

1031 Exchange Program

This product is designed for your clients who want to defer recognition of taxable gain income by disposing of investment property through a “qualified exchange” as defined by the Internal Revenue Code Section 1031 Like-Kind Real Estate Exchange (aka “1031 Tax-Deferred Exchange”).

Descriptions of the 4 different types of 1031 Exchanges and a Glossary of Common Terms used with these programs has been included below.

Loan Type:	N/O/O purchase and new construction
Loan Programs Available:	30 Year Fixed; fully amortized. (No call provision.) 5 Year Convertible; refer to 5-Year Convertible Program Description for details specific to this program, such as index, margin, interest rate cap, floor, etc. 7-Year Call; refer to 7-year Call Program Description for details specific to this program.
Maximum Loan Amount	For maximum loan amount, refer to current <i>Wholesale Lending Rate and Fee Schedule</i> . Select “pricing” on state home page to access.
Maximum Loan-To-Value:	For maximum LTV, refer to current <i>Wholesale Lending Rate and Fee Schedule</i> . Select “pricing” on state home page to access.
Property Type:	SFR detached, 2-4 family, townhouses and condos Ten acres or less
Pricing:	Select “pricing” on state home page to access a current <i>Wholesale Lending Rate and Fee Schedule</i> . Add .250% rate adjustment for “Reverse 1031 Tax Exchange” or “Improvement 1031 Tax Exchange” programs. For “ <i>Improvement 1031 Tax Exchange</i> ” refer to additional origination fees to WAFED required for “ <i>All-in-One</i> ” <i>Custom Construction Loan</i> ” program, which apply to this program also. “Reverse 1031 Tax Exchange” requires the additional processing fee for “Entity Vesting”. Refer to page 3 on Rate and Fee schedule.
Mortgage Insurance:	Not required.
Reserves/Impounds:	Monthly impounds for taxes and insurance can be waived upon request if LTV is 70% or less, subject to underwriting approval. Escrow Waiver Fee applies. Include this fee in “Origination Charges” to WaFed for GFE purposes.

If flood insurance is required, monthly impound for flood insurance is always required; cannot be waived. No exceptions.

Monthly impounds cannot be waived on Higher Priced Loans regardless of LTV. A Higher-Priced Loan is any owner occupied home loan with any APR exceeding the Average Prime Offer Rate by at least 150 basis points if \$417K or less and at least 250 basis points if over \$417K.

EZ Pay: Payment Processing Charge will be waived if monthly payments are made by EZ Pay (*automatic withdrawal from checking account of Borrower(s) choice*). If the facilitator company is taking title at closing on a Reverse or Improvement Exchange, EZ Pay will not be available until the property is transferred to the Exchanger at some point after closing. Temporary coupons will be provided at closing, but Payment Processing Fee will not apply in this case.

Tax Service: Required.

Prepayment Charge: 1% 'hard' prepayment charge for the first three years.

New Mexico: Please refer to current *Wholesale Lending Rate and Fee Schedule* for specific prepayment charge information. Select "pricing" on your state home page to access.

Flood Certification: Required.

4 Types of 1031 Tax Exchanges:

Simultaneous 1031 Exchange: Property Exchanges are simultaneous and require both properties to be closed at the same time.

Delayed 1031 Exchange: In a Delayed Exchange, the disposition of the Exchanger's *old* property occurs *before* the acquisition of the *new* property. The old property is exchanged for a promise from a Facilitator to acquire a new property for the Exchanger at a later date. Like-kind replacement property must be identified by the 45th day after closing the loan on the first property. The replacement property must be closed by the 180th day after closing the first escrow. Once the replacement property has been identified, the Facilitator purchases the property and immediately trades the property to the Exchanger.

Reverse 1031 Exchange Loan: In a Reverse Exchange, the acquisition of the new replacement property, occurs *before* the closing on the sale of the old property. The closing on the old property must occur by the 180th day after closing the new property.

Improvement 1031 Exchange: In an Improvement Exchange (sometimes referred to as the "Build to Suit" Exchange), the new replacement property is purchased with plans to have improvements made to the property while still qualifying under the rules of IRC 1031 "Tax-Deferred Exchange." Any improvements to be made to the property must still be completed within the 180-day time-line allotted. At the end of 180 days, the Facilitator will deed and/or assign their interest in the

**Loan Processing
Information and
Requirements:**

property to the Exchanger.

