LENDING CONSIDERATIONS: Reverse & Build-to-Suit Exchanges

A "Reverse" Exchange refers to the situation where an Exchanger closes on the acquisition of Replacement Property prior to selling Relinquished Property. Under applicable rules, the Exchanger may not acquire the Replacement Property in its own name before selling Relinquished Property. Rather, a third party called an Exchange Accommodaion Titleholder (EAT) must acquire title to Replacement Property on behalf of the taxpayer, which it typically does in the name of a Special Purpose Entity LLC (SPE). The Replacement Property is later conveyed to the taxpayer after the sale of Relinquished Property. Build-to-Suit or Property Improvement Exchanges are similar in that the EAT takes legal title to the property during the period of construction. Both Reverse and Build-to-Suit/Property Improvement Exchanges are sometimes referred to as "Parking" Exchanges since the EAT/SPE temporarily parks title to real property.

In either instance, when a loan is involved, the SPE, rather than the taxpayer, is the borrower under the loan. As a result, **the lending considerations differ greatly from a conventional "forward" 1031 Exchange, and it is critical that the lender understand the nature of the arrangement early on in the transaction.**

Lending in a Reverse Exchange

There are special requirements for lending in a Reverse Exchange which include the following:

- Mortgage brokers cannot do Reverse 1031 Exchange loans since those loans are sold in the secondary market.
- Loans must be done commercially because the property is held in an LLC as part of the Reverse Exchange process and the secondary market will not accept an entity borrower.
- Lending must be able to meet the 180 day Exchange Period to ensure a valid 1031 Exchange.
- The EAT holds title as the single member of the SPE, and at the end of the transaction, the EAT can either give a deed to the Exchanger or assign the membership interest in the SPE to the Exchanger depending upon the circumstances.
- If the Exchanger is going to retain the Reverse Exchange loan, it is helpful for the Exchanger to take over the membership interest so there is no change in the ownership of the SPE for loan purposes.
- In the loan documents it is advisable to add verbiage to the effect that a one-time transfer is allowed from the EAT to the taxpayer without triggering any due-on-transfer provisions.
- The SPE will generally be the Borrower of the non-recourse indebtedness and Grantor of collateral (if the replacement property is the collateral). The Lender's loan documents must explicitly provide the loan is non-recourse as to the SPE. The SPE then becomes Mortgagor or Grantor pursuant to the Mortgage or Trust Deed and Payor of the Note, Borrower under the Loan Agreement, and signs off on the Mortgage or Trust Deed.
- The Taxpayer will be the 100% Guarantor of the indebtedness. If the Lender cannot revise their loan documents to make the loan non-recourse to SPE, then we will provide a letter acknowledging the non-recourse nature of the loan as to SPE.

Documents Needed by Lending Institution in a Reverse Exchange

The following documents may be required for lending in a Reverse Exchange:

- Operating Agreement for SPE LLC
- Articles of Organization for SPE LLC
- Operating Agreement and Org Docs for EAT
- Operating Agreement and Org Docs for Parent Company of the EAT
- Evidence of Good Standing for EAT and Parent Company
- Personal information for owners of EAT's Parent Company
- Signing resolutions for LLC and EAT
- Specific borrorwing resolutions
- EIN for SPE LLC
- Taxpayer guaranty
- Non-recourse letter signed by Lender

Reverse Exchange lending requirements vary greatly from a typical Forward 1031 Exchange. It is very important for the Lender to be experienced and knowledgeable in Reverse Exchange lending at the beginning of the exchange process.

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