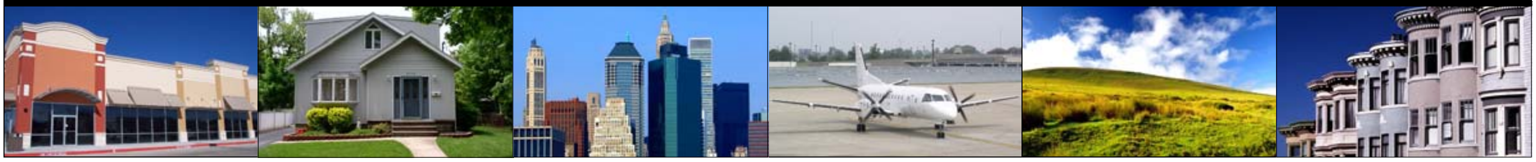
PROS AND CONS OF SELLING VS. EXCHANGING:

"CONSIDER THESE ISSUES BEFORE CLOSING ON PROPERTY HELD FOR INVESTMENT"



Assume a California real estate investor has held an investment property for many years and will have $500,000 in net proceeds after closing. Also assume this property has $500,000 of capital gain and $200,000 of this gain is due to depreciation recapture. As you can see in the comparison below, the investor who exchanges can obtain considerably higher investment returns from deferring the payment of capital gain taxes. The current low rates for financing provide a unique opportunity for investors to lock-in excellent loan terms. Investors should explore the possibility of exchanging before closing on the sale of investment property.

	SALE (CASH OUT)	**1031 EXCHANGE (REINVEST)**
Capital Gain Taxes Owed	$141,500 *	$0 (no taxes owed in the current tax year)
Net Income to Invest	$358,500 (proceeds less taxes owed) 1–5% possible cash flow (assume 3%)	$500,000 (entire amount of proceeds received) Many real estate investments provide 6-10% cash flow (assume 8%)
Possible Income	Bank CD, Bond Fund, Money Market Assuming a 3%** return on $358,500 $10,755/annual income $896/monthly income	Residential Rental, Commercial, Agricultural Land, etc. Assuming a 8% return on $500,000 $40,000/annual income $3,333/monthly income
Preferential Tax Treatment	Income is not tax-favored if earnings are in a non tax-qualified account May be fully taxable	Income generated is tax-favored Income can be partially sheltered with write-offs Depreciation tax benefits are also available
Liquidity	Very liquid if 100% cash	Real estate is generally not very liquid
Diversification	Yes	Yes, but must reinvest in real property May diversify by asset class and/or geography
Time Restrictions	None	Yes, 45 days to identify replacement property Maximum of 180 days to close on replacement property
Replacement Asset Basis	Basis equals purchase price	Only partial basis for new depreciation Basis equals purchase price minus deferred gain

FOOTNOTES:

* Depreciation Recapture: $200,000 x 25% = $50,000; Remaining Federal Capital Gain: $300,000 x 15% = $45,000; State Taxes: $500,000 x 9.3% = $46,5000
Total Capital Gain Taxes = $141,500; After-Tax Proceeds Available: $500,000 - $141,500 = $358,500

** Today's inordinately low rates of return for money market accounts, bank CDs and other liquid investments tilt the consideration in favor of exchanging.

This example is for education and illustrative purposes only and is not meant to provide the details for any specific portfolio or rates of return. Accordingly, you should review the details of your specific transaction with your own legal or tax advisor.

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