

THE PROCESS:

- 1.) **The Financing:** Take the time now to see what you qualify for. Even if you are completely solid, talk to a lender or a few and find out what possibilities you have. Feel comfortable with your payments, rates, and terms even before we begin. If nothing else, it's free financial credit advice from a professional! Please see me if you do not have any in mind and I can provide you with a list of reputable banks, lenders, and mortgage brokers.

- 2.) **Talk to your financial advisor:** If you are pursuing an investment property or looking into getting a piece of this paradise and use it to build your portfolio or for tax relief's, please consult your financial advisor or your accountant. Everyone has a different idea or outlook on what they can do on passive gains/losses, **please find out from an expert!**

- 3.) **Find a Realtor:** Hopefully you are using the best...uh; hum **ME**, if not, good luck! Just kidding, but do use a Realtor®, it costs you nothing and it can be the best move you make!!! You want to find a Realtor® and choose one and know that there is a difference between a Realtor and a real estate agent! Remember that it is state law to have the **Realtor or Real Estate Agent DISCLOSE** his or her relationship to you. You must read, understand, and sign the **SC Disclosure form**. The Realtor or real estate agent will represent the Seller and you as a customer. This changes if and when you decide to become represented by your Realtor or agent, meaning, you become a **CLIENT** and they become your **Buyers Representative**, still at no cost to you. If you become a client, we will sign a Buyer Agency agreement, outlining our agreement. So now you really get represented and they owe you **Fiduciary duties:**
 - Obedience -Disclosure
 - Loyalty -Accountability
 - Confidentiality -Reasonable Care and DiligenceIt is also important to know if your Realtor or Real Estate agent represents both parties: Dual Agency. This means that the Realtor or agent represents you and the seller.....Could become a conflict of interest. We either represent the buyer or the seller, never both. If we sell our team listings, we still will only represent one party, the other could seek other representation or simply become a customer, not a client. If this sounds confusing, let me know and I can explain this process in more detail. Pick a Realtor and work with him or her, but choose **ONE** that you both feel comfortable with and that is representing your interests.

- 4.) **The Search:** Well, if I have given you this, we have probably started to find out what it is you are looking for: A primary residence, a second home, a vacation rental property, or some type of investment property, i.e. land. Here are some sample questions to ask yourself:

1.). WHAT TYPE OF PROPERTY ARE YOU LOOKING FOR?

- ♦ Primary Residence _____
- ♦ Second Home or Villa _____
- ♦ Rental Home or Villa _____
- ♦ Investment Property _____

2). WHAT SIZE PROPERTY ARE YOU LOOKING FOR?

- ♦ Number of Bedrooms: _____
- ♦ Number of Bathrooms: _____
- ♦ Approximate Square Footage: _____

3). WHAT TYPE/STYLE OF FLOOR PLAN WOULD YOU MOST LIKE?

- ♦ Single Story: _____
- ♦ Multi-level: _____
- ♦ Split Level: _____
- ♦ Ranch: _____
- ♦ Other (please specify): _____

GENERAL QUESTIONS:

- 1.) How long have you been looking?
- 2.) How have you been looking?
- 3.) Are you currently working with anyone else?
- 4.) Do you have any signed agreements with other Realtors?
- 5.) Are you pre-qualified?

- 6.) What steps do you need to take to obtain financing?
- 7.) What price range are you looking in?
- 8.) What are you basing your price range on?
- 9.) Describe your dream house (that fits in your price range):
- 10.) What are some of the things you don't want?
- 11.) Tell me five things you love about your present home:

- 5.) **Take Your Time:** One of the most important things is to take your time!!! Make sure we find what it is you are looking for. The Island and the Low Country have so much to offer, find what you want, get specific, then we can gradually narrow down our search. I can get you any and all of the information you need, that's the easy part! Don't think or let someone tell you: "You better buy now, it won't be here" BLAH, BLAH, BLAH...you buy when you are ready, not when someone tells you to!!!
- 6.) **Plan ahead:** If at all possible, let me supply you with information way ahead of time, via internet or snail mail, it's worth it! We can save a ton of time if you are somewhat familiar with the market values, taxes, costs, the areas, and maybe even some of the villa complexes. Again, if we have time, we will keep narrowing down each time we look at property or each time you come down here for a visit. If you find a complex or an area you like, but there are no availabilities, I will MONITOR the market constantly! If something comes on, I will find it, and most likely before anyone else does: Then get you some digital photos and all the information on the property fast! Believe me, if your dream home is not on the market now, in time it will be, so don't get discouraged. It's much more important to find what it is you want and not to settle for less!
- 7.) **YOU HAVE FOUND THE PERFECT PROPERTY:** Now my job really begins: Make sure, before we make an offer the following is addressed: The expense information, the management fees (if there are any), the history of the complex/upcoming assessments, the assessments if any of the street/plantation. Our financing is set or we know where we stand on this. Do we have a closing date in mind and have we discussed what our next steps are going to be. It may

sound confusing, but this is why you have me!!! **Basically, we do not want any surprises!** Once we are fine with everything, we can proceed!

- 8.) **MAKING THE OFFER:** Well we have made it this far and hopefully by now our research and hard work will pay off. Let's make sure we discuss the following.
- A.) Initial offer must be written. If you are thinking about presenting an offer and need to find out if it may be too low, or if there is an offer on this property, have your realtor call and get as much information before you actually write the offer.
 - B.) When writing the offer, we always use the **SC association of Realtors** standard contract, a legal real estate contract in South Carolina. Remember, to bring a checkbook when submitting an offer, we do not write offers without a check for earnest money.
 - C.) **Points in the contract to discuss:**
 - 1.) Offering Price
 - 2.) Finance contingency
 - 3.) Date of finance contingency
 - 4.) Earnest Money
 - 5.) 2nd Earnest Money
 - 6.) "AS IS"
 - 7.) CL 100
 - 8.) COUNTERS TO PREPARE FOR
 - 9.) Inspection Report or Inspection Addendum
 - 10.) Assessment Protection Clause
 - 11.) Other Points of Interest or necessity that might be added that pertains to property.
 - 12.) A closing date.
 - 13.) Any questions you may have.
 - D.) Your Realtor will discuss all of these points in the contract, **but please feel free to ask away on the questions.** Without going over all of these or all of the possible different scenarios, here are a few that always warrant a few questions:
 - E.) **Earnest Money:** A lot of people are unsure what to put down for earnest money (Initial and second). You usually have an out of town owner and an out of town buyer, so a strong earnest money 5-10% is very normal and makes the most sense. The stronger the earnest \$\$\$, the stronger the contract, plus you still have other contingencies to protect yourself, as long as you stay within your time frames within the contract.
 - F.) **Inspection/Inspection Addendum:** It is always important to get a home inspection; it's the smartest move you can make! You want to know exactly what is wrong with the home or villa or what isn't. The seller is responsible for the following: ALL Appliances, Heating/AC, Electrical, Plumbing, and/or Safety concerns shall be in good working order, subject to reasonable wear and tear. You are not always buying a new

home, so remember that! Also, some homes will have Polybutulane piping, or lead paint, or other items not in code today that were in code when these homes were built. This does not mean that the seller has to provide all new piping or replace all of the walls. The most important reason to get a home inspected is for the Buyer to know exactly what he or she is getting!!! The purchaser can choose the inspector and is responsible for paying him/her as well.

