



Financing a Reverse 1031 Exchange

A reverse exchange is a procedure prescribed in the tax code which allows a 1031 Exchange investor to acquire replacement property prior to selling relinquished property.

Regulations require investors participating in a reverse exchange to assign their replacement property contract to an exchange company and the exchange company will close on the purchase. The funds required to close on the purchase will be provided to the exchange company as a loan from the client. Additional financing of the purchase can be provided, provided the lender is OK with the exchange company being on title for a short period of time. Additional information on reverse exchange basics can be provided as necessary. The following is a checklist to provide lenders who may be making a loan for the replacement property purchase.

1. The exchange company can be listed as a borrower, but the terms of the loan would need to make clear that the loan to exchange company is non-recourse.
2. Client can guarantee the loan and provide recourse.
3. The exchange company will not proactively apply for the loan. Other than providing tax ID number, no additional documents or information will be provided to lender. So all underwriting must be between client and lender.
4. Client will pay all interest on loan during the time exchange company is on title.
5. The loan should be assumable and without initial pre-payment penalty. A partial loan payoff may be required prior to transfer of property to client and assumption of loan.
6. Additional exculpatory language should be added to loan documents, a sample of which is provided here:

"Lender acknowledges that Borrower will hold title to the Property for purposes of facilitating a tax deferred exchange for Guarantor and that Guarantor is the real party in interest. In making the Loan, Lender has relied solely on the value of the collateral and the financial condition of the Guarantor. Accordingly, and notwithstanding anything to the contrary set forth herein or any other instrument executed in connection with this agreement by Borrower (collectively, the "Loan Documents"), Lender agrees to waive any and all rights, claims, remedies, causes of action that it may have or later acquire in law, equity, contract or otherwise, to bring any action or claim against the Borrower that would result in a monetary judgement against Borrower. Lender's sole recourse against Borrower shall be limited to the assertion of any rights that Lender may have in the collateral pledged as security for the Loan. Lender agrees that Borrower shall not be, or become personally liable for any sums which are or become due under the Loan Documents, including, without limitation, any agreement, covenant, warranty, representation, indemnity, environmental indemnity or other similar obligation contained in the Loan Documents. The limitation on the rights set forth in this paragraph are not intended to affect or impair any rights that Lender may have with respect to the Guarantor. The protections set forth herein are for the sole benefit of AEC EAT, LLC and its affiliated entities and shall not apply to or otherwise benefit Guarantor or any subsequent borrower that may assume the obligations of Borrower under the Loan Documents."

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