

NUMBER OF REPLACEMENT PROPERTIES TO BE IDENTIFIED AND DESIGNATED

The IRS Final Regulations issued in 1991 answer the question of how many Replacement Properties may be identified and designated for an exchange.

The Final Regulations also require that the Exchangor unambiguously identify and designate Replacement Property in writing to a party involved in the exchange (normally the facilitator). The identification and designation must be made before the expiration of 45 days from the Relinquished Property closing. The Final Regulations also allow for a revocation of an identification during the 45-day I. D. period, but do not permit additional properties to be identified following the 45-day period.

1. Three Properties Rule — The Exchangor may identify up to three properties regardless of their value.

Example: Relinquished Property sells for \$150,000. Three properties are identified as follows. . .

Replacement Property 1	FMV	\$250,000
Replacement Property 2	FMV	\$300,000
Replacement Property 3	FMV	\$200,000

Because only three properties are identified and designated, the identifications in the example are valid under the Three-Properties Rule. Any or all of the properties may be acquired to complete the exchange.

2. 200 Percent Rule — The Exchangor can identify more than three Replacement Properties as long as the total value of all the properties identified and designated does not exceed 200 percent of the value of the Relinquished Property. **This rule only applies if more than 3 properties are identified.**

Example: Relinquished Property sells for \$150,000. More than three properties are identified. . .

Replacement Property 1	FMV	\$ 60,000
Replacement Property 2	FMV	\$ 75,000
Replacement Property 3	FMV	\$ 50,000
Replacement Property 4	FMV	\$ 30,000
Replacement Property 5	FMV	\$ 45,000
Replacement Property 6	FMV	<u>\$ 40,000</u>
Total Value		\$300,000

Although more than three properties are identified, the total value of all the properties identified does not exceed 200 percent of the Relinquished Property value (\$300,000) so the identifications in this example are valid. **Problem:** The Exchangor must



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be able to prove the values did not exceed 200 percent. This is extremely difficult without Purchase and Sale Agreements signed by the seller and buyer for each Property identified. The fair market value of a property is not the price the Exchangor hopes to pay for a property. The "listed" price is good starting point, but in some circumstances (i.e., a "bidding war") even the listed price may be lower than the fair market value.

The Final Regulations offer one other alternative for identification and designation. But this alternative is only for the bravest of exchangors:

More Than Three Properties Worth More Than 200 Percent — An Exchangor may identify and designate more than three properties having a value of more than 200 percent of the value of the Relinquished Property. But the Exchangor must receive identified properties having a value of at least *95 percent* of the total value of all of the properties which were identified. **This rule only applies if more than 3 properties are identified wthat have a value of more than 2 times the Relinquished Property's value.**

Example of "None But the Brave" Identification. : Relinquished Property sells for \$150,000. These properties are identified. . . .

Replacement Property 1	FMV	\$ 100,000
Replacement Property 2	FMV	\$ 60,000
Replacement Property 3	FMV	\$ 140,000
Replacement Property 4	FMV	\$ 400,000
Replacement Property 5	FMV	\$ 150,000
Replacement Property 6	FMV	<u>\$ 150,000</u>
Total Value		\$1,000,000

Assume, after the end of the Identification Period, that the Exchangor receives all the identified property except Replacement Property 2. The Exchangor received properties worth only 94 percent of the total value of properties identified ($\$940,000/\$1,000,000 = 94$ percent). **THE ENTIRE EXCHANGE FAILS**, even though all the exchange equity may have been reinvested in identified Replacement Property. Any properties acquired within the Identification Period are treated as properly identified. If Replacement Property 1 was acquired within the 45-day period and \$50,000.00 of cash was left over in the exchange, the Exchangor has \$50,000.00 of "boot" even if additional identified replacement properties were acquired after 45 days.

The Final Regulations impose a very stiff penalty on those Exchangors who exceed the allowed number of 3 properties and allowed value of 200 percent but are unable to acquire 95 percent of the value of all of the identified properties. None of the properties (except those acquired with the 45-day Identification Period) are treated as properly identified and the exchange fails as to the remainder of the properties.

Caution would dictate that the Exchangor abide by the Three-Property Rule, and only use the 200 Percent Rule if fair market value can be substantiated.



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The Final Regulations do not require that a Purchase and Sale Agreement be in force for each of the identified properties. However, the Exchangor must acquire at least one of the identified properties to successfully complete the exchange. It would probably be prudent to have at least one of the identified properties under Purchase and Sale Agreement.

Because the number of Replacement Properties is limited by the Three-Property Rule and the value is limited by the 200 Percent Rule, it is important to confine the identifications to those properties the Exchangor has a high probability of being able to obtain.

Identifying and Designating Target Properties is definately an area where you want to hedge your bets!



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IDENTIFICATION TIPS

The most difficult part of a delayed exchange is meeting the identification and designation deadline. It's not easy to find suitable replacement property within 45 days of closing of your old property. By and large, the IRS identification rules are not "user friendly". We suggest that you start the search for your new property even before your old property sale closes. The 45 day deadline starts on the closing of the old property.

Here are a few tips to follow when identifying the new property:

Have the identification form back to us early enough so we can review it before the expiration of the 45 day deadline.

Try to have at least one of the identified properties under a binding purchase agreement by the 45 day deadline.

Include for each identified property two of the following items for that property:

1. Street Address
2. Legal Description.
3. Assessor's Tax Acct.#

If your exchange involves property other than real estate (such as personal property or a leasehold interest), please call Dennis P. Helmick or Kelly M. Yates for more information.

Identify any proposed property improvements including repairs and/or remodeling, that are to be part of the exchange, at the time you identify the property. Please attach a copy of the building plans, or a description of the repairs and/or remodeling, to the identification letter.

It is safest to limit your identification to 3 properties.

Make sure that each property you identify has only one assessor's parcel number or that property may be deemed to be several properties.

If you plan to identify **more** than three properties, please review with us, well in advance of the identification deadline, the fair market values of the properties you plan to identify to avoid exceeding the 200% rule.

If you plan to acquire less than 100% of an identified property (a fractional share), such as a Co-Tenancy interest, you must identify the fractional share of the property. Please review this question with us before you identify.

If you plan on identifying a property owned by a related party, please call Kelly or Dennis for more information. Acquisitions of replacement property from related parties only work in rare circumstances.

The above items are only a few of the issues in identifying property. Please stay in touch with us throughout the identification process.



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