Appraisal: Rent Schedule and Rental Comparisons are required. Property must have average or better marketability.

Prepayment Charge Applies: A *Truth in Lending Disclosure* is technically not required by law on investment properties, but we recommend you prepare one at application time in order to disclose the prepayment charge to the Borrower(s).

1031 Documentation: Loan Submission file must contain a copy of the Purchase & Sale Agreement including an *Exchange Cooperation Clause* detailing the 1031 transaction. "Reverse" and "Improvement" Exchanges require a copy of the *Qualified Exchange Accommodation Agreement*.

Personal Guarantee Requirement: On all "Reverse" and "Improvement" Exchanges WAFED will require the Exchanger to sign a Personal Guarantee at closing since an LLC or the Facilitator will initially be taking title to the property. (*WAFED form LO207: Continuing General Guarantee Agreement*)

Hazard Insurance: The named insured should match the grantor clause in the Deed of Trust.

Closing Agent: Washington Federal requires that all 1031 Exchange transactions be settled by the closing/escrow department of the same title company that is insuring our first lien position.

Reverse & Improvement 1031 Exchange when an LLC is taking title: The most common form of ownership for a Reverse or Improvement 1031 Exchange is to have an LLC take title. Most typically an LLC is formed for the specific purpose of completing the 1031 Exchange, and usually consists of one Member requiring one signature for one purpose. The Facilitator is usually the Member initially. WAFED will require the Exchanger to sign a Personal Guarantee Agreement at closing. (*WAFED Form LO207: Continuing General Guarantee Agreement.*) Once the 1031 Exchange is completed, an *Assignment of Membership Interest* must go of record. WAFED will require a recorded copy of the *Assignment of Membership Interest*. No title endorsement is required.

Reverse and Improvement 1031 Exchange when the Facilitator is taking title: If the Facilitator Company is taking title, the transfer of property to the Exchanger will not take place until the 1031 Exchange is complete. This may happen soon after closing the loan or take as long as 180 days. WAFED will require the Exchanger to sign a Personal Guarantee Agreement at closing. (*WAFED Form LO207: Continuing General Guarantee Agreement*) The Exchanger will be put into title by way of a Statutory Warranty Deed and assume the Facilitator's place on the loan at that time. WAFED will require a recorded copy of the *Deed* and the *Assumption Agreement* at the time title is transferred. No title endorsement is required.

Frequently Asked Questions on 1031 Exchange Loans:

Question: Are we required to have the Facilitators “approved” by WAFED?

Answer: No. It is the responsibility of the Exchanger to make sure they are dealing with a reputable Facilitator.

Question: Can Attorneys close 1031 exchange transactions instead of title companies as long as they’re not the Facilitator?

Answer: Washington Federal’s policy is to have the closing/escrow department of the title company that insures our first lien position be the settlement agent.

Question: Will we make a 1031 Exchange loan to an out of state investor/borrower? If so, does the maximum LTV of 65% still apply?

Answer: Yes, WAFED will make a 1031 Exchange loan to an out of state investor/borrower and the same parameters apply.

Question: What are the PATRIOT ACT Requirements for 1031 Exchange loans when a Facilitator takes title? Do we merely identify the Exchanger or do we identify the Facilitator company’s representative?

Answer: WAFED requires you identify the investor/exchanger. You do not need to identify the facilitator company’s representative.

Question: In an Improvement Exchange, who signs the Custom Construction Loan Policies and Procedures (WAFED form LO271), the Construction Loan Agreement, the Construction Contract, Description of Materials, Cost Breakdown, Draw Requests, Authorization of Method of Draw Disbursement (WAFED form LO231), etc.?

Answer: Have both the Facilitator and the Exchanger sign all of the above documentation.

Question: In doing a 1031 Delayed Exchange, we have the borrower’s original signature and the seller’s original signature on the HUD-1 Settlement statement. However, we only have a fax copy of the facilitator’s signature. Is that okay?

Answer: No, we don’t need the Facilitators signature.

Question: On the final loan application for a “Reverse Exchange” or an “Improvement Exchange, how should “title to be held as” be reflected? Should it be in the facilitator’s name or the exchanger’s name?

Answer: The application should reflect the way title will be held at time of settlement. That may be in the Facilitator’s name or it may be in the name of the LLC that the Exchanger formed for the purposes of that particular 1031 exchange.

Question: What kind of documentation do we need on the LLC if an LLC will hold title?

