Automated voice: Welcome to the REI Diamonds Show with Dan Breslin, your source for real estate investment, Jewels of wisdom.

Dan Breslin: Brandon Burns. Welcome to the REI Diamond Show. How you doing?

Brandon Burns: Thanks. I'm doing good. It's a pleasure to be here and be part of one of the Diamonds.

Dan: Nice. Love it. Yeah. You're a 1031 exchange expert. I have done personally one 1031 exchange. I'm in the middle of three right now as we speak. I think a lot of investors hear about that on the front end and probably some percentage are taking advantage of it and understand the power, and then some percentage are probably like I was for a lot of years where I was like, "Ah, it's just too complicated. Let me just sell this thing, kind of keep it moving." I'm not the poster child for perfectly holding property and exiting. That's not me. We buy and sell and we fix and flip, and it's always been a high-volume transactional nature kind of business for me, but I know for a fact a lot of the audience is buying and holding rentals for a long time. Kind of 1031 exchange into, let's say, a four-unit from a one-unit, probably. A good goal, right? It's a good investment move long term. And then the whole gamut of 1031s and what could be possible there. So, do you want to give a bit of an intro here and then we can get into it?

Brandon: Yeah, that's perfect. I run a 1031 exchange company. There's 119 in the country. There's a good amount, but not a ton. I think one of the things you mentioned that makes a lot of sense, even though I've been doing this for a while and I've been a part of about 4,000 transactions, I've still got a deal this year that I'm not going to 1031 exchange, right? I think there's two points in life, and sometimes they overlap somewhat, but at one point in life, you're in your wealth accumulation phase, and in another part of life you're in your wealth preservation phase. One of the nice things about real estate is that there's so many ways to win, right?

You can potentially get income, you can get appreciation, you can get tax benefits, and so on and so forth. Well, section 1031 of the tax code creates another benefit for people that own investment property, and it's just another tool for someone to have. There's actually two parts of the tax code that give benefits for people that own and are selling real estate that's made money. The first one is section 121 of the tax code, which is if you're selling your primary residence, if you've lived in it 24 out of the previous 60 months, and it doesn't have to be consecutive, but a minimum of 24 to the previous 60 months, then you get 500,000 tax-free if you're married, 250,000 tax-free if you're single. Well, section 1031 says that if you jump over a number of hurdles that we're going to quickly go over, then you can roll all of that money into all of your profits without paying taxes into one or more properties, which can be really powerful, and the math behind that is really interesting.

I think sometimes it makes sense to realize those profits, sometimes it makes sense to not realize those profits, and here's why. Here's that math that I mentioned. We all understand how compounding interest works, right? I'll be 41 this year when I went to undergrad the cost of college was 16,000. I think today university is like 50,000 for tuition. Compounding interests over time really accelerates things. The opposite of compounding interest is called a geometric average. If you sell a property and pay taxes or have an investment that takes a loss, the

geometric average says if you have a dollar, you lose half, you have 50 cents. If you then gain half, you're at 75 cents. The benefit of a 1031 exchange is if you have to pay 30% in taxes, you've got to earn probably 40% to 42% just to get back to where you were.

So, a 1031 exchange allows you to avoid having to go earn another 42% to get back to zero, right? So, over time it can be really dramatic as someone looks at their overall wealth goals. Typically, people do at 1031 exchange for one of two reasons. One, they're either trying to reposition an asset. Maybe they bought a single family where it's either one of the more higher priced homes in the area, or someone's not sure that they're going to continue to get the same amount of value growth that maybe they got over the last five or six years, and they're saying, "Hey, I think going forward, I'm not going to be able to get fantastic returns here, so let me take it and put it somewhere else where there's a lot of room to run," right? That's one of the main reasons.

Another reason is somebody says, "Hey, I want to potentially diversify or change my goals." I had a client recently, he is in coastal California, he had a threeplex and it had appreciated really dramatically over the last 10 years that he held it, but it didn't have a lot of cash flow. He wanted to quit his job and he wanted to travel. He'd recently gotten engaged to a travel nurse and he wanted to go with her every 8 to 10 weeks whenever she moved. So, he sold his asset with a lot of appreciation, and he went and bought a number of cash-flowing single families I think in Detroit or Ohio or somewhere like that, where you could get a lot better cash flow. So he took all this wealth that he kind of accumulated and he'd rolled it into something that cash flowed a lot better.

Those are typically the two reasons why somebody's going to 1031 exchange. Another thing that I think is important too before we get off this topic is... I mentioned those two parts of the tax code, right? Section 121 and section 1031. There are some times where you can combine both of those sections of the tax code. For example, if you lived in a property and you lived in it for a number of years, but maybe you moved out and made it a rental two years ago, you potentially, if you're a single person, as long as you lived in it 24 out of the previous 60 months, it's only been a rental for two years potentially in this scenario, you could theoretically put $250,000 in your pocket tax-free and roll all the rest of the profits forward into something that you're going to hold for business or investment purposes using that 1031 exchange.

That can be really powerful. There was a guy new, or a client that I had that had a fourplex, and he lived in one of the units for a long time. So, he was able to put 500,000 in his pocket and roll a lot of the rest into another cash flow asset. Money now, tax-free, and money in the future, cash flow. Those are some of the key things. Does that make sense? I know I covered a couple of things there.

Dan: It does. There's a lot there, and we'll pull on several of those threads as we go. But I think I want to focus in right now on the big problem for today's episode, and that's going to be the geometric average problem. Until you sit down and think that through, I don't think that's necessarily obvious upfront. I think there's a lot of other benefits that come with a 1031 exchange that maybe I'll share some of my own experiences in doing the 1031. And it was not necessarily the problem of the taxes devouring your investment gains. This is Warren Buffet 101. That was

what I took when I read the Snowball by Warren Buffet. It was like, find these ways to let your gains accrue in this tax-advantaged method. And that's one of the things that makes real estate such a powerful investment vehicle, is it's so hard to sell it, Brandon. Oh God, COVID came, let me quickly log into my TD account and sell all my stocks real quick. You can't do that with real estate. I got to organize.

