



NAFEP 1031 Exchange Services

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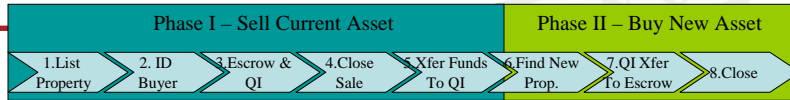


What Is A 1031 Exchange

- A method by which a property owner exchanges one or more relinquished properties for one or more replacement properties of "like-kind", while deferring the payment of federal income taxes and possibly some state taxes on the transaction.
- This tax deferred strategy accomplishes 100% deferral of capital gains indefinitely.

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How Does A 1031-Starker Exchange Works



1. List your current property for sale
2. Identify a buyer for the property
3. Establish escrow for the property and identify a qualified intermediary (QI) to handle the transaction
 - Note a QI is required in order to prevent taking receipt of the monies from the sale.
4. Close the sale through escrow
5. Transfer funds from sale to the QI
6. Find a new property (45 days)
7. QI Transfers funds to escrow
8. Buy new property (Total 180 days to close)

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What Are the Benefits



- Allows for a full and indefinite deferral of capital gains
- Enables wealth building
- Enables trading up to more desirable properties or assets
- Enables the ability to generate new depreciation when old property has reached the end of the depreciable life

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What are the downsides

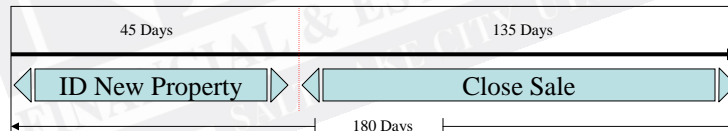
- Does not provide a exit strategy from real estate
- Keeps money illiquid for retirement planning or business development
- Can be difficult to find suitable property in 45 days
- Additional monies or other assets (i.e. "boot") may be required to complete the transaction
- Hi-failure rate for meeting the IRC 1031 timeline which forces taxes on the gains

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Requirements for a 1031

- Only applies to properties that are for business use or investment purposes
 - No primary residences, 2nd home, vacation properties, or foreign properties
- Replacement property price must be greater than or equal to the property sold
 - If not, then there will be capital gains tax due on difference
- Mortgage, if any, on replacement property must be greater than or equal to the property sold
 - If not, then there will be capital gains tax due on difference
- Need to use a qualified intermediary (QI) for the handling and holding of funds received from the sale of the property
- Property being exchanged must be "like-kind" per IRC-1031
- Can only identify up to 3 properties, or a unlimited number of properties whose combined value is not > 200% of the value of the relinquished property
- Must meet 45/180 day timeline requirements per IRC 1031:



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Applications for 1031

- Trade up to more desirable properties
- Relocate geography of real estate investment
- Change the type or character of the real estate investment
- Enables diversification or consolidation
- Ability to harvest non-productive properties from your portfolio and replace with more profitable properties

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Example of 1031-Starker Exchange

- Sam Big Bucks
 - Purchased a small retail complex 10 years ago for \$1,000,000
 - Current market value is \$4,000,000
 - Sam has located another property that he wants to exchange that costs \$7,000,000
- Objective:
 - Sam wants to stay in real estate for another 20 years so that he can continue to build his wealth.

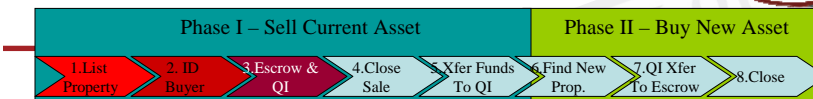
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Current Property's Profile

Purchase Price -	\$1,000,000
+ Capital Improvements -	\$200,000
- Depreciation -	\$250,000
= Adjusted Basis:	\$950,000
Mortgage	\$0
Sell Price	\$4,000,000
- Selling Expenses	\$200,000
- Adjusted Basis	\$950,000
= Capital Gain	\$2,850,000


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Phase I – Sell the current Property

