

Accruit
An Inspira Financial Solution

REVERSE EXCHANGES

THE LESSER KNOWN 1031 EXCHANGE TAX DEFERRAL TOOL

WHAT IS A REVERSE EXCHANGE?

A Reverse Exchange is a type of 1031 Exchange where an Exchanger purchases their new property, Replacement Property, prior to selling their old property, Relinquished Property. The typical order of events in a 1031 Exchange occur in reverse, hence the name.

In order to have a valid Reverse Exchange, the Exchanger cannot own the both properties at the same time. Therefore, the transaction must be structured such that they sell the Relinquished Property prior to acquiring the Replacement Property. Typically, this is accomplished by having an “Exchange Accommodation Titleholder”, or EAT, acquired the Replacement Property, via a Special Purpose Entity (SPE).

The EAT will hold title to the Replacement Property in a Reverse Exchange until the Exchanger sells the Relinquished Property, at which time the EAT then transfers the title back to Exchanger to complete the Reverse Exchange process.

REASONS FOR A REVERSE EXCHANGE

Below are the most common factors that require a Reverse Exchange rather than a traditional 1031 Exchange:

- **Competitive Real Estate Market:**
In a competitive market, finding suitable Replacement Property within the 45-day Identification Period can be difficult. A Reverse Exchange allows for the Replacement property to be identified and purchased prior without consideration of a 45-day regulation.

- **Financial Considerations**:
If an income-generating Relinquished Property is sold first, then income ceases until the Replacement Property is identified and purchased which could take up to 180 days with a traditional 1031 Exchange. Acquiring the Replacement Property first would allow the Exchanger to continue to generate income on the Relinquished Property, as well as potentially on the Replacement Property through a Reverse Exchange.

- **Ongoing Business:**
If the Exchanger operates their business in the Relinquished Property, they typically cannot shut down operations during the time it takes to acquire the Replacement Property. Acquiring the Replacement Property first allows them to relocate their business in a manner that minimizes business interruptions.

- **Timing Doesn’t Work:**
Sometimes the seller of the Replacement Property insists on the transaction occurring on or before a particular date, but the buyer of the Relinquished Property cannot complete the acquisition by that date. While the Exchanger hadn’t planned on a Reverse Exchange, the structure can save potentially thousands of dollars in taxes or other costs.

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LENDING REQUIREMENTS IN A REVERSE EXCHANGE

There are special requirements for lending in a Reverse Exchange which include the following:

- Mortgage brokers cannot do Reverse 1031 Exchange loans since those loans are sold in the secondary market.
- Loans must be done commercially because the property is held in an LLC as part of the Reverse Exchange process and the secondary market will not accept an entity borrower.
- Lending must be able to meet the 180 day Exchange Period to ensure a valid 1031 Exchange.
- The EAT holds title as the single member of the SPE, and at the end of the transaction, the EAT can either give a deed to the Exchanger or assign the membership interest in the SPE to the Exchanger depending upon the circumstances.
- If the Exchanger is going to retain the Reverse Exchange loan, it is helpful for the Exchanger to take over the membership interest so there is no change in the ownership of the SPE for loan purposes.
- In the loan documents it is advisable to add verbiage to the effect that a one-time transfer is allowed from the EAT to the taxpayer without triggering any due-on-transfer provisions.
- The SPE will generally be the Borrower of the non-recourse indebtedness and Grantor of collateral (if the replacement property is the collateral). The Lender's loan documents must explicitly provide the loan is non-recourse as to the SPE. The SPE then becomes Mortgagor or Grantor pursuant to the Mortgage or Trust Deed and Payor of the Note, Borrower under the Loan Agreement, and signs off on the Mortgage or Trust Deed.
- The Exchanger will be the 100% Guarantor of the indebtedness. If the Lender cannot revise their loan documents to make the loan non-recourse to SPE, then we will provide a letter acknowledging the non-recourse nature of the loan as to SPE.

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ABOUT ACCRUIT

Founded in 2000 and acquired by Inspira Financial in 2023, Accruit is a leading full service Qualified Intermediary and Exchange Accommodation Titleholder, as well as the developer of the industry's only patented 1031 Exchange technology

- Dedicated exchange officers provide individualized service
- Developer of patented 1031 exchange workflow technology, Exchange Manager Pro℠
- $50 million Fidelity bond, $25 million Errors & Omissions, and $20 million Cyber Liability
- Client funds held in segregated accounts at top-rated financial institutions
- Multiple Certified Exchange Specialists® on staff
- In-house CPAs and Attorneys
- Experience managing up to $9 billion annually in exchange transactions
- Board & Committee member of the Federation of Exchange Accommodators (FEA)

OUR PROCESS

Accruit works seamlessly with lending partners for a successful Reverse Exchange. Our process includes providing the lender a comprehensive document set which satisfies underwriting requirements, including the following:

- Operating Agreement for SPE LLC
- Articles of Organization for SPE LLC
- Operating Agreement and Org Docs for EAT
- Operating Agreement and Org Docs for Parent Company of the EAT
- Evidence of Good Standing for EAT and Parent Company
- Personal information for owners of EAT's Parent Company
- Signing resolutions for LLC and EAT
- Specific borrowing resolutions
- EIN for SPE LLC
- Taxpayer guaranty
- Non-recourse letter signed by Lender

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