“AS IS” is just what it says!

G.) CL 100- Seller agrees to provide at its expense at closing an "Official South Carolina Wood Infestation Report (CL-100)" in which no infestation or damage is reported or if there is damage observed, that it is insufficient to recommend repair. Such report must be dated within 45 days of the Closing. If infestation or sufficient damage is observed, Seller shall cause same to be repaired prior to closing or permit Purchaser's closing attorney to escrow funds from the sales proceeds at Closing in an amount equal to the costs of such repair.

H.) Again, **you will write the offer and the check**, payable to the seller's Real Estate Companies ESCROW ACCOUNT. **Please read and review** the SC disclosure if you have not or have decided to change from a customer to a client. Sign and initial/date everywhere you need to and PLEASE make sure your Realtor or Real Estate agent makes you copies. Personally, I always hand deliver the contract, if possible, but a signed fax contract is also binding and usually the only applicable solution.

I.) **REMEMBER**: Sometimes you may not find out right away (Out of town seller), your Realtor will let you know the second they respond, they have to, make yourself available to or at least discuss a game plan! Sometimes I place an expiration date on the contract or may even add a "Time is of the Essence" clause if we need to know ASAP! Generally a verbal counter is acceptable, usually a counter is expected in some form:

Ex: Counters

-Price

-Closing Date

-Earnest Money

-Contingencies

-Terms or additions

Once both parties come to an agreement, this verbal or these verbal counters must be signed/dated/ and documented. A fax is fine for now; an original should also be obtained.

J.) **YOU MUST CHOOSE**: The buyer and seller have to choose a **SC Attorney**, your Realtor should have a list of them. You must also choose a Home Inspector, see what your time frames are, it's usually ordered within 10 days of the signed contract.

- 9.) This is where you find out **how good your REALTOR really is.** The work really begins now and follow up to the tee is absolutely crucial.....I am the best here and my follow up is always documented, with copies to all parties and all attorney's involved.....Paper trail! I will stay on top of the lender (Get the finance letter), stay on top of the inspection process, document what we will have done, copy the attorney's, make sure follow up has been done and repairs are being made, handle any issues that may arise, and the main thing is KEEP YOU INVOLVED AND KEEP COMMUNICATION LINES OPEN!!! Remember, we will not close until I do a FINAL WALK THROUGH on your property, the day before and/or the day of closing. Making sure that everything has been completed and the home is in order. Please feel free to contact me with any questions.
- 10.) **YOUR ATTORNEY** will send you a letter explaining what you need to expect during the closing process. Remember your closing costs will be approximately 3% of your purchase price. They handle the transition with electric company and water/sewer. You need to be responsible for phone and cable, if in a home: pest control, trash pick up, and termite bond, etc. **Any questions I cannot answer,** our attorney will know, or I will find out!
- 11.) **INSURANCE:** You will need to choose insurance: Home owners, Flood, and wind/hail, to name a few. It's always good to check with a few companies, compare rates and/or programs. Please let me know and I will provide you with some names, if you do not already have some.
- 12.) **MOVING CHECK LIST:** Things you may need to do before you move!!!
- SERVICES:
- GAS -Lawn Service -Cell Phone
 - Electric -Newspaper/Magazine -Mail Service
 - Phone -Security -Cable/Satellite -Laundry
 - Garbage Collection -Fuel -Maid Service
 - Water/Sewer -Septic -Pool Service
- ACCOUNTS:
- Bank -Investments -Brokerage
 - Home/Life/Health/Auto/Misc. Insurance
 - Financial Advisor -Charge Accounts/Credit Cards
 - Retirement Accounts -Gym -Department Stores
- AGENCIES:
- DMV -Vehicle Registrars
 - Schools -Post Office -Social Security
 - Library -Daycare -Clubs and Associations
 - IRS -Veteran's Association
- PROFESSIONS:
- Doctors -Lawyers -Dentists
 - Accountants -Chiropractor -Broker
 - Medical Records -PT Records

-Other Doctors or Professionals

- 13.) **THE ACTUAL CLOSE:** It is not necessary for you to be at close. You have the option of doing a mail in close, signing prior to closing, doing a “Power of Attorney”, or coming to the close. The attorney can still go through all of the paper work with you by phone or you can attend the actual close. Either way, I will not give the go ahead for the attorney to close until the property has been thoroughly inspected on the day of the close! Usually the attorney will let you know an exact amount (Closing Costs), a day or 2 before close. In some cases, it is necessary to wire the attorney money; you cannot use a personal check at close, only wired funds or a certified check. The attorney’s will go over this process completely with you prior to close.
- 14.) **HOME WARRANTY’S** Sometimes a home or villa will come with have a home warranty that is included in the sale of the home or villa. Other times, you may want to purchase a home warranty, most insurance companies will have information on these warranties, please ask me, if they do not.
- 15.) **FURNITURE:** Since we are in a vacation-oriented community, you may need to furnish your property right away or upgrade the furnishings currently in your new home. I have lists of companies and lists of what a typical rental ready property really means! Just let me know and I can get you all of this information.
- 16.) **VENDORS AND CONTACTS:** You will need to make a checklist depending on what kind of property you are purchasing and what it will be used for to determine what vendors you will need. I have lists of reputable people from Locksmiths (Changing the locks) to Dog Walkers, just ask me!!! This is the kind of **FULL SERVICE you can expect from me...even years beyond the sale.**
- 17.) **YOUR NEW HOME:** Now you are officially a homeowner on Hilton Head Island, SC USA. Congratulations!!! You did it! Make a checklist of all of the things you need to do or of the people you need to see for a service (Bug people, contractors, lawn care, etc.). **Again, I have a list on everyone, just ask me.....anytime!**

It's always nice to have measurements taken, furniture possibilities arranged, or estimate from contractors taken before you close, it will save you time and money to do this ahead of time, especially if time becomes an issue of great importance. I can help you even if you are not in town; it's what I do!!! Also, please let me know if you would like me to arrange rental or management companies to view your home or villa, to give you an idea on what to expect or simply to find out who you would like to use!

If you do choose me as your Realtor, I can assure you that I will work the hardest, always be truthful and honest, communicate with you often, and most importantly "Do the right thing" at all times. I hope that I have made a new friend along the way! I am not in this for the sale, I do this thorough of a job with all of my clients, because I love what I do and I love this area...Don't forget, this Island is too small, you see me all of the time...I have to be good!!!

Best of Luck,

Rick Saba

All of the information is believed to be true, but must be verified. Rick Saba and the Carolina Realty Group have done their best to put together this list to assist you in the home buying process, but please, please ask us if you have questions or concerns about anything. We thank you!

Oceanfront Homes

The oceanfront property on Hilton Head Island is located in the Sea Pines, Port Royal, and Palmetto Dunes Plantations, as well as in Folly Field, Singleton Beach, and North and South Forest Beach. Dwellings range from small beach cottages to large oceanfront estates built on multiple lots. Prices vary by location, but in general, homes on the beach range from \$1.2 million to well over \$5 million. Vacant lots start around \$1 million. Strong demand for a limited number of beach homes on Hilton Head Island drives substantial price appreciation. We expect this appreciation to continue well into the future. Many people choose to purchase oceanfront homes for their retirement and, in the mean time, rent them to vacationers. As short-term rentals, these properties can generate gross incomes approaching \$200,000, annually. NB: Port Royal Plantation does not allow short term rentals.