1. Sam lists his property with a commercial realtor – Asking price of \$4,000,000
2. The Realtor finds a buyer to purchase the property for full asking price
3. Sam declares to the Buyer that he intends to do a 1031 exchange and adds the appropriate language to the buy-sell agreement and gets the buyer to agree to cooperate with the exchange
4. Sam identifies a Qualified Intermediary (QI) for the Exchange
5. Sam signs an assignment agreement with the QI that assigns the buy-sell agreement to the QI
6. The property goes into escrow for closing
 - The property closes 30 days later
7. Sam has the \$3.8M transferred to the (QI)
 - \$4,000,000 – Selling Price
 - \$200,000 - Closing costs, fees, etc
 - = \$3,800,000 – Net Cash

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Phase I – Sell Current Asset Phase II – Buy New Asset

1. List Property 2. ID Buyer 3. Escrow & QI 4. Close Sale 5. Xfer Funds To QI 6. Find New Prop. 7. QI Xfer To Escrow 8. Close

Phase II – Acquire New Property

1. Sam identifies a large, modern office building with a selling price of \$7,000,000.
 - Sam documents this property and notifies the parties (QI and Seller) that he has identified a replacement property
2. The seller of the \$7M property accepts Sam's offer.
 - Sam has 1031 exchange cooperation language added to the buy-sell agreement
 - Sam signs a buy-sell assignment with the QI
3. NAFEP transfers his funds to escrow so that Sam can close on the property
4. Sam closes on the property

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The Net Benefit Realized by the 1031 Exchange is \$1.0M+

	Taxable Sale	1031 Exchange
Purchase Price	\$1,000,000	\$1,000,000
- Depreciation	\$250,000	\$250,000
+ Improvements	\$200,000	\$200,000
= Tax Basis	\$950,000	\$950,000
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Selling Price	\$4,000,000	\$4,000,000
- Selling Costs	\$200,000	\$200,000
- Basis	\$950,000	\$950,000
Capital Gain	\$2,850,000	\$2,850,000
- Taxes (20% x Capital Gain)	\$570,000	DEFERRED
= Net Proceeds	\$2,280,000	\$2,850,000
Annual Appreciation Rate	6.5% for 10 Yrs	6.5% for 10 Yrs
Future Value of Investment	\$4,359,779	\$5,449,724
Net Benefit	--	\$1,089,945

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The Self Directed Installment Sale (SDISSM)



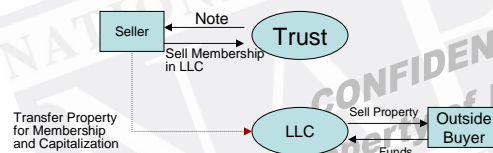
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The Self Directed Installment Sale

- A Self Directed Installment Sale, referred to after this as "SDISSM", is an Installment sale in which the seller is in complete control by transferring their property to a Trusted party of their choosing.
- The setup is comprised of creation of a LLC and a Trust.
- The Trust enters into a installment sale with you for your LLC ownership
- The LLC sells the property which then funds the Trust with enough money to make the installment payments



Basic Setup Steps

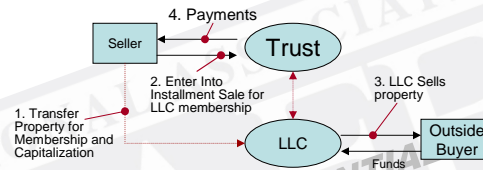
1. Setup a LLC and Trust and transfer property to the LLC
2. Setup Installment Sale with Trust
3. LLC Sells the Property
4. Start the payments

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How It Works



Your Role is on the Transaction

1. Sign documents
2. Find the buyer
3. Find a 3rd party for Trust
4. Receive Payments

NAFEP's Role

1. Create LLC
2. Create Trust
3. Create and prepare all document
4. Annual filings for LLC
5. Annual Tax Returns and forms
6. Issuance of payments

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Benefits of the Self Directed Installment Sale

- Deferral of capital gains
- Deferral of depreciation
- End-to-End control over the transaction
- Trusted party to act as buyer
- No worries about defaults and foreclosure
- Wide choice of investments for the funds
- Establish a fixed term for payments
- Establish variable returns and excess income
- Opportunity to request early pay-off
- Ability to sell assets from C and S- Corps
- Opportunity to change estate planning by not having paid capital gains taxes