Brandon: Right.

Dan: Is the tenant going to move out, this big single family, someone's got to live there, hire the broker. It's like 6, 7 months sometimes when you finally get your payday, it's like a month or two on the market, a month or two on the first buyer, they bail, a month or two in the second buyer, now you're at closing six months later. I think that's actually a really positive and good thing for people because you buy this piece of real estate and it's appreciating at 2%, 3%, and that's usually what real estate did. I think a lot of people are deceived by the power of real estate over what happened from COVID 2020. Even 2024 where we're at, I think that's very irregular and unsustainable.

Brandon: Sure.

Dan: But even at 2%, 3%, you're not having to pay the tax on this 2%, 3% gain. And before you know it, you've owned this property for 10 years and 2%, 3% appreciation. I'm not doing the math, but over the 10-year period, it's probably a 40%, 45% gain in the actual value without being taxed and chopped down all the way along each year, "Oh, we're going to pay another tax, oh, another tax, another tax." And that's what comes with transactions. So, you're forced to hold this in a tax advantage method. You're running your property, hopefully enjoying some cash flow, and these values are going up in the background, but the geometric average issue is a problem. I think the big problem, at least for me, is at first when I thought about my real estate, I bought the condo I'm living in, and I was like, this thing's never going to go up by $250,000. It's a condo, it's got a great view, it's a great place to live, there's no way it's going to go up by a quarter million dollars. It's been flat for 10 years.

And then it did go up, ironically. But aside from that gain, I think that the bigger problem that I wasn't aware of initially, is when you sell an investment property and you've had to take depreciation all the way along. Now you bought this property for 500 grand, let's say, and you're depreciating that every year, and your cost basis when you go to sell it suddenly is 200,000, I don't know, 15 years in. Well, even if you sold it for the 500 that you paid for it, you're still going to have this taxable $300,000 paper gain in a sense, even though you're breaking even on the deal, right? So I feel like that's a hidden loss that probably comes as a surprise to some people who maybe aren't in a real estate business full-time, operating dozens of deals and studying section 121 and 1031 of the tax code and listening to this podcast, and suddenly, it's too late.

They went to settlement on it, and they find out they have this tax bill. When they thought they were breaking even, they find out nine months after the settlement happened. The 1031 is a solution for even trading out of the property that didn't. Yet the guy in California who bought it for 500 grand and he's selling it for 1.4, clearly, it's obvious for him, but I think it wouldn't be so

obvious to the guy or gal who was selling their $500,000 property they've owned a while, and maybe it was a flatter market. Maybe they enjoyed a ton of cash flow. They bought it for five, they're selling it for 575 by the time their commissions and credits come out, they're netting 535,000, and they're thinking like, "Oh, it's just a $35,000 game," but really the depreciation beast comes home to roost. Can you explain how the 1031 would be a better solution for that investor so they weren't blindsided?

Brandon: Yeah, 100%. I think you're absolutely right. This is a great point that I haven't thought about in a while. A lot of times when people go to sell, they say, "Okay." Exactly as you said, they kind of guess on what those taxes would be because they're not doing it full-time, right? It's not someone's fault, but there's four taxes that somebody potentially is going to pay when they sell real estate. First is long-term capital gain tax. That's either 15% or 20% that goes to the feds. Second is estate tax. There's 11 states that don't have estate tax, but the rest of them do. Estate taxes: California, that's really high, Texas and Florida it's nothing, but it's important to look at. The third is the net investment income tax. That's 3.8%, and that goes to pay the Affordable Healthcare Act for Obamacare.

And then lastly is the appreciation recapture tax. That's a flat tax of 25%. When you add those up depending on where you live, people are typically between 28% and 40%. The 40% is really Californians, but it's certainly higher than what they think that tax rate. And then you're absolutely right, it's on a larger portion than what they think. I think one of the things that we've seen, or one of the things that I've seen a lot of is two years ago, people were getting these crazy offers and they were saying, "I've got to take this before they change their mind, my property's not worth this." Today, I think people are wanting to be a little bit more informed earlier in the process.

So, talking to someone CPA or if they're thinking about doing a 1031 exchange, I'm glad to talk to anybody and just make sure they have the right data for their situation so they can make the right decision, right? Whether that's to do a 1031 exchange, to not do a 1031 exchange. Just having a surprise, that's not where you want to be. I spoke to someone the other day and they just sold a property on a Friday. They called me on a Monday wanting to set up an exchange. An exchange has to be set up prior to the sale and they didn't realize that. They had another property they were planning on buying, they were under contract, they were going to buy three or four weeks later, and unfortunately, they still had to pay taxes.

Just being informed early in the process definitely is a positive thing. And then as someone goes through the 1031 exchange process, there's four major hurdles IRS wants someone to jump through or jump over. Just to kind of quickly touch on those, because I think they are important, the first one is time, and that's the one people I think are the most aware of because that's where people sometimes run into issues. Once a property sells, two clocks start, 45 days to identify or come up with a plan and write down a couple of properties that you may or may not end up purchasing, and then 180 days to close on one or more of those. Again, that starts on the day of sale, not going under contract or any other day. The time is important. The IRS doesn't want that to drag on indefinitely.

Second is value. I think as people research 1031 exchanges time is kind of the first thing they

see. Not as many people see the value hurdle. The value hurdle simply is the IRS wants the same amount of money to stay in the economy. If you sell for $500,000, they want you to buy for $500,000. It doesn't matter if you owe 400,000, if you owe nothing, doesn't matter if you bought it for 100,000 or 450,000. In a 1031 exchange, the IRS ignores the basis, the type of capital, and simply says, if you sell for 500, you've got to buy one or more properties for 500. That's something I think more people are surprised of right now. They say, "Hey, I bought this for 300, it's worth 600 I've got this $300,000 appreciation. Let me 1031 exchange and go buy another $300,000 property."

