details, at the planning stage, will help eliminate problems, and roadblocks, later on. Due to certain issues which arise in the context of the Method 2 arrangement, as described therein, Method 1 is definitely the preferable structure and should be used, rather than Method 2, if facts and circumstances allow.

### METHOD 1

1. REVERSE EXCHANGE SERVICES, Inc. a Nevada corporation (“RES”), will create a corporation or limited liability company in the jurisdiction in which the property is located (the “Exchange Accommodation Titleholder”, or “E.A.T.”); RES, which will be the owner of all of the equitable interests in the E.A.T., is owned by 3 people: Cecily A. Drucker, Esq. a real estate transactional attorney with over 25 years of legal experience (who practices in San Francisco), Max A. Hansen, Esq., a real estate transactional attorney with over 23 years of legal experience (who practices in Dillon, MT), and Ralph B. Bunje, Jr., a CPA who has a 30-year background in providing financial and real estate consulting services for developers and investors. Each of these principals has over 20 years experience structuring tax-deferred exchanges under Section 1031 of the Internal Revenue Code.
2. The taxpayer/exchanger (the “Exchanger”) and the E.A.T. will enter into a “Real Estate Acquisition and Qualified Exchange Accommodation Agreement” (“QEAA”), pursuant to which the E.A.T. will agree, on certain terms, to acquire property which Exchanger wishes to use as its “Replacement Property” in the tax-deferred §1031 exchange and to transfer that Replacement Property to Exchanger at such time as Exchanger has sold the property it wishes to use as its “Relinquished Property” to a third party buyer.
3. The Exchanger will assign to the E.A.T. all of its contractual rights to purchase the Replacement Property (the property which the Exchanger will ultimately be acquiring in the tax-deferred exchange), and the E.A.T. will close escrow and acquire the Replacement Property, and the title to the Replacement Property will be vested in the E.A.T..
4. Financing for the purchase will be provided by (a) the Exchanger, (b) the seller of the Replacement Property (if that has been negotiated between the Exchanger and the seller), (c) the E.A.T. taking title subject to existing financing, if that has been arranged by Exchanger, and/or (d) the E.A.T. entering into a new loan with an institutional lender. Loan Documents will include a security interest (Deed of Trust or Mortgage) which will be recorded as a lien against the Replacement Property.
5. The E.A.T. will enter into a Lease with Exchanger which will provide that Exchanger will lease the Replacement Property from the E.A.T.. The term of the Lease will be six (6) months, and will be on a NNN basis (taxes, insurance, debt service), with the



Exchanger paying the E.A.T. a nominal amount of rent (\$100-\$200/month), all of which will be prepaid at the commencement of the Lease. After six months, the rent will increase.

6. Pursuant to the terms of the QEAA, the E.A.T. will be obligated to sell the Replacement Property to a "qualified intermediary" (as defined in the Code) (QI) when the QI holds proceeds from the sale of the Exchanger's Relinquished Property to a third-party purchaser ("Buyer"). Generally, the E.A.T. is not a party to the exchange agreement between the QI and the Exchanger. At such time as the Exchanger has entered into a binding contract with the Buyer, and after Buyer has removed all contingencies and is ready to close, Exchanger will assign the sale contract for the sale of the Relinquished Property to the QI. QI will cause the Relinquished Property to be sold, with a deed directly from the Exchanger to the Buyer, and with the net sales proceeds delivered to the QI [this is just like any phase I of a 'delayed exchange'].
7. QI will use the proceeds from the sale of the Relinquished Property to purchase the Replacement Property from the E.A.T., and will cause the E.A.T. to deed the Replacement Property directly to Exchanger. This will complete the exchange of the 'like-kind' properties.
8. The net proceeds paid into the escrow for the purchase and sale of the Replacement Property will be used first to pay costs of sale (transfer and recording fees and taxes, title insurance, etc.), next to pay off the indebtedness which the E.A.T. incurred to purchase the Replacement Property. If the net proceeds are insufficient, then the Exchanger will have to either provide additional funds (cash or new loans), or take title subject to the remaining unpaid balance due on the existing loans. If the net proceeds held by the QI exceed the amount of cash needed to purchase the Replacement Property, the remaining cash may be used by the Exchanger to acquire other 'like kind' property, subject to the 45 day/180 day restrictions in any 'delayed' exchange.