Ocean Oriented Homes

"Ocean oriented" means that a home is located within a block or two of the beach. Typically, homes situated between two and eight rows from the beach - still a very short walk to the ocean. Many of these homes, particularly the ones in the second row, have views of the beach. Choices include modest beach homes built in the 60's and 70's to brand new extravagant 6-7 bedroom homes. These properties can be found in the same areas as the oceanfront homes. Port Royal Plantation does not allow short-term rentals of any kind. Prices range from \$400,000 to over \$3 million. Rental incomes of \$30K to over \$100K are typical for these homes. Ocean oriented homes have experienced substantial price appreciation with the trend expected to continue.

Oceanfront Villas

The oceanfront villas on Hilton Head Island can be found in the Sea Pines and Palmetto Dunes Plantations as well as in North and South Forest Beach and Folly Field. Choices range from one bedroom efficiencies in the Forest Beach area starting around \$100,000 to luxurious four bedroom penthouse villas in Palmetto Dunes priced from \$1 to \$3 Million. Currently, the average two bedroom oceanfront villa is sells somewhere between \$450,000 and \$650,000. Most of the villas are used as outstanding short-term rental properties and annual gross incomes range from \$20,000 to \$70,000, depending on the number of bedrooms, the condition, the view and the location. Generally, unobstructed oceanfront views from the top floors fetch the highest prices.

Ocean Oriented Villas

Hilton Head Island's ocean oriented villas can be found in the Sea Pines and Palmetto Dunes Plantations as well as in North and South Forest Beach and Folly Field. Most of these villas have one to four bedroom floor plans, with 2 bedroom/2 bath villas being the most common. Typically, these villas are located less than a ten minute walk to the beach. Owners can expect short-term rental income of \$15K to \$35K depending on age, size and location. Many investors begin their Hilton Head Real Estate investments with an ocean oriented villa with a goal in mind: to purchase an oceanfront villa in the future. Bearing this in mind, wealth can be created through appreciation and building equity (the short-term rental income subsidizes the equity).

Deepwater Access Homes

Deepwater access refers to the accessibility of a large boat to a dock at low tide. There are many homes on Hilton Head Island as well as the mainland that have deep water access. These homes can be found in Sea Pines, Wexford, Long Cove, Hilton Head, Spanish Wells, Blue Heron Point, Windmill Harbor, Colleton River and several locations in Bluffton on the May River. There is a very strong demand for deepwater access with available inventory in short supply. Wexford and Windmill harbor are both built around large lock-controlled harbors and provide a sheltered environment in which the tide never fluctuates. Prices range from \$600K to over \$3 Million.

Private Golf Communities

Private Golf Communities include Wexford, Long Cove and Palmetto Hall on Hilton Head Island and Colleton River, Moss Creek, Belfair and Berkeley Hall just off of Hilton Head on the mainland. Prices range from \$300K to over \$1 Million. Generally, these communities are designed around excellent golf courses available only to property owners. They feature large clubhouses, dining areas and other amenities like fitness rooms, tennis courts, boat docks and marinas, and a host of other activities. The golf course at Long Cove is currently ranked in the top ten courses in the country. The golf at Colleton River is ranked the highest in the country among private gated communities with two courses (both in top 100) and our newest community, Berkeley Hall, has taken the golf lifestyle to a new level of pristine playing conditions and state-of-the-art facilities, with a 35,000 square foot clubhouse, three restaurants. There is a wide selection of choices available to satisfy the needs of buyers desiring a private club lifestyle. Check the section for more detailed information about some of these communities.

Sea Pines Plantation

Located on the Southwestern tip of the Island, Sea Pines Plantation is Hilton Head Island's first developed community – or “Plantation” as it was originally termed when founded by Charles Fraser in 1956. In addition to being a residential haven area, Sea Pines has also come to be known as a World-Class resort! Here are just a few of the “highlights” Sea Pines has to offer:

- Five (5) miles of expansive & beautiful Atlantic Ocean white, sandy beaches.
- Miles of property on or near the Ocean and Intracoastal Waterway. Most homes near South Beach have dockage facilities available.
- Approximately 5,000 acres of land (1,300 of which are devoted to parks, forest preserves, lagoons & marshlands!) and over 6,000 homes and villas.
- **Sea Pines Conference Center:** Offers conference facilities & other amenities.
- Dining: Wide variety, with most cuisines available.
- Three (3) community Swimming Pools as well as pools in all Visitor areas (Villas) as well as in many private homes. (available with annual fee)
- Community Playgrounds/Recreation Areas.
- Sailing: Rentals of boats and sailboards. Lessons are also available.
- Four (4) Championship Golf Courses & Pro Shops:
 - **Club Course:** For member play only Sea Pines Country Club.
 - **Sea Marsh Course:** For member play & resort guests.
 - **Ocean Course:** For member play & resort guests.
 - **Harbour Town Links -- *Home of the famous MCI Heritage Golf Classic:*** For member play & resort guests.
- 50 miles of bike paths.
- Over 100 Tennis Courts.
- Two (2) Racquet Clubs:
 - **South Beach Racquet Club**
 - **Sea Pines Racquet Club – *Formerly hosted the Family Circle Magazine Cup Tennis Tournament***
- Two (2) Beach Clubs:
 - **Sea Pines Beach Club:** For property owners and resort guests. *Offers many amenities including a party room, outdoor “concessions,” picnic & Oyster roast facilities, etc.*
 - **The Ocean Club/Tower Beach Club:** Private membership limited to Sea Pines Property Owners. *Offers premier Beach Club facilities.”*
- Two (2) Marinas: Offering over 150+ Boat Slips!
 - **Harbour Town:** Open to the general public. *One of the most popular landmarks on Hilton Head Island! Premier Marine community featuring a picturesque Mediterranean Village with specialty restaurants, lounges & shops and many forms of entertainment and activities. The expansive docks -- capable of*

accommodating yachts up to 115' in length -- host a dock-master fuel station, telescope viewing & a site for many charter cruises to board. Recreational facilities blend naturally into the lush landscape. Also home of the newly refinished famous red & white striped Lighthouse overlooking Calibogue Sound & The Harbour Town Basin!.

- **South Beach Marina Village:** Open to the general public. *Quaint New England fishing village in Braddock's Cove with restaurants, shops, entertainment, lounges, dockmaster, bait & tackle shop, etc. Located at the Southern-most tip of Hilton Head Island!*
- **Sea Pines Property Owners Community Services Associates/Architectural Review Board (CSA/ARB):** Responsible for maintenance/upkeep of Plantation & for the well-being of Property Owners.
- Abundant Lagoons for fishing & boating.
- 41 miles of Nature trails & private forests for biking, walking, running, etc.
- Three (3) large Shopping areas.
- **Lawton Stables Equestrian Center:** Offers boarding and nature trail rides
- **Heritage Farms:** Organic gardening area. For property owners only.
- Two 24-hour manned security gates and roving security patrol
- Association Fee: Improved: \$811.00

Shipyard Plantation

Known as being both a residential as well as a resort community, Shipyard Plantation offers a full spectrum of amenities including the following:

- Approximately 800 acres and over 2,000 homes and villas, consisting of single family homes as well as villa residences and rental properties.
- **Shipyard Beach Club:** Offers guests & residents access to the lovely, snow white beaches of Forest Beach -- touted by some as being "the best stretch of beach on Hilton Head."
- **Crowne Plaza Resort:** Offers guests & residents access to fine dining and/or casual fare, nightclubs, meeting rooms, shops, indoor & outdoor swimming pools, and an on-site health club.
- Dining: A variety of restaurants at the Golf Club, Beach Club, Hotel & Convention Center.
- Boutiques and shops in Hotel and Clubs.
- Pools in all visitor areas (villas) as well as in some private homes.
- Over 4 miles of bike paths
- Van Der Meer Shipyard Racquet Club: *One of Tennis Magazine's "50 Greatest U.S. Tennis Resorts." Features 23 Championship courts nestled among magnificent oaks and beautifully landscaped grounds. Also has covered courts in the Shipyard Racquet Club. Special programs and clinics have been designed to provide for*

thorough, comprehensive learning; yet they also allow plenty of time for shopping, the beach or any of the other Island activities.