Well, unfortunately, that triggers taxes on that variance. So, it's a value hurdle. Third is a financial hurdle. The IRS says if a seller takes possession of any of the funds, then they have to pay taxes on those. Like we discussed, paying taxes isn't always the worst thing. Sometimes it makes sense. Probably 10% of our clients take out some amount of money, whether that's to pay off credit card debts, to send a kid to college, or even to buy a nice fancy car they've always wanted. You're only taxed on the money you take possession of. If you've got a three or $400,000 gain, if you want to take $50,000 or $75,000 off the table, you certainly can. It's not an all-or-nothing thing to do a 1031 exchange, and they're only going to be taxed on that money they take out.

The IRS calls it the boot, which is a crazy name. I don't know why, but that's it. And then the fourth hurdle is an ownership hurdle. The IRS still wants to track these deferred taxes over time, and so they want the sale and the purchase to show up on the same tax return. If that doesn't happen, they disallow the exchange. If you're selling under your personal name and then you're doing a joint venture or a partnership on that replacement property, you would want to go on title for your share rather than creating a partnership entity and having that partnership entity take title, because then you have the sale on your tax return, you have the purchase on that partnership tax return, the IRS kind of loses track of what's happening.

If you change who's on title before or after, there's a clear record. You notarize deed, you publicly file it, but if you change who's on title in the middle, the IRS kind of loses track. As long as somebody does those four things, which there are a few moving parts, but if you can avoid a significant taxable event over time, that can just be really dramatic as you're in your wealth accumulation journey or as you're trying to preserve your wealth, right? Not have to go and fight that uphill battle every time you make a sale just to get your wealth back to the same amount it was.

Dan: On the ownership hurdle piece, Brandon, could a person sell the property they had in their own name and then buy in like a single-member LLC? When they're disregarded entities, they would show up still on the same tax return, so maybe they get that liability protection and be able to get their own personal name out of the crosshairs of ownership record. Is that accurate?

Brandon: For sure. I mean, that's how I buy property. There's two types of entities that are, and your great point, are disregarded entities that don't file a tax return, a revocable trust, or a single member LLC. You can sell into your personal name, buying a single-member LLC, or a revocable trust. Sometimes these entity structures can get really complicated. The key thing to pay attention to is does it show up on the same tax return. Am I going to be able to say, "Hey, I

purchased this and I bought this, and I'm reporting on the same tax return under the same tax ID"? So, that's the key there, but great point for sure.

Dan: Yeah, it's funny. As a segue, before I jump in further, I just want to plead to anybody that's listening, I've seen some people sort of... I don't know what the word I'm looking for is. ...abdicate responsibility for their taxes, 100% wholly to the accountant. Oh, I just need a great accountant who will get me all these tax returns. And it's like, I am pleading to you right now, if that happens to be your mindset, you have to take the ownership. You have to do the homework. You need to read up on these different strategies. We're talking about 1031 today, but there are a lot of other tax topics that you as a successful real estate investor and wealth creator, you need to be aware of these things at a level that's probably higher than your CPA. I feel like it's best when you bring the idea to the CPA versus the other way around.

The CPA sees these great tax strategies like how the hell are they going to be great real estate selectors, which is what most people who are probably listening to this are. In addition to being a good deal maker, real estate selector, I urge myself and urge anyone listening to also develop expertise in tax strategy, right? You may not have to be the master of all of these, but you certainly should have an awareness of the ingredients that exist in the kitchen if you're planning on baking a cake, the cake being your wealth long term.

Brandon: That's a great example. I love that.

Dan: Yeah. Back to the regularly scheduled programming here, Brandon. There were three terms that I found when I was researching for today's episode, and I'm going to ask you if you could define each of these three. One is qualified use, the second was time constraint, and the third was holding periods. They seemed important as terms. Would you mind elaborating on those three?

Brandon: Yes. One of the interesting things about the 1031 exchange is it's called a like-kind exchange. This is defining qualified use. It's called a like-kind exchange. Inherently, I think if I was to guess at what a like-kind exchange is, if I'm selling single family, maybe I need to buy single family. However, that's not how the IRS defines it. The IRS takes a much broader definition, which is really nice. Essentially, as long as you buy real property where you go on title, it's like kind. Then the question becomes what is real property? A good rule of thumb, anything that pays property taxes is real property. You can sell single family, you could buy a hotel; you could sell a hotel, you could buy multifamily; you could sell multifamily, you could buy land; you could sell land and buy a commercial building.

There's a lot of flexibility into what type of real estate, simply it has to be used for business or investment purposes. Has to have that qualified use, has to be real property. The IRS says, "Hey, if it's your primary residence, we've got section 121 over here for you where we give you that if you've been using it for business or investment purposes, and the next property your intent is to use for business or investment purposes, then you get to use section 1031." I think the IRS makes it more complicated than it is, trying to create a new term. The second, you've mentioned time constraints. What's interesting about the tax code is it actually doesn't talk about time as it relates to a 10 31 exchange.

What it does talk about is your intent, and it's very clear. The intent has to be to hold for business or investment purposes. Well, how do you define intent at the end of the day, right? What if you planned on maybe doing a 1031? Maybe you've got an investment property that's done really well and you want to sell it and buy a home that you're going to use for investments, but maybe eventually you want to retire and retire into that house. That language has been part of the tax code since the early 90s. About 10 or 15 years ago, the IRS came out with a private letter ruling and they said, "Hey, we understand that intent is a little bit of a gray area, maybe a he said she said situation at times. If there's no other proof of your intent, then if you hold on to the replacement property for two years, we're not going to question what your intent was, so you're going to be fine."

