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Beyond the Spreadsheet with Margo McDonnell CRE, CES

Helena Carmel (00:02)

According to NASBA, there are currently about 62,000 actively licensed CPAs in the U.S. That doesn't sound like many, compared to professions like doctors, over a million, or lawyers, 1.3 million. However, one financial professional is even rarer than the CPA. That's the Certified Exchange Specialist, a real estate practitioner federally licensed to facilitate 1031 exchanges. There are only 200 of these professionals in the US. And today, we're talking to the woman behind the designation. Margo McDonald is a respected author, speaker, and subject matter expert who's been working in 1031 exchanges for over three decades. Margo spearheaded the effort to establish a national certification to regulate the industry. And she served on the Federation of Exchange Accommodators Board of Directors for 20 years. Margo also holds the prestigious Counselor of Real Estate designation.

I'm Helena Carmel. Today we'll discuss the benefits of like-kind exchanges, the importance of the CES, and why 1031 exchanges are easier than you might think. Welcome to the AMA spreadsheet. And welcome, Margo.

Margo, I'm so happy to have you. You have been a friend of Capstan for many years. You're an incredible resource when it comes to 1031 Exchanges. Everybody here loves working with you. Thank you for joining us, Margo. Thank you for making the time.

Margo McDonnell (01:44)

The pleasure is mine. Thank you for the invitation.

Helena Carmel (01:48)

I know Bruce was very much hoping to be here today. He's under the weather, but Bruce has just raved about you pretty much as long as I've known him. And I know you guys have collaborated. You've done workshops together. You've done webinars together. And it's just, we're very, very happy to have you here and share your subject matter with our audience.

Margo McDonnell (02:12)

Well, I appreciate that. And it's always a pleasure to work with the Capstan team. I've learned so much about cost segregation from them, which has allowed me to share that information and help be a good advisor to my clients as well.

Helena Carmel (02:21)

That's awesome. Love to hear it. Margo, tell our listeners a little bit about yourself. How did you get here?

Margo McDonnell (02:36)

I have been with the company for almost 31 years. It's hard for me to believe that as well. But I did it the old-fashioned way. Remember three decades ago, you were looking for a job and you opened up the local newspaper and the classified ads and you typed up your resume and you put it in the mail and waited. Waited for a possible interview.

And it was an ad that appealed to me. It talked about using your management and accounting skills. And I really interviewed for a sales position with this company.

And I started in 94.

I worked there for, gosh, five or six months. And the person who was running 1031 Corp left and I had a great mentor. We were part of TA Title Insurance many years ago. And he said to me, *you can have any title you want except president, but do what you can with it*. And he allowed me to run this company like it was my own baby.

And I did that, you know, long before I had children or a husband. And I read all the information that was written by attorneys and accountants. And I was quite frankly, really confused by it. And I really made it my mission since then to simplify the process. So anybody could read through 1031 Corp literature, look at our website and know exactly what a 1031 exchange is, what the requirements are, what our role is and really let them see the power of 1031 exchanges. It's a lot more than just rates and vertex.

Helena Carmel (04:33)

It's funny that you mention simplification is like your watchword because that's so true. That's something that I really am so impressed by 1031 Corp. All of your materials are so readable. Everything is so clear. You guys are, you've nailed it when it comes to really making things straightforward and distilling material for your audience.

Margo McDonnell (05:01)

Well, thank you. That's one of the things that we are most proud of because if someone reads it and they don't understand it, they're going to be intimidated by the process and not want to move forward.

Helena Carmel (05:15)

See, I already feel like I'm in good hands here, Margo. I feel like if I was ready to do an exchange, I would be like, yes, *I'm feeling good. I'm feeling confident*. So what is your role as a Qualified Intermediary? What does that, what's your day to day like?

Margo McDonnell (05:32)

So our day to day has a lot of different parts to it. The most important one is answering the calls from someone contemplating a 1031 exchange. They might be thinking about it in the future, or maybe they just entered into an agreement of sale to sell their investment property and just learned about 1031 and they reach out. And our job is really to explain the rules, talk about their situation and how a 1031 might help and answer all their questions.

But once they decide to move forward with the 1031 exchange, the Qualified Intermediary will prepare all the necessary documentation that would include the exchange agreement, an assignment of their agreement of sale. We would coordinate with their closing agent. So we would provide instructions to that escrow or title company. We would also set up a segregated bank account to hold their exchange funds. And we would instruct the closing agent to wire all of their sale proceeds to that brand-new bank account that we set up. It would be set up "1031 Corp. for the Benefit of the Name of our Client" with their social security number or EIN number attached to that. And we want full transparency for our clients so they can log onto the bank's website, see their account balance. They'll get statements from the bank that shows the interest posting, any withdrawals, maybe for an earnest money deposit. And then when they're ready to buy that new property, we'll work with the closing agent, make sure the funds are wired with the client's written authorization as well. We keep the client aware of all the necessary timelines and help them with their identification, as well as making sure they wrap up the exchange within that necessary time period, holding their hand through whole process to make sure that each step is as easy as possible and that they don't miss anything.

