



March 2025 Newsletter

by **Greg Lehmann, Attorney**

Double Board Certified • Commercial and Residential Real Estate Law

Improvement Exchanges

The Big Picture

The tax code allows an exchanger to add improvements to a desired replacement property. The structure that permits this is called an "improvement exchange."

Why it Matters

1. **Defer All Gain.** One reason to pursue an improvement exchange is to be able to defer all the gain. Sometimes the purchase price of the replacement property in its current condition is less than the sale price of the relinquished property. For full deferral the exchanger must reinvest all cash obtained from the sale of the relinquished property ("exchange funds") and replace all debt that was paid off at the sale. Exchange funds and debt used for improvements on the replacement property are added to the base purchase price to defer more -- and perhaps all -- of the gain.
2. **Meet Specific Criteria.** Frequently an improvement exchange is used when the exchanger has specific criteria for the use of the property, such as a factory or place of business, and is unable to find a pre-existing property that fits those needs. In that case the exchanger must construct or improve a property to satisfy the exchanger's specific requirements.
3. **Avoid Competition.** In a sellers' market, finding desirable replacement property within the 45-day identification period can be difficult. Improvement exchanges allow for a larger pool of potential replacement properties given the ability to customize a property as needed.
4. **Save Money.** Even though improvement exchanges are more expensive than forward exchanges, sometimes the exchanger is able to find vacant land that can be acquired and constructed at a cost that is much less than the purchase price of a comparable property that has already been constructed.

The Process

The 1031 qualified intermediary creates a special purpose entity, usually an LLC, to take legal title to the replacement property during the period of construction. This entity is referred to as an exchange accommodation titleholder (EAT). In other words, the EAT "parks title" to the replacement property until the earlier of the improvements being completed or the 180th day of the exchange (unless a non-safe-harbor reverse exchange is being conducted). Once the EAT transfers ownership of the replacement property to the exchanger, the exchanger has acquired improved real estate that includes the original cost of the property plus the amounts spent on construction that has been done by that time.

The planned project does not have to be fully completed within the 180-day exchange period. A certificate of occupancy is not required. During the 45-day identification period the exchanger must provide as much detail as is practicable regarding construction of improvements. At the end of the exchange, the exchanger must receive substantially the same property as the one identified. The improvements need to be in place prior to the exchanger's taking title to the replacement property. If a lender is involved, it is important to make sure they understand the EAT's role.

Finally, improvement exchanges can be performed with forward exchanges and reverse exchanges. If the exchanger sells the relinquished property prior to acquiring the replacement property then a forward exchange parking arrangement is implemented, and the EAT funds the cost of the property acquisition and improvements from the exchange funds held from the relinquished property sale. Alternatively, if the exchanger acquires the replacement property prior to the sale of the relinquished property, a reverse parking arrangement occurs. In that structure, the exchanger provides the EAT the funds for the cost of the acquisition and improvements. These funds can come from the exchanger's own funds, a bank loan, or both.

The Takeaway

The improvement exchange is a great way to (1) increase the value of replacement property to defer the most gain, (2) build specific-use property, (3) provide more choices of replacement properties, and (4) profit from the expertise of the exchanger.

About Us

Greg Lehrmann is the founding member of Excel 1031 Exchange with 42 years of experience in commercial and residential real estate. For the past three decades he has dedicated his career to 1031 exchange work and has handled tens of thousands of exchanges throughout the country.

Mr. Lehrmann is a distinguished attorney double board certified in commercial and residential real estate law by the Texas Board of Legal Specialization. Only 2% of attorneys in Texas meet this exacting standard. He has a B.B.A. with honors in accounting from The University of Texas and a J.D. from The University of Texas School of Law.

Mr. Lehrmann facilitates 1031 transactions while educating and advising attorneys and fellow real estate professionals about the transformative benefits of 1031 exchanges. He has written and spoken extensively about 1031s, and has published numerous articles including:

"§1031 Tax-Deferred Exchanges: Evolving Rules, Greater Opportunities" (July 2002 Tierra Grande)

"Using Advanced §1031 Exchange Strategies to Improve Client Investment Returns", (Spring 2005 SIOR Professional Report – national publication of Society of Industrial and Office REALTORS®)

"Keeping Uncle Sam Out of The Oil Patch", (January/February 2008 – Landman national magazine)

"Safe Harbor" (July 2008 Texas Realtor article on vacation-home exchanges.)

Mr. Lehrmann and his wife, Texas Supreme Court Senior Justice Debra Lehrmann, have two sons, Gregory & Jonathan, practicing attorneys, and three beautiful grandchildren.

TEXAS REAL ESTATE LICENSEES: NEW 1031 ADDENDUM

The Texas Real Estate Commission adopts new addendum for Section 1031 Exchanges, effective January 3, 2025. Scan this QR Code for more information:



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