- Three (3) Nine-Hole Golf Courses: Clipper, Galleon & Brigantine
- Winding trails for walking, biking, rollerblading, jogging, etc.
- Association Fee: Improved or Unimproved: \$635.00

Palmetto Dunes Plantation

Located near the middle of the Island on the Atlantic Ocean side, Palmetto Dunes Plantation offers a unique combination of being both a resort as well as a residential community. The Plantation itself consists of three distinct areas: Palmetto Dunes Plantation, Shelter Cove, and Leamington.

Palmetto Dunes Plantation (main)

- Approximately 1,800 oceanfront acres and over 5,000 single-family homes and villas.
- Three (3) miles of white, wide, sandy Atlantic Ocean beach for walking, running, swimming, fishing, windsurfing, sailing, canoeing, or parasailing! Facilities available for rent.
- **Hyatt Regency Hilton Head Resort:** Oceanfront accommodations with restaurants, shopping, pools, entertainment, conference facilities.
- **Hilton Hotel:** Oceanfront accommodations with restaurants, shopping, pools, gym, conference facilities.
- Three (3) Golf Courses:
 - **Robert Trent Jones Golf Course**
 - **George Fazio Golf Course**
 - **Arthur Hills Golf Course**
- 25-court Rod Laver Tennis Center, featuring Har-Tru, Laykold, super grass & lighted courts.
- Miles and miles of bike paths. Bike rental available.
- Boasts a 12-mile network of lagoons meandering through the resort for canoeing & fishing. Canoe rentals and Charters available.
- Pools in all visitor areas (villas), hotels, as well as in many private homes.
- **Palmetto Dunes Property Owners Association:** Responsible for maintenance/upkeep of Plantation & for the well-being of Property Owners.
- Dining: Variety of restaurants -- both public (in hotels) and private.
- Unique mingling of "Residential" and "Resort" -- separated by security gates.
- Three 24-hour/day manned Security Gates.
- Association Fee: Improved or Unimproved: \$1,145.00

Shelter Cove

- Located across the Highway from Palmetto Dunes -- though still considered a part of Palmetto Dunes. Located on the “sunset” side of the Island.
- Hosts 230-acre **Shelter Cove Marina Community Center**, which includes a 15.5 acre deep water Harbour -- the largest deep water Marina on the Island.
- Fine harbourfront restaurants, shops, nightly entertainment, weekly fireworks shows.
- Disney Resort on premises.
- **The Mall at Shelter Cove**: Located near the Shelter Cove premises, this is the only indoor shopping mall on the Island!
- Association Fee: Improved or Unimproved: \$550.00

Leamington

- Secured premiere exclusive neighborhood community located within Palmetto Dunes Plantation.
- Host to the **Arthur Hills Golf Club**.
- Property owners have access to private beach cabana, recreation center & private Golf Club.
- Association Fee: Improved Resident: \$1,414.00

Forest Beach

Consisting of both “North” and “South” Forest Beach, The Forest Beach Area covers the large stretch of Oceanfront land between Shipyard Plantation and Sea Pines Plantation. Its location provides for many unique amenities including:

- Contains over 3 miles of lush, white sandy beaches -- considered by some to be the “best stretch of beach on Hilton Head Island.”
- Waterfun Park: Water Park & Miniature Golf -- fun for the whole family!
- Coligny Plaza: One of the “oldest” shopping plazas on the Island. Offers many small shops, abundant restaurants, entertainment, grocery store & many service-oriented businesses.
- Treasure Island: Miniature Golf Course
- Beach Market: “Boutique” shops and specialty restaurants located right on the waterfront.
- Circle Center: Grocery store, Drug Store, many other local and national shops and restaurants.
- Forest Beach is considered a “non-plantation,” although there is a Forest Beach Property Owners Association that is optional to join (\$55.00/year).

Estimated Cost of Owning HHI Villas

- 1) Each plantation has annual **Association Fees** or POA (Property Owner Association) Fees
- 2) **Regime Fees** – These are monthly condo fees. These typically cover water and sewer, grounds maintenance, outside electrical, trash pickup, monthly pest control, and maintenance of pool or tennis courts if on premises. Typically these fees are based on size of unit and will run \$250 to \$350 monthly (for a 2 bedroom) and \$375 to \$500 (for a 3+ bedroom) plus an insurance assessment of \$800 to \$1200 per year.
- 3) **Current conforming mortgage** rates are 7.125% plus a point to close. This is approximately \$674.00 per month per \$100,000 borrowed (P&I) on a 30 year mortgage. Current jumbo rates (Loans over \$275,000) are @ 7.25% plus a point. Or, \$682 per month per \$100,000 borrowed on a 30 year amortization.
- 4) **Short term** (weekly) management companies will typically charge rental management fees of 25 – 35% of gross plus housekeeping fees. You should net 60 – 65% of gross income.
- 5) **Long Term** (Annual) management companies will typically charge rental management fees of 10% a month of total rental. Tenants, unless specified are responsible for their own utilities.

Please contact me anytime for a list of preferred vendors, including rental companies, regime/H.O.A. information, and more!

Guide for Income Producing Property Ownership

If you have ever considered owning a home or villa on Hilton Head Island, you might want to consider placing your property on the short term rental market. By generating additional income through vacation rentals, you can subsidize your mortgage and expenses and create wealth through appreciation.

First, you will want to hire a property management company. Property management companies rent properties on a weekly basis to people who are here on vacation. Since Hilton Head Island is one of the most popular destinations on the South Atlantic Coast, the short term rental market here booms. These companies have a number of homes and villas which they advertise. In return for placing renters in your home or villa, you pay the company a fee, usually 20% to 30% of the income they generate through rentals.

Most people who choose to rent their property in this fashion are “absentee” owners. Absentee owners prefer to hire someone to maximize rental income as well as look after their property in order to minimize damage and keep up with basic maintenance needs. They are usually too involved in their lives away from Hilton Head and don’t want to be distracted by day to day problems involving vacation property. This being said, you will want to interview several property management companies on the island to assess their capabilities, fees and contractual terms. Another good way to find out more about a company is to talk to someone who currently owns a home or villa that rents with that company.

Compare the estimated annual gross income to the fees they will charge. You will want to choose a company with good references and that is located relatively close to your property. Also, your property might get closer attention if the company only manages properties in your area, as opposed to all over the island.