If somebody thinks there's a chance, they're doing a 1031 exchange and they think that there's a chance that they may need to make another move before two years I just recommend they document their intent as much as possible because that's what the IRS is going to look at in an audit and also changing the use in the future. I do see this fairly often where somebody says, "Hey, 10 or 15 years ago, I bought this great investment property, it's been great for me. I'd like to buy something else, but as I 1031 exchange into this other property, I may be 10 years or five years from retirement, why not buy a house that I potentially could live in in the future?"

If you do change the use, it's not a taxable thing. So, if you rent it out for five or 10 years and then you move into it, you don't have to pay taxes. To pay taxes, you have to not only have gained value, but you also have to realize that value. In the same way that you don't have to pay taxes on a stock you know until you sell it, it's the same with real estate even if you change the use. That's kind of why that ownership hurdle is there because IRS still wants to track that should you sell it at some point in the future. That's two of the three terms. What was that last term?

Dan: The last term had to do with the holding periods?

Brandon: Oh, yeah. I think that I covered that kind of too. Again, it really comes down to your intent and how you can prove that intent should you get audited. If you're doing a flip, for example, the IRS unfortunately has come out and said, "Hey, you're doing a flip. That's a business, not really an investment." So, in the same way that somebody buys a car to fix it up and sell, doesn't get a tax break, they don't want somebody that buys a property with the intent to fix it up and sell to get a tax break. As we look at that concept plus what we just talked about, if you do a 1031 exchange into a property and then you sell it in less than a year, that really looks like a flip to the IRS. There are a few circumstances where that could happen in an eligible 1031 exchange, but if somebody hadn't documented that properly and the IRS comes in and says, "Hey, this looks like a flip," there's a strong chance they're going to disallow that exchange. I think kind of high level, those are the concepts to be aware of. [inaudible]

Dan: When was it that they came out and said that the flipping is actually a business activity and not an investment? Do you remember when that was?

Brandon: It was at some point within the last, I think, 6 to 10 years.

Dan: Okay.

Brandon: But I can find it and send it over to you.

Dan: Yeah, I asked because I did know a guy, and that was his model. This is probably 10, 12 years ago now. I remember he was like flipping, that was his thing. He had some professional, he was an accountant. He had a good income already, so he wasn't like living off the money from flipping houses. He would do the flip and then sell that flip and then do a 1031 exchange, and he would use that full profit as down payment on a nicer, more expensive, probably a little bit higher-end rental than a lot of what you would think of as rentals. I don't know, he may have held them for a year, he may have done some kind of rent to own, he may have had some other strategy there that was tied into that. I didn't do it when I heard that, I was like, "Yeah, spirit of the law, doesn't really seem like that fit, so I'm not going to do that."

Brandon: He's tiptoeing right up to the edge. You can buy a property and if you document your intent and maybe write a small business plan or email a friend or a relative and say, "Hey, I'm planning on holding this for long-term investment purposes," and then you somehow, 10 months later, 15 months later, get an offer that you didn't expect, it can change the intent and say, "Okay, well, I didn't mean for this to be a flip maybe six months later. My intent was not for this to be a flip but I've got this great offer. I think I'm going to take it." Then on the next property, it's just really important to toe the line really, really well because if you say, "Oh, I'm going to hold this for long-term investment purposes," and you sell it six months later and you buy something and you say, "I'm going to hold this for long-term investment purposes," and then six months later sell, the IRS is going to come and say, "Ah, you're not being honest with us."

Dan: Yeah. We're doing like 300-plus per year, so what was I going to do? Like 25, 1031 exchanges in a year? Like, come on man. The audit's coming and you know what the law is if you figured that out. I just stayed away from that.

Brandon: That's very smart.

Dan: My 1031 exchange, I had some small apartment building, two units, three units, something like that in south side Chicago. I bought it for like 5, 10, 15 grand. I put 60, 70 grand in it or something, and then I sold it for 140, 150. It was like a $30,000, $40,000 actual profit in the end. I did have that for like two years, and I was like renting it out and couldn't find tenants. So that was why I turned around and sold it. My intent was there for sure, but looking back, it was like it was a super small gain, and it still felt great when we did the tax return. It was like, I don't know, 15 grand in taxes that I didn't have to pay on that money. It just felt so satisfying to get that done. But some of the benefits for me came in this mindset around the 1031 exchange. It was like I was getting out of something that I had just cash tied up in getting my cash back. I must have used the actual cash as the down payment.

Brandon: You would've had to roll the whole thing. Yeah.

Dan: Yeah. I must have done that actually. And that was sort of like, "Oh, I have this like $120,000 in the exchange. Let me do the math, let me see what other cash I have lying around." I bought an apartment building for like 685,000, somewhere in there. 10-unit building.

Brandon: Awesome.

Dan: Yeah. So, I stepped up. And here was the mindset. The mindset, Brandon, was I wanted to buy as much property as I could so that I would have a high mortgage balance, not buy idiotically, but buy in a way where the cash flow made sense and there were still profit and there were low enough rents where I could still push the rents and improve the property. That mortgage paydown since that point in time was probably 150 grand or something like that.

Brandon: Wow.

Dan: It may be like six, seven years, right? The mortgage paydown alone.

Brandon: Awesome.

Dan: And then I drove the value and everything. I'm actually under contract to sell that and the 1031 set up to kind of do something similar again because the number of units I got turned out to be a little bit of a management headache. So I'm kind of trying to achieve scale in another way. More expensive property, less tenants, higher rents, is sort of the mindset as I've grown in my career, and in my portfolio, I have different goals than what I was aware of when I bought that. Different money to play with as well. I'm a big fan of not overpaying for the property, but going for as much property that I possibly can. I'm blessed to be in a position where the business is still growing and my income is not fixed.

