PETROLEUM STRATEGIES
Your 1031 Exchange Partner

Improvement Exchanges

The improvement exchange allows an investor, through the use of a Qualified Intermediary, to make improvements on a replacement property using exchange equity. In other words, an investor can *maximize investment opportunities* using tax-deferred dollars while building or improving new investment property. This type of exchange is also referred to as a “construction” or “build-to-suit” exchange.

BENEFITS OF THE IMPROVEMENT EXCHANGE

Improvement exchanges offer an Exchanger a wide array of benefits which often result in a better investment than properties readily available on the open market. The ability to refurbish, add capital improvements, or build from the ground up, while using tax deferred dollars, can *create tremendous investment opportunities.* Due to the additional options provided by this variation and because the 1991 Treasury Regulations and Rev. Proc. 2000-37 established parameters for improvements to be produced, improvement exchanges continue to become more common. Another benefit is that the new replacement property does not necessarily have to be fully completed within the 180 day exchange period. A certificate of occupancy is not required.

REQUIREMENTS OF AN IMPROVEMENT EXCHANGE

An Exchanger must meet three basic requirements in order to defer all of their gain in the improvement exchange format. The Exchanger must; 1) spend the entire exchange equity on completed improvements or down payment by the 180th day, 2) receive substantially the same property they identified by the 45th day and 3) the replacement property must be of equal or greater value when deeded back to the Exchanger. The final value of the replacement property is the combination of the original purchase price *plus* the capital improvements made to the property. [Note: The improvements need to be in place prior to the Exchanger taking title to the replacement property.]

WHEN CAN THE IMPROVEMENT EXCHANGE BE USED?

The improvement exchange is commonly utilized to the benefit of §1031 Exchangers in the following situations:

• The property to be acquired in the exchange is not of equal or greater value to property being sold. In this case, the improvement exchange can eliminate a taxable situation by *adding capital improvements to an existing property.*

• *To build a new investment from ground-up*. This example maximizes the investment opportunity in a given area by enabling an Exchanger to build their own property. You don’t have to be subject to property on the market and the seller’s terms. Build a new one!

• The new investment *is* of equal or greater value but it needs refurbishments. Utilize the improvement exchange to *refurbish the new property* while again using tax-deferred dollars.

POTENTIAL OBSTACLES

The main obstacle in this type of §1031 exchange occurs when there is a lender involved. This is true because throughout the improvement process, the Intermediary is holding title to the property. This can be overcome in most cases and a successful exchange can be completed.