§1031 Exchange Replacement Property Solutions

Sandlapper Capital
Investments, LLC

Securitized Fractional Real Property Investments

An investment in real estate or other real property can provide unique investment portfolio benefits. Property owners often seek a steady stream of income, capital appreciation and property-related tax advantages. Yet some property owners may no longer be interested in actively owning and managing property, but still want an allocation in real estate. For those individuals, securitized fractional real property investing may be the perfect fit.[1]

Securitized fractional real property investments can come in several forms, including but not limited to: Deleware Statutory Trust programs ("DSTs"), tenant-in-common programs ("TICs"), sole ownership, royalty and over-riding royalty interests, undivided fractional working interests, etc.[2]

SIMPLY LIQUIDATING ASSETS CAN CAUSE UNDUE TAX BURDENS

These structures allow owners to invest in potentially larger investment-grade assets while retaining real property ownership. Investors will also shed day-to-day management responsibilities of property ownership, while continuing to defer capital gain and depreciation recapture liabilities created through real property ownership, when executing an Internal Revenue Code Section §1031 tax deferred exchange (IRC §1031). When used as like-kind real property replacements in a §1031 Exchange, these forms of real property may become powerful tools to manage investments and tax strategies.

Possible benefits include, but are neither limited to nor guaranteed to: increasing the grade, quality, and income from real property holdings, offer greater diversification options by geography and asset class, create inverse relationships to broader public markets, professional property and/or asset management and tools to aid owners for retirement and estate planning purposes. Owners of securitized fractional real property programs also enjoy many of the same benefits of sole ownership including asset depreciation and interest deductions, when leveraged, on income as well as ownership in real property.

Problem/Solution

When it is time to sell an investment property (met expectations, fully depreciated, tired of active management), there are many factors to consider. Whether investors are seeking to maximize gains, looking to increase the current level of income, or seeking to dispose of an underperforming asset, simply liquidating a property can create a number of taxable or recapture liabilities and obligations.

Investors are taking the first step in maximizing investment results by executing a §1031 Exchange. In some of the highest tax brackets, simply "cashing out" can erode up to 40% of the gains on profitable, low basis assets on a combined state and federal level.[3]

With guidance from the Internal Revenue Service, investment sponsors like Sandlapper Capital Investments construct securitized real property investments for use as suitable replacement property in a §1031 Exchange.[4] By reinvesting sale proceeds into a securitized fractional real property program, investors may:

DEFER LIABILITIES INDEFINITELY

KEEP INVESTMENT DOLLARS FULLY INVESTED

IN MANY CASES IMPROVE UPON THE GRADE AND QUALITY OF HOLDINGS

When the strategy and the assets are used as part of a broadly diversified portfolio, the inclusion of securitized fractional real property interests may mitigate some of the overall risk in an investment portfolio, could improve current cash flow and provide significant tax advantages and appreciation potential.[5]

A §1031/Securitized Fractional Real Property Strategy May Offer Investors Significant Tax Advantages, Income and Appreciation Potential.

Characteristics of a §1031 Exchange

A **tax-deferred exchange** is a transaction involving the sale and purchase of investment property or property held for productive use in a trade or business which meets requirements of Section§ 1031 of the Internal Revenue Code and qualifies for non-recognition of gain or loss.

Technically, the exchange is **tax-deferred**, not **tax-free**, since the gain deferred in the transaction will be recognized on the ultimate sale of the replacement property received in the Exchange.[6]

During a tax-deferred exchange, the investor may not have constructive receipt of their exchange funds. Therefore, a Qualified Intermediary (QI) as an independent third party is needed to facilitate a §1031 Exchange transaction and hold the funds on behalf of the investor.

Exchange Structure

When structuring an Exchange, there are two critical time limitations that begin on the day the original property is sold. They are:

It is important to note that the identification period and the closing period do run concurrently, and make no concession for weekends and holidays.

In addition to the time limitations when completing an Exchange, investors must also consider the value requirement. There is a general rule of thumb used in order to meet the exchange value requirement for full deferral treatment:

"Any cash received plus debt relieved from the relinquished property must be reinvested into the replacement property."

The only exception to the above is with the investment of new cash to replace any or all of the debt relieved. Additional debt, while allowed when acquiring a replacement property, does not get an exchanger to the value requirement if cash is withdrawn from the transaction.