I'm not a W2 guy who's getting this amount of salary and it's never going to change. It's going up a little bit over the years. But getting as much property so that there's a big fat mortgage on there, and then that mortgage pay down is significant over time so that if I look back in 20, 30 years, a $2 million mortgage paid down, if no appreciation at all, at least that 2 million was there. Like an IRA or a pension plan or something if nothing else went my way in a sense, but I was able to rent it out, maybe make a little cash flow, maybe feed it a little, don't care, but that big mortgage paying down is for simplicity. It's one lender versus nine lenders across the 49 units. It's one insurance company versus a nine-insurance company. It's one set of the whole thing. It's just simplicity in a larger deal. It just would've seemed completely out of the question way beyond anything I would've thought was going to come down the pike when I was doing that first 1031 six years ago, or seven, whatever it was. Yeah.

Brandon: No, that's a great point. I think it's so important to own things. As we look, I think at the environment that we're in today, like you said, taking on a little bit of a bigger mortgage and getting to scale. If let's say inflation is 5%, and then taxes go up a little bit, let's say you make $200,000 a year, which is a great living as a W2, right? If increased taxes and inflation you need to grow by 8% or 10% a year in order to keep your same standard of living because it's being deteriorated by the cost of things rising, so on and so forth, that means if you make 200,000 this year, you got to make 220,000 next year, right?

You got to make like 242 in year two. And if you don't see yourself increasing your salary by one-third over the next four to five years, you're probably losing a little bit of your spending

power. I think right now the middle class is getting squeezed a little bit and the difference between moving down or moving up in my opinion, is owning things. So, having that ownership, right? Like you said, even if a property doesn't appreciate, even if a property doesn't cash flow, if you can have tenants that are paying down the loan, how powerful, right? If potentially you have a little bit of cashflow, you have a little bit of appreciation, you have great tax benefits, and you have tenants paying down the loan, that's going to be the difference between continuing to move up financially in life and just getting squeezed and hammered down by increased taxes and inflation.

Clearly, inflation's higher than it's been in the past. We just sent $100 billion to Ukraine. I think taxes are probably going to go up at some point. That's I'm grateful that I live in America and I can buy stuff and get loans. I think in other countries it's hard to get loans. I think actually the access to credit is one of the biggest differences between the United States and Mexico. Our headquarters are in San Diego and there's just no middle class in Mexico. Tijuana is right next to San Diego and there's some nice wineries down there. I was up and down just past Tijuana a couple of times. It's just so interesting to see there's no middle class.

There's people that are driving around and really high-end range rovers and there's people that look like they can barely afford a bicycle. Myself, I wasn't born into wealth and if I didn't have the ability to go get a car loan and a school loan to get a better job that wasn't right next door to my house, and then once I was able to accumulate some money, I had enough to put a down payment on a property, but not enough to buy something, being able to get a loan for the balance, I think that's a big differentiator.

Dan: Yeah, it's interesting as you talk about the access to credit and some of the things that make the US such a great country. It reminds me of a book. The book was The Secret Life of Banking and Real Estate, I believe. It talks about the entire history of how these prices came to be over time and how that banking system certainly proliferated and is very abundant and vibrant here in the country, even now as we sit here in 2024. It's a phenomenal system, but the amount of wealth creation, like you described, is off the charts. The funny thing too is I remember being so scared when I bought my first rental house and I paid cash for it, but it was like all my savings when I bought it, 60-something thousand maybe, and I sent it off. Whoa, that was huge scary.

And then I think I got somehow this three flat that I still owned that I'm going to sell here shortly. I was able to put a lot less money down on that one. It was like 400,000 purchase, 10%, and do like a ReFi. So it didn't really cost me like 25% down in that one. I remember being like scared of that one, "Oh my gosh, what if these tenants don't pay?" I have this mortgage payment, this 400,000 loan, and then the next one was a 500-something thousand-dollar loan. The 1031 I did was sort of like, I had to get over that fear and like level up to the next property. I'm at that same point now as I do these next 1031s, I'm recognizing. It's not maybe keeping me awake at night, the fear like it did way back then because I've faced this one a couple of times and moved forward, but stepping up to the next property where it is a new learning curve.

You're used to single family, guess what, a 10 or a 15-unit building's going to be a different animal. I imagine it's a different animal if you step up and decide to do industrial property from your regular single-family thing or whatever the transition is maybe as the 1031s going on. I see

a lot of people do 1031s where they sell the house in California and buy like four or five, two or three flats in Chicago here, and they pay cash for all of them. They sold it for a million and a half, and then they just kind of bought them all for cash. Maybe that's a way of not having the same kind of fear because there's not this giant mortgage that's then attached to it. It's just clean, paid-off properties. There's probably some other risks they should be aware of doing the California to Chicago landlord kind of a thing. But that's a topic for another day. My Chicago listeners are aware of that and a lot of them are doing very well in this market. It's a great market, but there are definitely some things you need to be aware of.

Brandon: Well, I think those are really good points because I think there is a relationship at times between risk and reward. One of the things that I think is nice about real estate is that you don't necessarily often have to take on a ton of risk to get a ton of reward. Like you mentioned, it's a little bit harder to sell a property than it is to sell a stock, so on and so forth, right? When I was in grad school, one of the things that I thought was really interesting, one of my professors talked about how markets that are inefficient that you can get a lot better risk-adjusted returns.

It's like in the stock market, for example. You can't really buy stocks with loans, while in real estate, you don't have to put down the full amount of cash. So, if it goes up 8% per year in the stock market, you get an 8% return. If you put down 25% on real estate and it goes at 8%, your return is a lot better than 8, because proportionally to your down payment, you're getting more. And then also there's access to information. If you have more information than other people in the stock market and you act on that information, that's insider trading. Martha Stewart went to jail for that. If you have more information than other people in real estate and you act on it, you make money. If you know that a university's going to come build and nobody else knows that, and you buy up all the land around it, you've done really well. Generational wealth in that circumstance. That's something I think is really nice about real estate. Just so many ways to win and it's nice to win sometimes.