Before you go any further, you need to understand that property on the short term rental market will incur more than normal wear and tear. People who are on vacation tend to be careless. This is not meant to scare you, but simply to prepare you. An anecdote: A client of ours bought a nice beach home in the Forest Beach area and remodeled. The house has always rented very well and in four years, they have only had one “mishap.” It turns out that a group of ten lady golfers rented the house. One night, one of the “ladies” managed (they still don’t know how) to fall into the drywall in the closet, through the wall and into the bedroom, creating an extremely large hole (apparently they had been drinking...quite a bit). You need to assess whether your emotional makeup allows for the thought of strangers occupying your property and creating wear and tear, and quite probably being careless and sloppy with your personal possessions. Weigh this against the income you will receive, keeping in mind these guests are helping you pay your mortgage.

You should furnish nicely, but not extravagantly. Use floor and wall coverings that will stand up to the test of time, water and sand. Choose kitchen and bath items that are

durable, inexpensive and can easily be replaced (Wal-Mart, Sams). If you are mentally prepared for the property to get "beaten up," you will have a much easier time with the whole process. When it comes time to take the property off the market, you can replace the floor and wall coverings as well as the furniture and other items.

If you are shopping for a property to place on the short term market, it is important to understand cash flow. Never expect a positive cash flow if you have a mortgage; it isn't possible. Any rental agent or Realtor who tells you otherwise is to be viewed with great suspicion. Don't listen to talk about how many weeks of rentals you can expect. If your rental agent rents your property to "snowbirds" for the winter months, you will get twelve to fourteen weeks of rentals, but you will get about the same for a month as you would for a week in the summer. Ask for estimated gross annual income and forget the rental agent who says you can get 20 to 22 weeks of rentals. Ask to see monthly statements for comparable properties.

Scrutinize all costs carefully. All rental agents take a percentage commission of the rental fees collected. Some add an "advertising" charge. Someone will clean your property and replace all of the sheets and linens after each occupancy. Find out if the property manager bundles the cleaning cost with the rental price or charges the guest all or part of the cost. Make sure you understand where this cost goes. Who supplies the linens? If you do, then they should be laundered in your property using your appliances, water and electricity. There will probably be an expense for linens and towels that wear out or vanish.

Find out if there are any charges involved when you use the property yourself. What are the "friends and family" rates - when you send a relative or business associate? Can you participate in the rental of your property or in referring people you know to the rental agent (commissions to you)?

Understand the maintenance policy. Many rental agents do not have a maintenance staff. Therefore, if a toilet is clogged, they will call a plumber. Likewise, if a light bulb burns out, they call an electrician and if a doorknob comes off, they call a locksmith. You can also expect the company to mark all ancillary charges up (a handling charge). We have seen a monthly billing statement with a \$50 charge to change a light bulb. Scrutinize a number of actual monthly statements from the property management company. If they want to provide copies with the owners name and address blacked out, that's reasonable, but do see some actual statements. If you need repair people, I can recommend some.

Some rental agents limit how many weeks you can occupy your own property, and the IRS also has strict allowances for "personal use," particularly if you have plans to perform a 1031 tax deferred exchange in the future.

Some rental agents hold out some number of rent free weeks as a promotion, ostensibly to entertain travel rental agents. Travel rental agents make up a very small part of the majority of rentals, which occur in the already busy summer months.

As we mentioned earlier, property managers who concentrate in limited areas are able to give those properties more personal attention. Also, the employees are more likely to be familiar with your particular property, which helps to sell it. Don't underestimate the importance of having someone "nearby."

A good rental agent will send someone to inspect your property after each occupancy. This is to ensure the property has been cleaned properly, to touch up where needed, to replace burned out light bulbs and dead batteries in TV remotes and smoke detectors, spot and report any maintenance needs, and ensure there is an adequate supply of kitchen items and towels. A good rental agent will "turn over" 80% to 90% of the properties under management on summer Saturdays. One inspector can inspect about 10 to 12 properties in one day. Ask the rental agents how many inspectors they employ on "turn day" and compare that to the number of properties managed. Also, when you come to stay in your property yourself, if you find burned out light bulbs or dead batteries in greater frequency than can be explained by human error, a red flag should go up.

If you want to be extremely thorough, you can check with the Better Business Bureau and with the South Carolina Real Estate Commission to see if the property manager in-charge has ever been sanctioned by the commission or had a license suspended. The rental the rental agent you select has to be one you trust to a great extent for your peace of mind. If a rental agent rents a property and doesn't tell the owner, his commission is 100%, and the chances of being caught are minimal (the consequences are not). Trust is crucial.

The best rental agents try to relieve you, the owner, of the burdens of ownership. When the time comes to redecorate, replace furniture, draperies or flooring, your rental agent should direct you to the appropriate retailers. You should be able to select the floor you want from The Home Depot or Lowe's in Ohio and your rental agent should be able to coordinate the installation through The Home Depot or Lowe's in our area. A good rental agent will coordinate deliveries to avoid loss of rentals and supervise any work done to ensure that things are done right. If your new refrigerator arrives with a dent, a good rental agent will not only know, he will have it replaced and let you know when the new one arrives. If you need additional assistance, please do not hesitate to contact me!

Practical Tips

Following are some practical tips for owners of short-term rental properties. These are simply guidelines to help you when making decisions such as types of furniture to buy, types of flooring, etc.

Furniture with horizontal tops should have laminate tops or, if wood or other porous substances, be covered by glass. Hilton Head is very hot and humid; cold drinking glasses sweat like crazy and the resulting moisture destroys wood tops.

Dining room and indeed all chairs should have rungs between all legs. Make sure they are strong, durable, and well-built. Consider that your favorite uncle weighs 300 pounds and don't forget about him when you buy anything that someone will sit on. It helps if upholstered seats and backs are plastic, or at least covered with a stain guard fabric. Chairs can't be too sturdy; you usually can't replace just one.

Paint your property any color you want, as long as it's white. There are dozens off nice shades of white and off-white to choose from. White makes a room look bigger and will not offend any taste. Bring color in with artwork, furniture and window treatments.

Avoid wallpaper like the plague. A damaged wall (suitcase dings) can be repaired easily and cheaply if painted. Wallpaper creates a whole different situation. The high humidity

on Hilton Head causes wallpaper edges to swell and curl, especially in bathrooms. Plumbing repairs sometimes require cutting a hole in a wall. Not a problem with a painted wall.

Avoid vertical blinds. They are high maintenance and generally have no standardized parts. Most renters either don't know how to treat vertical blinds or don't care. I have even seen owners walk through vertical blinds rather than take the time to open them. Without exception, every installation of vertical blinds I know of has been replaced with drapes.

Microwave ovens are a necessity – many people don't know how to cook without them! And VCRs are a necessity as well (DVD players are now being placed in high-end properties). Multiple Televisions are also a necessity (kids TV, adults TV, video game TV). Consider losing a weeklong rental during the summer because you only have one television!

Matching bedspreads and bedroom drapes is not a good idea. When a bedspread needs to be replaced every few years, things tend to get complicated and more expensive than necessary. .

Sofas wear out fast! Believe it or not, the sofa will be the first thing you will need to replace. Don't spend a lot of money on sofas and buy one that can be easily replaced. Love seats are impractical. A love seat really only seats one, as a practical matter, and it probably matches the sofa, which will wear out first anyway. When the sofa needs to be replaced, what happens to the love seat? Get some comfortable club chairs instead.