Qualified Exchange Properties[7]

- *Raw or vacant land*
- *Commercial properties*
- *Rental properties*
- *Farm land*
- *Retail properties*
- *Industrial properties*
- *Leasehold interest of 30 years or more*
- *Delaware Statutory Trusts*[8]
- *Royalties*
- *Working interest in oil and gas*

Disqualified Properties[7]

- *Primary residence*
- *Second home*
- *Stock in trade or inventory*
- *Property specifically held for resale/speculation*
- *Vacation homes (most)*
- *Partnership interests*
- *Securities or other evidences of indebtedness*

BENEFITS OF

Securitized Fractional Real Property Investments

1. Income paid monthly (with most sponsors)[9]
2. Help to reduce the stress of mandated 45 and 180 day §1031 Exchange deadlines
3. The ability to partially shelter income through proportional participation in interest deductions and property depreciation
4. No day-to-day management
5. Professional property and asset management
6. Commercial assets available nationally
7. Quarterly and annual performance reporting and analysis
8. Ability to utilize IRC §1031 again in the future upon[10] disposition of current securitized fractional real property investment
9. Pre-arranged financing with non-recourse loan structure in most cases
10. Greater disclosure requirements than needed in traditional real estate investments

Footnotes

[1] *Income, returns, appreciation and tax advantages are typically never guaranteed and could be subject to risks outside of the control of an investment sponsor and outside the normal parameters of real estate and real property investing. See individual, deal-specific, Private Placement Memorandum ("PPM") for more information regarding potential risks.*

[2] *For the purposes of this brochure the term "Real Property" will be all encompassing. Various structures of fractional ownership interests of real property may have their own limitations and risks. Such risks will be discussed in individual, deal-specific PPMs.*

[3] *Consult with a tax advisor before liquidating any asset and taking the proceeds directly to best understand the taxable liability.*

[4] *DSTs, TICs, and other fractional real property investments can only be bought by qualified accredited investors via PPM. This PPM will outline the risks of such investments and generally have included via PPM or are accompanied by a tax opinion to disclose if such investment "will," "should" or "more than likely" comply with the conditions set forth by the IRS to be viewed as suitable replacement property in a §1031 Exchange. Absent having a Private Letter Ruling on a specific investment from the IRS, no guarantee can be made the IRS will allow any securitized fractional real property investment to be viewed as real property in an exchange. Consult with a tax advisor before making any replacement property decisions.*

[5] *Income, returns, appreciation and tax advantages are typically never guaranteed and could be subject to risks outside of the control of an investment sponsor and outside the normal parameters of real estate and real property investing. See individual, deal-specific PPMs for more information regarding potential risks.*

[6] *Real property assets currently are allowed a "step-up" in basis to the beneficiaries upon the death of the owner(s) and as such erases any previously liability for capital gains and depreciation recapture. It does not address any specific estate taxation liabilities. Beneficiaries should consult with their tax advisor before disposing of inherited assets.*

[7] *This is not a comprehensive list and investors should seek the advice of a qualified tax attorney or their CPA.*

[8] *See Footnotes 1, 4, 5, 9 and 10 re: who may invest and general risk disclosure. In addition to risks as outlined above and in the PPM for a specific offering, prospective purchasers of DST interests should be aware that under IRS Revenue Ruling 2004-86, the Service provides the parameters by with a DST investment MUST be structured to properly qualify as replacement property in a §1031 exchange. Within this, there are certain limitations that could create additional risks to the investment beyond standard real estate investments including; an inability to purchase additional assets, or make contributions of additional assets thus limiting the ability to make any structural changes, substantive improvements, renovations or additions to properties held in trust, cannot renegotiate leases or loans, refinance or make modifications to such, may not sell or exchange property or reinvest proceeds of a sale as a business unit. In addition, since owners of undivided fractional interests in a DST simply own beneficial interests of the trust, investors do not maintain any control or management of the asset(s).*

[9] *Income is not guaranteed.*

[10] *Continued ability for deferral is based on the Internal Revenue Code and applicable Revenue Rulings and Revenue Procedures as written. Future changes in the Code may impede the ability for later exchanges. Consult with a tax advisor on any applicable changes to the Code.*

About Us

Sandlapper Capital Investments, LLC was created to take advantage of opportunities brought about through the dynamic and ever-changing economic landscape. Often some of the greatest investment opportunities throughout history have been missed by those who lack the agility necessary to seize them. Our experienced team has the skills, tools and resources necessary to identify, analyze and act upon timely opportunities across a vast universe of industries.

Sandlapper principals collectively have decades of experience across a broad range of industries and investment vehicles covering both the public and private markets. These industries include packaged product analysis, commercial real estate equity and debt, tax credits and shelter programs, oil and gas and related industries, equipment leasing, corporate and municipal debt as well as other debt obligations and portfolio management.

Interested in learning more? Reach out to us!

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