Dan: So what are some other pitfalls that we may not have already covered on 1031s? Where do you see clients calling with frustrations? Either they're in the 1031 or like you touched on one example where the person didn't set it up and they've already gone to settlement? That was a terrible event for that guy or gal, that person who missed the boat, right? So what are a few other examples of pitfalls that listeners should be aware of?

Brandon: I think real estate, every situation is often real unique. Even on the settlement statement side on the closing side, there are publicly traded companies that have spent $100 million to try to streamline and AI and technology the process. They've been medium to poorly successful because in real estate, there's so many moving parts, it's really difficult to take the human element out of it. I could certainly talk about 5 or 10 different stories, but I think from an overall perspective, being fully informed is number one, right? I got a call last week from someone. It was a financial advisor and they'd heard me on a podcast. They had a client that was in a 1031 exchange, but the client hadn't filled out some of the identification paperwork properly. Nobody had checked it.

The 1031 exchange company that they were using wasn't being very proactive, wasn't being very helpful, so they just didn't know. So, they did something wrong and it ended up causing a fairly

significant taxable event for them because they were past that 45-day identification period and they couldn't change it at this point. Certainly, not setting up an exchange before closing, that nullifies and voids it. I think if someone can be fully informed, they can say, "Okay, I'm selling this property, I'm under contract. Let me understand a 1031 exchange, let me talk to somebody and explain my situation." There's a gentleman that I'm talking to right now, he's getting divorced, he owns a couple of rental properties, and he's got a really complicated situation as he needs to sell those rental properties. He also needs to walk away from his partnership at that same time. What are the next steps that he needs to take?

I could talk for an hour here and we wouldn't cover everything that he might run into. On his, it was important to go in and change title ahead of time. This typically isn't true for a marriage, it is true for divorce, but if you have a partnership you want to disengage from... Let's say that, Dan, you and I were in a deal, we're 50/50, and it's on 123 Red Street. So, you and I 50/50 own an LLC, it's 123 Red Street, LLC, we go to sell that and you're like, "Gosh, I want to go do deals somewhere else and Brandon wants to go do deals somewhere else," We're going to separate. Or we don't like each other, we're going to separate. Before closing, it's important to have one or both of us leave that LLC and go on title as a tenant in common with our ownership percentage spelled out on title.

That allows us at close to move independently of each other because otherwise, if I do an exchange or you don't want to do an exchange or whatever it may be, if we're inside the same LLC, our actions are going to reflect on each other. If I incur taxable event, you might be responsible for part of that or vice versa. I think just being informed as early as possible is the most important thing, just because there's so many scenarios that could be that it's kind of tough to cover all of them or to cover all of them well. I could go into all this stuff because this is what I do day to day and I love it, but if I was on the other side of this podcast and I was doing something else full-time, maybe it would be a lot of information that I wouldn't remember or feel overwhelmed by.

I would say that's number one. Especially if you can find a 1031 exchange company, that's all they do, and that's what my company does, so of course I'm a little biased to that, but out of the 1019 1031 exchange companies that are out there, a number of them, it's a little bit of a side bus. Their main business may be something else and they say, "Hey, let's go ahead and build out a 1031 exchange company as a sister company or a side company." If that's not something they do full time or sometimes those people aren't as proactive just to make sure that everyone knows all the rules, so I would say find a 1031 exchange company that has great credentials and maybe that's independent. Of course, I'm biased toward that. And just make sure you're informed. Make sure you know what the rules are, that way you can make the best decision for whatever it needs to be.

Dan: Yeah. It's funny, as you were mentioning the partner needing to come off of the LLC from the other partner, I was writing the Jewels of Wisdom newsletter, which I kind of published in cooperation with the podcast, and I was literally talking about my own preference. I was born into the real estate business in 2006, so the market got real hairy in 7, 8, 9, and 10. I saw a lot of partnerships dissolved, fly off the rails. You talk to this partner and the other one's a crook, you talk to the crook, and the other partner is the crook.

Brandon: Right.

Dan: My dad had a few partners in his rentals back in like '87. I was a 6, 7, 8, 9-year-old kid and they didn't end well. So I've always had sort of my own operating philosophy like, look, we can flip houses together. I have a lot of partners on the flips that I'm doing. I love flipping property with partners because there's like an end date. And I have great partners and we've been doing this stuff for 5, 6, 7, 10, 15 years almost. Some of those partners they've been very productive. I don't own any rental properties with those partners for exactly that reason. It's like I'm in the middle of a moment where I'm going to sell all my stuff and simplify. Thank God I set them up the way I did. I don't have to go figure out how the other partner and have this buyout conversation, they're not ready to put a bunch of cash back on the table.

So it's like wherever possible for simplicity's sake, the advice I would give to my mom, my dad, my daughter, would be own anything that's going to be like really long term. Own that on your own, and then anything else, it's got to be a short-term flip. A short-term flip could be buying and fixing and selling a house, and maybe that's a 6 to 12-month kind of a thing, or maybe it's a syndication in a commercial real estate deal where it's going to run for 2 to 5 years. Five years is a long time, but it's not 'we're going to hold hands and we're going to run to our final destiny together on this property'. A lot of rental properties you buy, that's sort of the mindset going in. So I just caution, you know, against ownership in that structure. That's me personally. I'm sure there's a lot of people listening, "Ah, go to hell, Dan. We've got great partnerships and we own 48 properties together," and that's fine. To each his own. I guess that's my own. Brandon, what are the fee structures on a 1031 exchange?

Brandon: Yeah, the cost of a 1031 exchange is really low. We charge per closing, so $995 when you sell, $295 when you purchase, and we just get paid for the time we spend on the closing and doing the compliance and documentation. So, that's true if it's a $100,000 or a $10 million property. So mathematically, if you're planning on selling real estate and planning on buying another piece of real estate, it almost always mathematically makes sense to spend a little bit over a grand, then pay 50,000, 100,000, 500,000 in taxes. So, yeah, mathematically, it often makes a lot of sense.