Additional Considerations: Where the Exchanger desires that improvements be made to the Replacement Property prior to the time that the Exchanger acquires it, then unless the improvements can be installed and become, under state law, real property (e.g., merely purchasing materials to be installed later on doesn't qualify), the Exchanger will have to use a "Non-Safe Harbor" 'reverse' exchange. These transactions are more complex, and are structured using the facilities of RES' sister company, Consolidated Reverse Services, Inc.

#### METHOD 2

1. The Exchanger will enter into a QEAA with the E.A.T. pursuant to which Exchanger will agree to sell to the E.A.T. the Relinquished Property (the property which the Exchanger wishes to sell in the tax-deferred exchange). Exchanger will assign the contract between it and the E.A.T. to the QI. Exchanger will transfer the Relinquished Property to E.A.T. in exchange for which the QI will acquire the Replacement Property from the third-party seller ("Seller") and cause the Seller to deed the Replacement Property to Exchanger.
2. This will result in an 'immediate' exchange, and the E.A.T. will be the owner of the



Relinquished Property. If Exchanger has an agreement with a third-party purchaser ("Buyer") for the purchase and sale of the Relinquished Property, that contract will be assigned to the E.A.T. (and the purchase price at which the E.A.T. will acquire the Relinquished Property from Exchanger will be the same as those in the contract with the Buyer). If there is no existing contract, then the price will be the Exchanger's "best guess" of the net (after all closing costs) price to be received on subsequent sale to the Buyer.

3. Financing for the purchase of the Relinquished Property by the E.A.T. will usually be a combination of (a) taking title subject to existing financing, if that has been arranged by Exchanger, and/or (b) financing provided by Exchanger. Loan Documents will be similar to those described in paragraph 4, for Method 1, above.
4. The net proceeds paid by the E.A.T. on account of the purchase of the Relinquished Property will be paid to the QI (since a QI is recommended, even in a 'simultaneous' exchange, due to the "Safe Harbor" provisions of §1031 of the Internal Revenue Code), and the QI will use those proceeds to purchase the Replacement Property and cause the seller thereof to deed title directly to the Exchanger.
5. The E.A.T. will enter into a NNN Lease with Exchanger (see paragraph 5, for Method 1, above).
6. Pursuant to the terms of the QEAA, the E.A.T. will be obligated to sell the Relinquished Property, and the E.A.T. will enter into a listing agreement with a broker (if there is not a contract already in place) which is acceptable to Exchanger. At such time as the Relinquished Property is sold, the net proceeds, after payment of closing costs, etc., will be used to pay off the indebtedness secured by the Relinquished Property.
7. If the purchase price at which the Relinquished Property is actually sold is more than the price at which the E.A.T. purchased said Property from Exchanger, the excess amount will be paid to the Exchanger. This will constitute taxable 'boot' to the Exchanger. Care must be taken for the Exchanger not to file its tax return for the year in which the exchange occurred until after the Relinquished Property has sold, since otherwise it might not be possible to correctly report the amount of 'boot' received, even if it is reportable on the installment basis. If, on the other hand, the price at which the Relinquished Property is sold is less than the price at which the E.A.T. purchased it from the Exchanger, and no loan was made by the Exchanger to the E.A.T., the Exchanger will be obligated to pay the E.A.T. the difference, which the E.A.T. will use to pay down the loans (these are the 'make-up' provisions.) If the Exchanger made a loan to the E.A.T., then such shortfall shall reduce the amount to be repaid to the Exchanger.

We hope this summary has been helpful to you. If you want further clarification, please call us toll-free at 1-866-276-1031 or visit us on the web at [www.reverse1031.com](http://www.reverse1031.com).