Don't place too many knick - knacks around your home or villa. They add clutter, complicate the cleaning process and more than likely will wind up broken, missing or both.

Do have family photographs on display. They personalize the property, and guests will take better care of things having seen the likeness of the owners.

Do make your property non-smoking. You won't lose many, if any rentals. And although your rental agent can't police smoking, it will reduce the incidents of burn holes in carpets and upholstery and nicotine stains on bathroom counters. Non smokers hate nothing more than the smell of smoke in a home.

Although vinyl is less expensive than ceramic tile, the latter is infinitely more durable. Even expensive vinyl will not hold up to abrasive sand, and although tile is more expensive, it is extremely long lasting. Consider ceramic tile for the dining room also, with an area rug to soften it. Dining room carpeting takes a terrible beating with food spills and constant cleaning. The area rug can be easily replaced.

Last, when you come to visit and you see a little wear and tear in your home or villa, remember that anything can be fixed. After all, it's just wood, sheetrock and fabric.

TAX DEFERRED EXCHANGES

The 1031 tax deferred treatment of capital gains tax is one of the best real estate investor vehicles for preserving and building real estate wealth. Section 1031 of the Internal Revenue Code allows property owners to exchange their property for other like-kind property. This makes it possible to transfer the financial gain that is realized from the sale of a property into another property without paying the capital gains tax.

Exchanging properties is not new. The "your property" for "my property" type of direct exchange (i.e., a swap) has been in practice for ages, and is not uncommon in the Hilton Head area. In June 1990 all of this became easier for real estate investors. The IRS issued regulations governing deferred (sale & purchase) exchanges. By using a *qualified intermediary* to handle the transaction, anyone can now turn the sale of their property, and subsequent purchase of another "like-kind" property, into an "Exchange".

A 1031 Deferred Exchange is not difficult, but there are very strict rules and timetables that must be followed. We recommend that you consult a qualified intermediary if you are interested in performing a 1031 Exchange. For more information, contact us and we will be happy to have someone contact you directly.

INTRODUCTION

In June of 1990, the IRS issued the rules governing Delayed Exchanges. This gave everyone the opportunity to use purchase and sale techniques to structure tax deferred exchanges. The deferred exchange is an alternative to a common sale and purchase transaction. If you wish to keep your investment money in real estate, you should consider the tax advantages of a deferred exchange.

Definitions:

- Relinquished Property: This is the property you now own and are planning to sell or exchange.
- Replacement Property: This is the property or properties (there can be more than one) which you are planning to purchase.
- Non recognition of gain: IRS terminology which means you don't have to pay the Capital Gains Tax on the transaction.

During an exchange, there are three conditions which must be met to accomplish non recognition of gain:

- The properties exchanged must qualify, and be of "like-kind".
- There must be an actual exchange, not a transfer of property for money only.

- The time requirements must be strictly followed.

QUALIFIED PROPERTIES

The IRS classifies real estate into the following four classifications:

- Property held for personal use (Personal Property)
- Property held primarily for sale (Dealer Property)
- Property held for productive use in a trade or business (Business Property)
- Property held for investment (Investment Property)

The classification of properties exchanged determines if the property qualifies for Section 1031 treatment. Classifications 3 & 4 qualify; classifications 1 & 2 do not. It is your use of the property that determines its classification. What the other party does with the property does not affect your tax status.

“Like-Kind” Property

Like-kind refers to your use of the property and not to its grade or quality.

"1031" property may be mixed as to type and still be like-kind. As an example, you may exchange land for a duplex, or a commercial building for a retail store, etc. Property held outside the USA and its territories does not qualify for exchange with property held within the USA.

Partnership Interests

Your interest in a partnership cannot be traded for an interest in another partnership, but a partnership as an entity can exchange real estate it owns for other like-kind real estate.

Transfer Between Spouses

There are no income tax consequences in entering into financial transactions between spouses. In addition, most transfers incident to a divorce are tax free. However, transactions with a former spouse are normally subject to tax unless they qualify for misrecognition under the provisions of Section 1031.

Sale/Lease Back As An Exchange

A lessee's interest in a lease for real property with a term of 30 years or longer is considered like-kind to other real property. In addition, property which is subject to a lease can be, if the lease is for a term of 30 years or longer, the subject of a tax free exchange. The receipt of prepaid lease payments, whether for a 30-year lease or not, are taxed as ordinary income and will not qualify for tax-free exchange treatment.

Business Assets

The personal property assets of one business can be exchanged for like-kind assets of another business and will be held as a like-kind exchange under Section 1031. The real property is treated the same as any other exchange. The like-kind requirements for personal property are much more stringent than for real property (e.g., a truck cannot be exchanged for a car, nor can a sailboat be exchanged for a cargo ship).

Vacation Homes & Properties

This type of property does not qualify if it is used solely for personal use. However, in the Hilton Head Island area, most people rent their vacation homes and villas on the short-term rental market. This classifies the property as “income-producing” property and thereby qualifies the property because it is not used solely for personal use. The property also qualifies if it is not used for personal purposes more than fourteen days per year. (I.R.C. Section 280A)

TIME RESTRICTIONS

In 1984, Congress amended the Internal Revenue Code adding an identification and exchange period for like-kind exchanges. This signaled their approval for delayed multi-party exchanges. However, it was not until the spring of 1990 that the IRS issued preliminary regulations defining delayed exchanges. Final adoption occurred in July of 1991.

The "1031 Exchange" rules have two Time Limitations:

The period of time to identify the replacement property begins on the date of closing of the exchange property and ends 45 days later. The replacement property must be identified in writing, and delivered to the facilitator by midnight of the 45th day after the closing of the relinquished (exchange) property. In identifying, the replacement property must be unambiguously described. We recommend that you use both the legal and specific street address.

The period of time in which the replacement property must be received by the exchanger begins on the date of closing of the exchange property and ends on the date that the tax return of the taxpayer is due, including extensions, or in 180 days, whichever is earlier.

REPLACEMENT PROPERTY

The term "REPLACEMENT PROPERTY" simply means the property or properties intended to be purchased with the funds that are received from the sale of the relinquished property. Meeting the technical requirements of identification is critical. You must satisfy one of these rules:

- You may identify not more than three replacement properties of any value, or;
- You may identify any number of replacement properties so long as the total value of all property identified does not exceed twice the value of the relinquished property, or;
- You may identify as many properties as you desire so long as you close and take title on 95% of the value of such properties.

The property you wish to acquire ("replacement property") needs to have a value equal to or greater than the relinquished property. All of the proceeds from the relinquished property sale need to be invested in the replacement property. The gain will be taxable only to the extent that these goals are partially achieved. If all the goals are accomplished, the entire gain will be deferred. In layman's terms, all of the money you make from the sale of your property must be invested in the purchase of the new property(s) during an exchange in order to defer the capital gains.

Incidental Property

For purposes of completing a proper identification within the 45-day identification period, it should be noted that property which is incidental to Real Estate property, such as furniture, laundry machines, appliances, personal items, etc., is not treated as separate property from the real estate property if:

- In standard commercial transactions the property is typically transferred together with the real estate property, and;
- The aggregate market value of the incidental property does not exceed 15% of the market value of the real estate property.