Dan: So the 995 sell is collected and due, like if I don't identify the property, that $100,000 is essentially my risk for trying the 1031 exchange?

Brandon: Yeah.

Dan: And then once I finished the other side, it would be 295, but if I bought three properties instead, that's 295 on each of those three because there's paperwork. Are there any other hidden fees there? Notary stamps, travel, FedEx, anything like that?

Brandon: Our bank charges $30 for an outgoing wire, but no other fees, no FedEx or notary. All of our documents are signed electronically, which is nice. So, don't have to worry about that too much. Those are good questions. Occasionally, I've had someone that says, "Gosh, I've got a closing next week. I'm not sure if I want to do a 1031 exchange. I might, but I might not." My

comment to them is, "If you're sure that you're not going to do it, no reason to spend any money and go through a little bit of hassle signing a few extra documents. But if you think you might, if your taxable event is more than 20 or 30 grand, why wouldn't you try? It's cost you a grand, essentially to have a month and a half to try to figure it out."

So in the grand scheme of things, that becomes really inconsequential in that process and just gives you more optionality, right? Because if you sell and you take possession of those funds, you're locking in that taxable event. So sometimes it can be nice to have that optionality. Our fees are a write-off, so you don't have to write them out of pocket. They go on the closing statement, on the settlement statement just like a title company or a closer. It's a deal cost and you can write it off at the end of the day. It's nice. You don't have to send a check. It's nice to potentially have that optionality, again if you're planning on buying more real estate or you think you might want to buy more real estate.

Dan: Yeah. I would say the $100,000 should be like inconsequential. It's not really the consideration. I think the big consideration an investor who's participating in the 1031 should be, you really have to be disciplined around the selection on the next property. We love getting lucky and selling to the 1031 buyer. In the commercial game in a residential game, in Chicago, we get that 1031 buyer who's buying from California. That's pennies from heaven. They are paying a little bit more. Let's say they're the winning bid, they're paying a little more, we know they're motivated because they have that 45-day identification timeline. If I went on their side of the table, it probably makes sense to pay a little more because they're not getting whacked down 40% on the purchase. So if they paid 3% more than everyone else in the market, went to settlement on our property, they're still way ahead and it makes sense.

Brandon: [inaudible]

Dan: But I do want to make sure that I'm telling myself out loud and hopefully the listener, you got to be disciplined. I don't know, I guess it's like playing chicken with the tax bill in a sense. Sometimes it's better to maybe pay the tax than buy the wrong property that turns out to be like a real dud and a real loser. Do you have any other insight on... I know we can't get into the whole real estate selection thing, but what would you layer on the mindset about not becoming a motivated buyer and only driven by the 1031 versus making sure you get a reasonable, risk versus reward, the right deal? Maybe it's a grand slam of a deal you were going to do regardless of the 1031, but what advice would you give around that portion of the 1031?

Brandon: Great question. I do think it's important to not have to tail wag the dog, which I think is a lot of what you're saying here. That timeline starts when you sell the property. Some things that people will do is if they want something really specific and they're really worried that it may be difficult to find in the timeframe needed, there's kind of two options for them. Especially people that are comfortable with the property they have, maybe you have an offer, maybe you're thinking about taking it to market, and trying to figure out exactly what you said that next selection. So, one is once you're under contract. That's probably the right time to start looking for that replacement property rather than waiting until it's sold.

Now, there's two sides to every coin. If you start looking for that great replacement property,

before getting an offer or taking a property to market, a lot of times I see people find great replacement properties, but then the seller isn't willing to wait for them to go find a buyer or list their property or whatever it may be, especially because typically great properties have multiple buyers, right? So, why would a seller say, "Sure, I'll wait for you," it might be four months or two months or six months, and I'll let this other person who's got cash today? "Eh, screw them," right? So, I would say one, start looking for the property once you're under contract. Two, potentially as a seller, you can write some small extensions into the contract.

Maybe I want to buy something really specific, maybe I'm a little bit worried about the timeframe, so I find someone to buy my property, and in the contract, I say, "You know what? I have three 10-day extensions that I can exercise at my leisure," and I make multiple ones smaller rather than one that's a big one. That way it gives you flexibility to move forward when you find that great replacement property. Let's say it's a 30-day close, you have three 10-day extensions built in, and that's when your 45 days start. Now we're talking about 105 days from the day you enter the contract to the last day that you have to write down a number of properties you may or may not buy. That's one thing that I think can make sense.

Another thing is you can write down multiple properties in that 45 days. There's one type of fund that's eligible. So, you typically have to buy real property where you're on title, when you sell real property where you're on title, buy real property where you're on title. It's the same ownership. We talked about that ownership hurdle. There's one exception to that. There's one type of fund called the Delaware Statutory Trust. We're all familiar with Real Estate Investment Trusts or REITs. In 2004, the IRS said, "Hey, there may be sometimes where somebody doesn't want to be an active landlord anymore. Maybe they don't have the ability to replace the debt on the replacement or what have you." So they said, "We're going to make this one fund structure be eligible for 1031 exchange."

They made that fund structure be really restrictive. You can't move any structural walls, you can't refinance, and there's a number of other things you can't do. The IRS tried to make it the most restrictive structure to make it the safest structure. So, if somebody is on day 30 and they're saying, "Hey, I'm just going to go make a couple of offers on some properties, I'm going to write those down." and maybe they also put that DST, Delaware statutory Trust fund as one of the options on their replacement property so that they're not just hammered should the properties that they want not be available or they don't win those and then run out of time or have [inaudible] really dramatically.

Dan: Is the Delaware statutory trust what I think of, that sort of like an LLC where the cash would go in there until I find a property that I would buy in the Delaware statutory trust, and then that trust would own it?