Answer: The *Secretary of State Certificate of Formation* indicating who is authorized to sign and who the managing member(s) are is required. Initially, the managing member will be the facilitator. Once the exchange is completed, an *assignment of membership interest* will need to be recorded to assign their interest to the exchanger, which we require, a copy.

Glossary of Common Terms:

Exchanger/Exchangor:	The property owner(s) seeking to defer capital gains tax by utilizing an IRC 1031 exchange. (The Internal Revenue Code uses the term “Taxpayer.”)
Facilitator:	A Qualified Intermediary. The entity that facilitates a 1031 tax deferred exchange.
Qualified Intermediary:	<p>The entity that facilitates the exchange for the Exchanger. Although the Treasury Regulations use the term “Qualified Intermediary,” some companies use the term “facilitator” or “accommodator”. The Qualified Intermediary provides the following important services:</p> <p>Shields parties (Exchanger, buyer and seller) from certain liabilities;</p> <p>Ensures the preservation of “safe harbor” treatment under 1991 Treasury Regulations;</p> <p>Provides a paper trail validating the flow and structure of the transaction; and</p> <p>Reduces the agent and closing officer’s liability for the exchange structure.</p>
Replacement Property:	Newly acquired 1031 real estate.
Relinquished Property:	Sold 1031 real estate.
Simultaneous:	The exchanger disposes of old property and acquires new property in a concurrent, interdependent escrow.
Delayed:	The old property closes before the acquisition of the new property.
Reverse:	The new property purchase closes before the old property sale closes.
Improvement:	Improvements made to the replacement property to add to the purchase price and/or use up proceeds from a relinquished property. (Sometimes referred to as Build to Suit.)
Like-Kind:	Refers to the type of property being exchanged. You can exchange any real estate investment for any other real estate investment; but you cannot exchange productive use for personal use. Example: Rental property for rental property. That can mean selling a rental house and buying a rental 4-plex. The use is still productive.
Adjusted Basis:	This figure is determined by original purchase price plus capital improvements reduced by depreciation and capital losses. The end result is used in the capital gains calculation. This may need to be used when improvements are not completed within 180-day timeline.
Realized Gain:	Taxpayer’s actual capital gain in a property.

Recognized Gain:	That portion of the realized gain that must be claimed in a tax year. In a fully deferred exchange, there is no recognized gain and the realized gain is carried over to the replacement property.
Exchange Agreement:	Written agreement between the exchanger/investor and facilitator that outlines the intermediary's obligations to transfer the relinquished (old) property to the buyer <u>or</u> the replacement (new) property to the exchanger/investor, subject to specifications of the tax code and Treasury Regulations. The agreement necessary to address "parked property" and/or "safe harbor" transactions is called the Qualified Exchange Accommodation Agreement.
Exchange Accommodation Titleholder:	An entity that is treated as the owner of the "parked" property for federal income tax purposes. The EAT cannot be a disqualified person as defined in the Treasury Regulations for IRC 1031. Examples of a disqualified person include, the Exchanger's attorney if they have acted as the Exchanger's agent or even related parties to the Exchanger.
Identification Period:	The period during which the Exchanger must identify Replacement Property in the exchange. The Identification Period starts on the day the Exchanger transfers the first Relinquished Property and ends at midnight on the 45 th day thereafter.
Exchange Period:	The period during which the Exchanger must acquire Replacement Property in the exchange. The Exchange Period starts on the date the Exchanger transfers the first Relinquished Property and ends on the earlier of the 180 th day thereafter or the due date (including extensions) of the Exchanger's tax return for the year of the transfer of the Relinquished Property.
Sequential Deeding:	Transfer of title from seller or taxpayer to facilitator, followed by transfer of the title from facilitator to taxpayer within 180 days to accommodate "tax deferred" exchange, a/k/a "parked property".
2nd Home/Vacation Property:	Section 280A, IRC is designed to limit deductions taken on business use of primary residence, rental or vacation home. Per the code, if taxpayer makes personal use of a property more than the greater of: 14 days a year <u>or</u> 10% of the number of days that the property is rented at "fair market rent" the property will be treated as being used by the taxpayer as his residence. The only deductions allowed would be taxes and mortgage interest.

Programs, interest rates, fees, terms and conditions are subject to change without notice. This information is intended for mortgage and real estate professional use only and should not be distributed or shown to consumers or other third parties. Washington Federal NMLSR Company #410394.