The Lease Agreement in Reverse Exchanges

During the time the Special Purpose Entity (SPE) holds title in a Reverse or Improvement Exchange the parked property will be leased to the Exchanger or an affiliate of the Exchanger. This enables the Exchanger to use or sublease the parked property and enjoy the economic benefits, as well as the burdens, of operating the property.

In a Reverse or Improvement Exchange under the "safe harbor" guidelines of Revenue Procedure 2000-37 ("Rev. Proc. 2000-37"), the Lease Agreement will typically have a term of 180 days to coincide with the time periods set forth in the Qualified Exchange Accommodation Agreement.

Under the terms of the Lease Agreement, the Exchanger is required to pay rent to the SPE, consisting of all holding costs associated with the parked property. These holding costs include items such as mortgage payments, as well as local and state property taxes. The tenant will make these payments directly to the billing party. The Lease Agreement is structured so that the SPE does not derive any profit. Rev. Proc. 2000-37 does not require the Lease to be arms-length between the SPE and the Exchanger.

Holding costs do not include operating expenses. The tenant under the Lease Agreement is responsible for all operating expenses. The tenant is also entitled to all revenue generated by the property, including any rental income generated by any sub-leases of the parked property.

At the end of the exchange the Exchanger must provide the SPE with a schedule of the payments the Exchanger made on behalf of the SPE (the "Tax Accounting"). The Tax Accounting is needed so the SPE can file the applicable federal and state income tax returns required under Rev. Proc. 2000-37. The payment of expenses (other than operating expenses) should be reported by the Exchanger as rent payments made to the SPE. The SPE will report such items as rent and take the corresponding tax deductions, so the net income result for the SPE should be zero.

Rev. Proc. 2000-37 allows for the use of either a lease or a Property Management Agreement. In almost all cases a triple net lease is the preferred option. However, IPX1031 will agree to use a Property Management Agreement in the appropriate situation. A Property Management Agreement is typically used when the parked property is subject to an existing lease. The property manager will collect all the rent, pay all the expenses, and retain the balance as its management fee.