Brandon: No.

Dan: How does that work actually?

Brandon: Yeah. So it's more like a REIT than an LLC. There's a number of companies out there that will go and they'll buy a large property. Maybe they'll buy a handful of CVSs, maybe they'll

buy a headquarters building for a major company like Tesla, maybe they'll buy some industrial, some self-storage, what have you. And then they'll structure it, they'll pay the money to set it up legally in this fund to structure, and then the property will already be purchased, the debt will already be signed for, the legal structure will already be set up, and then you invest and buy a portion of that and then your money sits there until it sells. There are always two sides to every coin. The benefit of that Delaware statutory trust fund is that a lot of times you get the benefit of having debt without having to personally go get it. It's just allocated to you.

You have the benefit of being able to have certainty of close if your other projects don't work out. A lot of times you're in an institutional property. Even with 100, 200 grand, you can be a part owner of a very large institutional-level property. The flip side to that, again, two sides to every coin, it's not liquid. One of the things that IRS had is, "Hey, you can't move money in and out of these," so you're in it until it sells, which is typically 5 to 7 years. That is a while. You can't go get loans against it like you could with a paid-off property. There are definitely pluses and minuses, and also because it tends to be these properties where you can't go add a ton of value. You can't move any structural walls, you can't do any development. They typically are kind of steady eddies, so they'll give you 5% or 6% a year in cash flow, 5% or 6% a year in appreciation, but you're certainly not going to double your money, or typically you're not going to double your money over a 3 to 5 year time period, which you can do sometimes in real estate as an individual owner and not in a fund.

Dan: So these are like always available. Like right now as we speak, there's probably a handful of these DSTs somewhere that's available that you could go into.

Brandon: Yes.

Dan: That's the key, right? So always a deal in the background here for this asset class.

Brandon: Yes, that's exactly right.

Dan: Okay. Got it.

Brandon: There's about 20 or 25 companies that put these together that are out there. There's one in Chicago named Inland, but there's a bunch of them. Typically, that's their business model. They'll go put together a fund, they'll find 1031 exchange investors when it's full, they'll go do another one. At any given time, there's probably 10-plus of these out there. Different companies will specialize in different things. One company might be really good at self-storage, another company might be really good at apartments, another company might be really good at triple net, but there's typically always a number of these funds out there.

Dan: All right. Cool. What else did I forget to ask that might be important before we get to our closing questions here?

Brandon: I mean, I think this is pretty, pretty comprehensive, right? We talked about the four major hurdles. You've got time, value, financial, and ownership. It has to be a like-kind exchange, which is a pretty broad definition. We've talked about intent, which really matters.

We've talked about some of the pitfalls. No, I think this has been really comprehensive.

Dan: Is there any books you would recommend or maybe other things the listeners can go read to get more granular information about our discussion today?

Brandon: I wrote about a 30-page booklet. Certainly glad to send that to anybody if they'd like it. I don't know that there's some great books out there like on Amazon or whatnot. When it comes to 1031, when it changes, it's a little more technical. So it's like, "Okay, well, what is the IRS going to look at? What's my situation? Out of the 10 potential moving parts, 3 of them apply to me, and how do they interact with each other?" But I've got a pretty deep informational booklet that I'm glad to send to anybody if they just shoot me an email.

Dan: Yeah. I think it's important, back to the cake analogy, you take this episode and you have some ideas on what your portfolio's going to do or look like. I know that I had some hair-brained ideas when I came up with my 1031 plan, I don't know, three months ago or something. Listeners probably remember me starting to mention it on certain podcasts and things like that. And then I went to the intermediary who happened to be an attorney, and then I kind of sheepishly paraded out my hair-brained ideas and I could do them, but they were like it wasn't worth all the effort what I was trying to do. We came up with like a more simplified plan, and I had to make peace with, okay, I'm going to sell a few of these and probably have to pay the taxes or maybe 1031 into some other stuff that maybe isn't this ideal hair brain situation that I came up with.

Where I'm going is, maybe you get the booklet, you read it, you listen to the podcast, and then if and when the time comes, you're reaching out to someone who's doing them all, you're presenting your exact situation, and then you're going to find out real fast, oh, yeah, this is straightforward and easy, or no, like my answer. Well, it can be done, but it's all this other stuff, and I was like, "Yeah, I'm not ready to do all that other stuff, so let me re-simplify and organize my plan. Get the cursory top-level education that we just did on this episode here, and then bring your situation to the expert to figure out if it's going to work.

Brandon: Yeah, totally agree.

Dan: Is there a website that listeners can maybe go to for that booklet or just some more information about you and your company?

Brandon: Yeah, our website is vanguard1031x.com. You can email me at brandon@vanguard1031x.com and call us. Our office number is (858) 331-1031. I'm on social media. You add me on LinkedIn, Instagram. My Instagram is @brandon.the1031guy. On Instagram, I do like to share some memes, so if you like to laugh at that stuff, love to connect. But yeah, shoot me an email again, Brandon@Vanguard1031x.com. Call us. Any way that I can make sure people have right information, make the right decision, I feel like is a win. So, any way I can help.

Dan: Nice. My final question, Brandon, what is the kindest thing anyone has ever done for you?

Brandon: The kindest thing anyone has ever done for me. I think I've been blessed with a lot of kind people over in my life. I remember somebody really going out of their way when I was a teenager to bring me a birthday present when I was in a bunch of a lot of different things. I remember that being a really kind moment.

Dan: Wow.

Brandon: Yeah, they really went out of their way though, so, yeah.

Dan: Interesting. Very cool. Very cool. All right. We are at the conclusion. I appreciate your time. Pages of notes here. I feel even more informed on the 1031s than I did, even though I've done a bunch of them and the studying. So, I really appreciate you coming on the show.

Brandon: Yeah. Glad to be here and appreciate the time and opportunity.

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