For description purposes, the legal description or street address of the real estate property can be used to describe the entire property. There is no need to list the particular incidental property attached to it. For example: The Exchange or Replacement property is an apartment house complex worth one million dollars. The furniture, laundry machines, and other items that go with the apartment complex should not then exceed \$150,000 in value, which is 15% of one million dollars. For purposes of identification the entire apartment complex, including furniture, laundry machines, etc., will be treated as one property.

NB: The foregoing discussion relates to the identification of replacement property during the 45 day identification period. However, any non-like-kind property which is received will be treated as taxable boot unless like-kind replacement personal property is acquired by the taxpayer."

Revocation of Replacement Properties

Replacement properties can be revoked as long as it is done within the 45-day identification period. This revocation must be done in writing and should include a rescission of a purchase and sale agreement, if one was written.

Receipt of Replacement Property

Replacement property is treated as received *before the end of the exchange period* if you actually acquired the replacement property. That is, you closed the transaction prior to the end of the exchange period (180 days, or the due date of the taxpayers tax return, whichever is earlier), and The Replacement property acquired is substantially the same as identified during the 45- day identification period.

New Construction Replacement Property

There is an interesting regulation that permits you to exchange for real property that has not yet been built. A transfer will still qualify for Section 1031 treatment if the new construction is identified within the 45-day period, and received within the 180-day exchange period. This property must be carefully identified. This identification should include the legal description of the underlying ground and as much other description as possible for the property to be constructed. Also, the new construction must be completed and received in substantially the same form as described in the identification documents. You can not exchange for services. Partially completed real property can be received in a like kind exchange if properly identified. {IRC 1.1031(k)-1(e)(3)(iii)}

EXCHANGE OR SALE

Introduction

The intent of the delayed property exchange is that you have an actual continuation of your old property investment into your new replacement property. To qualify, you must follow the rules and requirements of Section 1031 of the Internal Revenue Code. Intent does not count. What you actually do is what determines if you qualify. Actions taken for the primary purpose of avoiding tax will usually be disqualified.

Exchange Requirements

Section 1031 requires an actual exchange of properties. If you simply sell your property and reinvest the money in another property, you will not qualify for exchange treatment, even though it is a simultaneous close. This type of transaction will result in "Constructive Receipt". Constructive receipt occurs when you have the funds in a position in which you may draw on them, direct their usage, or give notice of intention to withdraw. In other words, you must not have control of the funds. If you have any type of control on the funds or control over the person holding the funds, you will be considered to have constructive receipt. One of the primary ways that you avoid constructive receipt is with a written contractual agreement with a qualified intermediary.

You are not in constructive receipt if your control over this money is subject to a substantial limitation or restriction. You are in constructive receipt at the time such limitations or restrictions lapse, expire, or are waived. Additionally, you are in constructive receipt if the money is accepted by your agent.

Safe Harbors

Although there is more than one type of safe harbor, the only practical safe harbor for most exchangers is a qualified intermediary. The other two safe harbor arrangements call for establishing special trusts or special security and guarantee arrangements, which are quite complicated and usually are beyond the range of the average exchanger (ask your attorney). Qualified intermediaries act on your behalf in accordance with a specific written contract. The qualified intermediary, for a fee, facilitates the deferred exchange by entering into an agreement to exchange the properties. Under this agreement, the qualified intermediary sells the relinquished property, acquires the replacement property, and transfers the replacement property to the exchanger.

The following persons may not serve as a qualified intermediary for the exchanger:

- Related parties such as a spouse, ancestors, descendants, siblings
- Exchanger's employees or employer
- Exchanger's attorney, accountant, investment banker, broker, or agent
- Related corporations or trusts where 10% or more of the stock or ownership is owned directly or indirectly by the Exchanger. {Treas. Reg. 1.1031(k)-1(k)}.

The Qualified Intermediary does not provide legal or specific tax advice to the exchanger, but will usually perform the following services:

- Coordinate with the "Exchangers" and their advisors to structure a successful exchange
- Prepare the documentation for the exchange and replacement properties
- Furnish escrow with instructions to effect the exchange
- Secure the funds in an insured bank account until the exchange is completed
- Provide the documents to transfer the replacement property to the Exchanger, and disburse the exchange proceeds to escrow

PROPERTY BASIS

For the purposes of a 1031 exchange, *basis* is the term we give to the price which was originally paid for the relinquished property, less any depreciation, plus any costs to improve that property. For example, let's say you bought a villa on Hilton Head ten years ago for \$250,000 and that you've depreciated the villa at \$8,000 per year for the last ten years. Let's also say you spent \$20,000 to remodel the villa two years ago. To calculate the basis, you take the purchase price (\$250,000), less the depreciation (\$80,000) plus the cost of the remodel (\$20,000) for a total basis of \$190,000.

The basis of the replacement property becomes the same as the basis of the relinquished property, plus any amount paid in excess of the adjusted sale price of the relinquished property. The adjusted sales price is the price the property sold for, less the selling cost, and less any other cost to make the property ready to sell.

Example: You sell a property for \$100,000 with a basis of \$20,000, and you buy a replacement property for \$150,000. You paid \$50,000 more for the new property, so the basis on your new property is now \$70,000. Also any expenses which you pay to acquire the replacement property are added to the new basis, including commissions, closing costs, inspections, etc.

Basis is used as the base point for the calculation of capital gain on a transaction. Capital gain is described as the difference between the basis and the adjusted sales price of a property.

Do not confuse capital gain with equity. There is no comparison between the two. Equity is the amount of money you have in your pocket after you sell property and all debts (mortgage) and closing costs (attorney fees, commissions, etc.) are paid off. As an example let's consider the property that you bought for \$250,000 ten years ago, which now has a basis of \$190,000. If you sold that property for \$500,000, and paid out \$25,000 in sales and other costs to prepare the property for market, you have equity of \$475,000. However your capital gain on this property is the difference between your basis of \$190,000 and your adjusted sales price of \$475,000, or \$285,000. If you do not do a 1031 Exchange, you could be obligated to pay a capital gains tax of \$77,000(!) - (\$80,000 depreciation X 25% = \$20,000 plus \$285,000 X 20% = \$57,000).

If you have borrowed some money on this property, you will need to repay this loan at the time of closing. This will result in the relief of debt, which is the same as the receipt of cash according to IRS rules. Let's assume you have borrowed \$200,000 on the property. Your equity on the adjusted sale price is now \$275,000, but you have an obligation to pay capital gains tax of \$77,000. It is in this area that you must be extremely careful not to trap yourself with a regular sale. You are almost bound to exchange in a case like this unless you have the additional funds to pay the taxes. In larger transactions with larger dollars and leveraging, the situation only gets worse.

Figuring Basis Where the Property is Subject to A Mortgage

The primary rule to consider when the relinquished property has a mortgage is this: the relief of debt is considered the same as the receipt of cash by the IRS. This rule applies whether the mortgage is assumed by the other party, or whether it's paid off. The basis calculation remains the same, regardless of the equity. The easiest rule to follow when considering replacement property is this: You need to purchase replacement property with a total value equal to, or greater than, the adjusted sale price of the relinquished property. And you need to use all of the proceeds being held by the qualified intermediary. You can add either cash or borrowings to the exchange proceeds to accomplish this.

