



# 1031 NEWSLETTER

## DO YOUR DUE DILIGENCE BEFORE YOU EXCHANGE

BY MARY LOU SCHWAB CPA, CES

Protect Yourself! Make sure that all due diligence on a qualified intermediary for your 1031 exchange is completed prior to beginning your exchange transaction. Within the first four months of 2007, there were two large nationwide qualified intermediary holding companies that were unable to provide 1031 exchange proceeds to their exchange customers as required.

Federal investigations are currently underway regarding the use of exchange funds for both holding companies and owners of nine intermediary companies in total. In the first instance, customer funds amounting to \$110 million were utilized by the owner of the qualified intermediary holding company to invest in silicon breast implants. This holding company, which had three separate intermediary companies nationwide, is currently in receivership.

In the second instance, the owner of a holding company that owns six separate qualified intermediary companies just filed Chapter 11 Bankruptcy. It is unknown when and if the \$151 million of exchange proceeds will be returned to the exchangers.

Beware and think twice! The minimum due diligence questions 1031 exchangers should ask are:

1. Is the qualified intermediary bonded with an employee theft bond and an errors and omission bond? Review the evidence of insurance and call the insurance provider to verify. **(Bankers Escrow has both a surety employee theft bond and an errors and omission bond.)**
2. Are separate or segregated accounts set up for each client's 1031 exchange proceeds? Check with the qualified intermediaries' banker to confirm. If the qualified intermediary utilizes a commingled, escrow-type account, it can be considered a bankruptcy asset and be available for the creditors of the bankruptcy proceedings. This includes exchange clients who recently purchased replacement property within the last 90 day period prior to bankruptcy. **(Bankers Escrow is one of**

**the few qualified intermediary companies that sets up individual money market accounts for each exchange under the exchangers federal ID number and also provides inquiry only access directly on the banks website. Exchangers can check their 1031 account balances at any time.)**

3. Obtain referrals and references for a qualified intermediary company from bankers, real estate brokers, accountants, lawyers & prior customers of the intermediary. An intermediary company should immediately be able to provide you with such contacts.
4. Verify how long the qualified intermediary has been in business and if there have been any recent ownership changes. If the qualified intermediary is a member of the Better Business Bureau check out their current standing, number of complaints within the last 3 years and how any arbitration issues were resolved. Additionally, see if the qualified intermediary company is a member of good standing with the Federation of Exchange Accommodators at: [www.1031.org](http://www.1031.org). **(Bankers Escrow has been a member of the FEA since 1993 and a member of the Denver Boulder BBB since 1993. We received our third Gold Star Award in 2007 from the BBB.)**
5. Confirm if all interest earned on your exchange proceeds while held by the qualified intermediary will be paid to you. Find out if you can verify the interest rate and funds held by the bank. **(Bankers Escrow pays all interest earned to the client and they can verify the interest rate paid from the bank's website.)**

Time spent asking these 5 questions could save you from a horrible situation. Don't just trust what an intermediary says — VERIFY! Please call the exchange specialists at Bankers Escrow if you have any questions — toll free 800-571-6595.

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Please note that all material provided in this newsletter is for informational purposes only and the author is not providing legal, tax accounting or other professional services. The accuracy of the information provided as it pertains to your situation is not guaranteed. Please seek professional consultation if legal, tax accounting or other expert assistance is required.



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