



1031 EXCHANGE SERVICES

How do I keep my exchange money safe?

In times of financial uncertainty, safety of funds is always a concern for exchangers. For an exchanging investor, there are three areas of concern; the Qualified Intermediary ("QI"), the account structure and the investment type. Let's review each of them.

QI's hold the proceeds of a sale while the investor locates replacement property. Until recently, QI's could be any person or firm not associated with the investor, with no licensing or other qualification required. With recent QI failures, some states now have regulations governing who can be a QI, and how they must operate. Generally, the regulatory scheme of the state where the exchange begins is the one that controls. Idaho, California, Nevada, Washington and Colorado all have some form of QI regulation. Utah, like the rest of the states, has no active regulation program.

How the money is held also important. Traditionally, the structure has been that the QI's own the money in accounts pooling many investors together in the interim. Concerns over failures and bankruptcies have inspired some investors to ask for some separation from other accounts. Some QI's responded with sub-accounting which allows the QI to account separately for each investor on their own books, while pooling funds in large accounts with their banks. These large accounts help the QI's maximize the interest they receive. The hope that this sub-accounting would provide more safety in a bankruptcy was dimmed in a recent case. The segregated accounts of a defunct QI were held by a court to be part of the bankruptcy estate, leaving them open to claims from other investors and other creditors (*see Millard Refrigerated Services, Inc. v. LandAmerica 1031 Exchange Services, Inc.*).

Some savvy investors now use the Qualified Trust (or similar qualified escrow) structure. This puts the proceeds into a trust owned by the investor, but restricts access to the funds, satisfying an IRS safe harbor. The funds belong to the investor, not the QI. In the decision ruling against the segregated investors, the judge refers to the unused Qualified Trust method. For the security of its investors, all of Exchange Services exchange accounts use the Qualified Trust model.

What investment risks are of concern? Well, none of the recent failures were due to a bank failure. And, since Exchange Services is part of a publicly-held bank, its parent's management, balance sheet and safety are of public record. Each trust has its own separate (not just segregated) bank account. And, although many QI's keep some of the interest earned, at Exchange Services all the interest earned on the bank accounts are given to the investor. Some of the problems have come about because of the QI investing in complicated securities thought to be safe and liquid that became unmarketable. Others made personal investments, not expecting to need the money soon. When investors needed the funds, they weren't available. It is important to know your QI's ownership, operating and investment strategy.

If the QI's depository is a bank, they may be insured by FDIC and have some measure of protection. Accounts opened by Exchange Services, LLC are eligible for the standard maximum deposit insurance amount (SMDIA) based on the individuals customer relationships with the bank. Additionally, Exchange Services, through Zions Bank, participates in the Temporary Account Guarantee program, under which all funds held in checking accounts, including exchange trust checking accounts, have unlimited FDIC coverage through the end of 2010.

At Exchange Services, we have chosen to use the Qualified Trust method: separate accounts, in a strong, stable, well managed publicly held bank, with FDIC insurance. Our management and ownership is publicly held, and our investment strategy conservative and safe. That might give you one less thing to worry about. We welcome your questions, and to serving as your qualified intermediary.



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