

## THE IMPROVEMENT OR “BUILD TO SUIT” EXCHANGE – THE BASICS

The Improvement Exchange is a powerful strategy that enables an investor to make improvements to a replacement property, and utilize the value of those improvements, in a 1031 exchange. Also known as a “construction” or “build-to-suit” exchange, this vehicle enables exchangers to maximize their investment opportunities by using tax deferred dollars to build or improve new investment property.

### When is an Improvement Exchange typically utilized?

- **When the replacement property is not of equal or greater value to the property being sold.** In this case, the improvement exchange defers capital gains taxes by adding capital improvements to an existing or new 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 his own property.
- **When the replacement property needs renovations.** The benefits of an improvement exchange can be leveraged to refurbish or renovate the new property while using tax-deferred dollars.

### How the Improvement Exchange process works

An Improvement exchange can be accomplished either in a straightforward delayed fashion (“delayed improvement exchange”) by first selling the relinquished property or as a reverse exchange by first acquiring the replacement property. In the delayed improvement exchange, the Investor first sells the relinquished property using a Qualified Intermediary (“QI”). The Exchanger then has the standard 45 days to identify the replacement property but must also identify the improvements that will be made on the subject property with as much detail as is practical. The Exchanger enters into a contract to purchase the replacement property along with a written Qualified Exchange Accommodation Agreement with the QI’s *Exchange Accommodation Titleholder* (“EAT”). The EAT’s role is to hold title to the replacement property while the improvements are being made to that property. Upon completion of the improvements, or at the end of the 180<sup>th</sup> day, whichever is earlier, the investor receives title to the improved property from the EAT.

In many instances, the investor needs additional capital through a construction loan to complete the improvements. At this point, the EAT acts as borrower under a non-recourse loan. Upon transfer of the replacement property to the exchanger, the exchanger is substituted as the borrower and assumes the construction loan. *(Continued on Next Page)*



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In order to defer all gain, the exchanger must essentially satisfy the following three requirements:

1. They must utilize the entire exchange equity on completed improvements, or down payment, by the end of the 180 day exchange period;
2. They must ultimately receive substantially the same improved property as that identified by the 45<sup>th</sup> day; and
3. The replacement property must be of equal or greater value to the relinquished property they sold at the time it is deeded back to the exchanger.

While the ultimate goal is to use all the exchange equity, complete all of the improvements and acquire a replacement property of equal or greater value, the exchanger will still receive deferral for any improvements that have been incorporated into that property when it is ultimately deeded back to the exchanger even though all of the work has not been completed.

### **The Advantages of an Improvement Exchange**

An Improvement Exchange is extremely valuable in a market where viable replacement properties are scarce. The ability to renovate, refurbish, add capital improvements, or build from the ground up while using tax deferred dollars can create tremendous investment opportunities. Also, tax deferral can still be achieved even if all of the improvements have not been completed within the 180 day exchange period and even though a Certificate of Occupancy cannot be obtained.

As you can see, an Improvement Exchange is quite complicated and can involve a number of moving parts. It is therefore imperative that you utilize a competent Qualified Intermediary who can coordinate the transaction smoothly for a successful outcome. Want to know more about Improvement Exchanges? Peak 1031 Exchange is here to help.

*\*Peak 1031 Exchange, Inc. does not provide legal or tax advice. Always consult with your attorney or tax adviser.*



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