Example

I sell a property for \$100,000 which I have mortgaged for \$40,000. The exchange proceeds are \$60,000 and I have a relief of debt of \$40,000. I buy a new property for \$160,000 by paying the \$60,000 of proceeds, \$25,000 from savings, and the balance from proceeds of a new loan for \$75,000. This results in a complete tax deferred exchange.

Boot and Taxable Gain

Cash, notes, and unlike property in an exchange is called boot. Receiving boot as part of an exchange does not defeat the non-taxable provisions of Section 1031. However if you receive boot, you probably will have taxable gain. If the other party assumes any of your liability as part of the exchange, it will be treated as if you received cash.

Example 1.

Sale Price	\$500,000.00
Selling Costs	-\$50,000.00
Adjusted Sale Price	\$450,000.00
Original Price	\$250,000.00
Depreciation	-\$80,000.00
Improvements	\$30,000.00
Adjusted Basis	\$200,000.00
Adjusted Sale Price	\$450,000.00
Less Basis	-\$200,000.00
Taxable Gain	\$250,000.00
Tax on Gain (25%)	\$62,500.00
Depreciation Recapture (20%)	\$16,000.00
Total Capital Gains:	\$78,500.00

Instead of paying the \$78,500 in Capital Gains tax, the "Exchanger" can use these funds to purchase replacement property. Leaving this money in real estate holdings through a delayed exchange, and leveraging a conservative four times, the exchanger could grow the original investment to well over \$300,000 of purchasing power!

Example 2.

Adjusted Sale Price

Sale Price	\$835,000.00
Selling Costs	-\$65,000.00
Adjusted Sale Price	\$770,000.00

Property Basis

Original Price	\$475,000.00
Depreciation (6 years)	-\$103,636.36
Improvements	\$55,000.00
Adjusted Basis	\$426,363.64

Tax Computation

Adjusted Sale Price	\$770,000.00
Less Adjusted Basis	-\$426,363.64
Current Taxable Gain	\$343,636.36

Tax on Gain (25%) **\$85,909.09**

Depreciation Recapture (20%) **\$20,727.27**

Total Capital Gains: **\$106,636.36**

Available Cash Through Exchange

Sale Price	\$835,000.00
Less Sales Cost and Exchange	-\$67,000.00
Adjusted Sale Price	\$768,000.00
Less Mortgage	-\$320,000.00
Net Available Cash	\$448,000.00
Leveraged Four Times	\$1,792,000.00

Available Cash Through Sale

Sale Price	\$835,000.00
Less Sales Cost and Exchange	-\$65,000.00
Adjusted Sale Price	\$770,000.00
Less Taxes	-\$106,636.36
Less Mortgage	-\$320,000.00
Net Available Cash	\$343,363.64

Leveraged Four Times

\$1,373,454.55

FREQUENTLY ASKED QUESTIONS

Do I have to spend all of the proceeds from my relinquished property on replacement property?

No you do not, however you will be taxed on the amount you don't spend. Unused proceeds are known as "boot" and are taxed on their face value at the capital gains tax rate.

If I don't spend all of my proceeds when can I receive the unused amount?

You can receive unused proceeds at anytime after you have acquired each one of the properties identified in your 45 day identification. If you do not acquire all of the properties identified in the 45 day identification, then the unused proceeds cannot be released until the earlier of the due date of your tax return including extensions, or 180 days after the closing of the sale of the relinquished (exchange) property.

Can I take a note on the sale of my relinquished property?

Yes, you can sell your relinquished property using a Note & Trust Deed to finance the sale. It is possible for the promissory Note and Trust Deed to be made out to the "Exchanger." If this is done, the Note is taxable and may not be used to buy replacement property. However, if the Note & Trust Deed is made out in the name of the qualified intermediary, you have four choices on how to use it to buy replacement property:

- You can use it to acquire replacement property by trading it to the "Seller" for part of the equity in the new property (that is spend it like it was cash).
- You can instruct the qualified intermediary to sell the note on the open market (you can negotiate this sale or have the intermediary do it) and add the amount realized to the exchange proceeds. This will give you all cash to negotiate your replacement purchase. It is less desirable because of the discount given on the sale of the note.
- A party *related* to the "Exchanger," such as a closely held corporation or relative can either purchase the Note from the qualified intermediary, or provide financing so that the qualified intermediary receives all cash at closing. You should consult with your tax advisor regarding structuring this type of transaction.
- You can wait until the end of the exchange and receive the note back from the intermediary. This will result in the note becoming "boot" and it will be taxable. However, you will only have to pay tax on the amount received each year.

What should I know about new construction of replacement property?

There are two ways that new construction is handled in an exchange:

- You contract with a builder to purchase a property which will be completed, and closed, prior to the end of the 180 day exchange period. You can purchase the land prior to construction as one of your replacement properties, or you can purchase the land & building from the builder at the time of closing. This is the least expensive and easiest method for the exchanger.
- You can contract to do what is known as a "Build-out Exchange". This is where the exchanger finances all or part of the construction. Through a special agreement with the qualified intermediary the builder draws on the exchange proceeds as certain steps of the construction are completed. This arrangement is much more complicated and risky for the Exchanger, and the Intermediary, and increases the cost of the exchange by \$1,500 or more.

In either case the purchase or sale agreement should have language in it that requires the builder to bear responsibility for the exchanger's taxes if the exchange fails due to the completion of the construction later than the required 180 day exchange closing period.

When should I open escrow on my Replacement Property?

The safest way is to wait until after your "Relinquished" property has closed. The opening of escrow (or notification to the closing agent) may constitute identification as the escrow agent is listed by the IRS as a person involved in the exchange { 1.1031(k)-1(c)(2)(ii) example }, and if it is done prior to the closing of the "Relinquished" property, it can shorten the entire exchange period to 45 days. It is a dangerous practice and does not speed up the "replacement" property closing. Replacement property is identified if it is designated as replacement property in a written document signed by the taxpayer and sent to the qualified intermediary prior to the end of the 45 day identification period.

Can I combine multiple relinquished properties into one replacement property?

Yes you can combine multiple relinquished properties into one replacement property. The rule here is that the first relinquished property to close starts the clock running for all the rest. All the relinquished properties to be combined must be closed within 45 days of the first one to close. The same replacement property is then identified for each relinquished property to be combined. Treas. Reg. 1.1031(k)-1(b)(2)(ii).

If the replacement property is a rental property, how long does it have to remain a rental before it can be converted into a primary residence?

There are no hard rules here. What the IRS requires is that you show intent to use the replacement property as a rental. Most tax attorneys feel that if the property shows up as a rental on two or more consecutive tax returns you will have shown intent.

If the replacement property is sold how are the capital gains taxes calculated?

The capital gains tax is calculated the same as in any other sale, assuming that you have not converted it to residential use, and that you are not going to do another 1031 exchange. The trick here is to be able to establish the basis on the new property at the time of sale. The basis on the new property is the sum of the basis transferred from the old property, plus the difference between the sale price of the old relinquished property and the new replacement property, minus the depreciation on the new replacement property.

IRS section 1031 can be an extremely complicated transaction to perform, depending on individual circumstances. The Carolina Realty Group, Rick Saba or RickSaba.com is not a qualified intermediary, nor do we practice as an intermediary in Real Estate transactions. If you have questions about what has been discussed in this document, please contact us and we will be more than happy to have a qualified intermediary contact you to discuss your individual situation. There is no cost or obligation.

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