The Replacement Property "Parked" Reverse Exchange

BEFORE CONTINUING - If you are not familiar with the concept of a reverse exchange, please read our white paper on "The Reverse Exchange" before continuing with this more detailed description of the process. You can find the definition of capitalized terms that aren't defined in this article in "The Reverse Exchange".

The most common reverse exchange structure involves the "exchange accommodation titleholder" taking ownership in a "Replacement Property Parked Reverse". This structure, also known as an "Exchange Last" reverse exchange, has two distinct phases.

Phase I: Accommodator Acquires Title to Replacement Property

The process begins with the Taxpayer assigning its rights to acquire the Replacement Property (the New Property) under the purchase agreement to the disregarded entity owned by NExT1031 (the "NExTLLC"). See "The Reverse Exchange" for an explanation of the role of the disregarded entity.

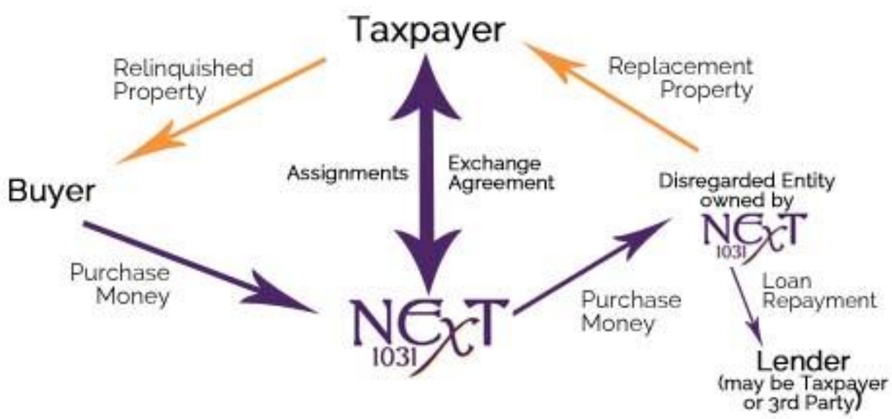
Since NExTLLC does not have the capital to acquire the Replacement Property, it must borrow funds for the acquisition. Financing can be provided from one or more sources: (1) the Taxpayer, (2) an affiliate of the Taxpayer, or (3) a third-party lender (a bank or the seller). NExTLLC gives the lender(s) a promissory note(s) for the amount of funds borrowed. The note will be secured by pledge of the membership interest in Holding Entity and, when available, a deed of trust or mortgage on the Replacement Property. All loan documents to which NExTLLC is a party must contain NExT1031's exchange exculpation language.

NExT1031, NExTLLC and Taxpayer enter into a Qualified Exchange Accommodation Agreement ("QEAA") setting forth the structure of the reverse exchange and stating that the Taxpayer will have 180 days to purchase the Replacement Property from NExT1031 to complete the exchange. NExTLLC and the Taxpayer (or an affiliate of the Taxpayer) will also enter into a master lease agreement for the Replacement Property with NExTLLC as landlord and the Taxpayer, or affiliate, as tenant. This master lease allows the economics of the Replacement Property (i.e. rents and expenses) to flow directly to the Taxpayer.

Upon closing, title to the Replacement Property is taken in the name of NExTLLC. When available, Taxpayers are encouraged to explore the option of obtaining "binder" (sometimes called a “hold-open”) on the title policy to prevent double premiums. Binders are not always available, so Taxpayers should speak with their title insurance officers to determine their options. If a “binder” is not available, Taxpayer should consider taking the membership interest in NExT1031 at the conclusion of the exchange as an alternative to NExT1031 deeding the Replacement Property to Taxpayer.

Phase II: Simultaneous or Delayed Exchange

Once the Taxpayer is prepared to close on the Relinquished Property, NExT1031, as the Qualified Intermediary, and Taxpayer enter into an Exchange Agreement. NExT1031 is assigned into the Taxpayer’s rights as seller of the Relinquished Property and instructs the settlement agent to transfer the Relinquished Property to the buyer through “direct deeding” (i.e. NExT1031 does not take title). Upon closing NExT1031 receives the exchange proceeds.



When NExT1031 has the proceeds from the sale of the Relinquished Property, it can then use those funds to purchase the “parked” Replacement Property from the NExT1031. Taxpayer may elect to have the Replacement Property transferred either by deed or an assignment of membership interest in NExTLLC. If the Taxpayer requests a deed transfer, the same settlement agent who handled the transfer of title to NExT1031 will be asked to handle the closing.

NExT1031 will use the exchange funds to purchase the Replacement Property out of the QEAA. NExTLLC will receive those funds and then use them to pay-down or pay-off the loans it received to acquire the Replacement Property. If proceeds from the sale are not sufficient to fully pay-off all loans, then the Taxpayer may assume the balance of any outstanding loans or take the Replacement Property subject to any remaining obligations.

In a deed transfer, the settlement agent will be instructed to record a deed to the replacement property (generally a quit claim or bargain and sale deed) directly from NExTLLC to the Taxpayer. Likewise, if the Replacement Property is transferred by an assignment of membership interests, ownership of NExTLLC will run directly from the NExT1031 to the Taxpayer.

In a reverse exchange intended to obtain the protection of Revenue Procedure 2000-37, NExT1031 must transfer the Replacement Property to the Taxpayer within 180-days of NExT1031’s acquisition of the Replacement Property.

It is often impossible for the exchange to be completed as a simultaneous transaction due to the recording and funding restrictions in many states. Although it is usually preferable to conclude the exchange as soon as possible, Taxpayers should be aware that NExT1031 must confirm closing of the Relinquished Property before completing the transfer of the Replacement Property to Taxpayer. Therefore, it is likely the Replacement Property will be transferred to the Taxpayer a day or two after the closing of the Relinquished Property.