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Who Can be the 3rd Party Member of Trust

- Due to related party rules, the following individuals cannot be involved as members of the Trust
 - Spouse
 - Son
 - Daughter
 - Parent
 - Grandchildren
- Examples of who can act as the 3rd party member
 - Cousin
 - Brother (Not for property that is depreciable)
 - Sister (Not for property that is depreciable)
 - Business Partner
 - Nephew
 - Niece
 - CPA
 - Attorney

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What cannot be deferred in the SDIS

- Depreciation
 - 1245 asset depreciation cannot be deferred, but capital gains can.
- Publicly traded stocks (GM, IBM. Etc.)
 - Stock or business interests in non-public entities are deferrable

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Basic Guidelines for SDIS

- Seller cannot have entered into buy-sell agreement
 - No rescinding and re-instatement allowed
- Seller cannot have entered into escrow
- Buyer must be an independent 3rd party – arms length
- Seller cannot have direct access or ownership of an annuity
- Buyer cannot be relieved of obligation to pay

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Example

- Current Situation
 - Bob and Carol are husband and wife. Bob is 67 years old and his wife Carol is 64 years old
 - They own a rental property with an original cost of \$250,000. They are planning on selling this property to help fund their retirement.
 - Current market value: \$2,500,000
 - Property Basis: - \$250,000
 - Capital Gains: = \$2,250,000
 - Taxes: - **\$546,750**
 - Net Proceeds: = \$1,953,250
- Objective: To Sell this property and minimize the taxes so that they have more for retirement

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Step 1 – Setup

1. Setup 2. Buy 3. Sell 4. Pay

- NAFEP sets up a Nevada LLC for Bob, Carol
- Bob and Carol appoint Emily, their daughter to act as the managing member of the LLC.
- Bob is appointed as the “Investment Manager” of the LLC
- Bob and Carol transfer their property to the LLC
- NAFEP sets up a Trust in which Emily and Joe, their CPA are beneficiaries. NAFEP is the Trustee.

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Step 2 – Buy

1. Setup 2. Buy 3. Sell 4. Pay

- Bob, enters into an installment sale with the Trust for his membership units in the LLC
 - This now places the Trust as the owner of the LLC. Bob and Carol are removed from the LLC as members.
- Bob will continue to act as the investment manager for the LLC
- Emily will continue to act as the Manager. As such, she is in control of the LLC

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Step 3 – Sell

1. Setup 2. Buy 3. Sell 4. Pay

- As the Investment Manager, Bob finds a buyer for the property
- Upon closing, the LLC receives the buyer's monies
- Bob, acting as investment manager, invests the monies

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Step 4 – Pay

1. Setup 2. Buy 3. Sell 4. Pay

- As investment manager, Bob hires NAFEP as a 3rd party administrator for the LLC's administrative tasks.
- As an administrator, NAFEP will insure that all LLC filings and tax returns are completed. Additionally, NAFEP will administer the payment of the note to Bob and Carol via the Trust.
- NAFEP will be required to make regular distributions to the members. The Trust receives 99% of all distributions, This allows the Trust to make the installment payments to Bob and Carol

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Comparison – SDIS vs. Tax Sale

Bob and Carol's \$2.5M sale through the Self Directed Installment Sale will net them an Additional **\$609K** over 25 years.

	Taxed Sale	SDIS
Property Sales Price	\$2,500,000	\$2,500,000
Taxes Paid ¹	\$546,750	- Deferred -
Interest and Growth Rate of Investment	5.75%/5.9%	5.75%/5.9%
No. Yrs of Payments	25	25
Total Payout ²	\$3,491,402	\$4,769,561
Taxes and Fees Over Term ³	\$445,349	\$1,114,268
Net	\$3,046,053	\$3,655,293
Total Net Benefit Received Over 25 Yrs	\$0	\$609,240

1. Assumes a 24.3% capital gains tax rate which includes both federal and state rates

2. Uses a payment frequency of annual payments

3. Assumes a 25% ordinary income tax rate for Bob and Carol, plus an additional 0.125% annual administration fee from NAFEP for the SDIS sale. Assumes 0.5% annual management fee for taxed sale.