Helena Carmel (07:36)

I was just thinking that. I was literally just thinking you are holding hands. Like you are literally walking somebody through this process, holding their hand and guiding them. What a service. I mean, it sounds like nothing could be overlooked. You guys have all the details and you are just checking them off and keeping everything and everyone on track and all of the moving pieces and the multiple players. You guys are like directing the show. That's an incredible service.

Margo McDonnell (08:05)

That's exactly right. And we really take pride in simplifying that process. Our goal really is to provide an exceptional exchange experience made easy. That's our tagline. That's what we tell all of our clients.

Helena Carmel (08:17)

So, Margo, forgive me. I feel like I should have started with this because maybe some of our listeners aren't familiar with the 1031 exchange. Can you just give us a high level? What's the purpose of the exchange? What are the associated benefits?

Margo McDonnell (08:23)

Absolutely. So a 1031 exchange is a tax deferral strategy allowed under section 1031 of the tax code. And it allows the seller of any business use or investment property to defer the gain when they're selling and want to reinvest in another business use or investment property. The 1031 exchange will allow them to defer their gain and perhaps their depreciation recapture. And that gain is on the state and the federal side.

So as long as they acquire another property of equal or greater value and they reinvest all of their net equity, then they should maximize that tax deferral. But a 1031 exchange, as I mentioned earlier, does a lot more than just avoiding the tax right now. Think about the time value of that deferral. Instead of paying $50,000 or $200,000 or more in tax right now, you get to take pre-tax dollars to invest in your next business use or investment property. So you have the power of that tax deferral working for you. And that money will continue to appreciate for you.

It's a way to help an investor consolidate a number of properties into one or relocate their investment. Perhaps they are relocating and they want to take their property in Pennsylvania and buy something in Florida because this is part of the federal tax code.

You can buy and sell anywhere in the U S you can sell more than one or buy more than one. Just last year I had someone sell 146 single family rentals in Philadelphia to acquire one replacement property.

Helena Carmel (10:18)

Wait, 146 for one? Wow!

Margo McDonnell (10:33)

So think about the change in life for that person and how much easier life is for them only to have one property instead of those single-family homes scattered throughout the city that the family had acquired over a period of time.

And it also works on the other side. If you have one and let's say you want to diversify, maybe you made a great investment and there's been significant appreciation over the years and you'd rather sell that and get three or four properties, perhaps different asset classes or different geographical locations so that you're really preparing for retirement and have a well-diversified real estate portfolio.

It's a way to buy something that will eventually become a primary residence or a second home after a two-year waiting period after you buy it. And it's also a way for a business owner to relocate their business or perhaps expand. We've had many business owners do a sale-lease back and use their exchange proceeds to buy another one or two properties, so instead of having one location, now they have two or three. And a little-known fact is a long-term lease of 30 years or more also qualifies as real property.

Helena Carmel (11:45)

Really?

Margo McDonnell (11:56)

Yes.

Helena Carmel (11:59)

So this is really like a strategy that can be used in so many ways and it can really be used strategically depending on, you know, the taxpayer’s end goals.

Margo McDonnell (12:13)

Exactly. And let me, can I add one more thing, which is one of the most powerful parts of 1031. The gain is deferred as long as you own that replacement property. If three years, 10 years, 20 years down the road, you sell that property and it's still held for business use or investment, you can exchange again and you can continue to exchange. So you're using those pre-tax dollars to grow your real estate portfolio. You're preserving all your equity.

If you do an outright sale down the road, that's when you would settle up with IRS and your state. But if you never sold that last property, you held onto it because you're really proud of the real estate portfolio that you've built and it’s doing well for you. When someone passes away, their heirs inherit all of their assets with a step-up in basis, meaning they inherited at the current fair market value and the way that the estate tax rules work, all the gain that was deferred is all forgiven at the time of death. So not only did you have the opportunity to grow that portfolio, but you get to pass it on to your children potentially without any estate taxes. In 2025, the estate tax exclusion is $13.99M.

Helena Carmel (13:25)

That's incredible. Years ago, I remember Bruce telling me when he was first explaining this concept, he said, there is a saying and it's, you know, *defer, defer, defer, die*. [Laughter]

At the time I thought it was like very crass, but I see the point. It's a little crass, but I see what he's saying. You know, if you just keep flipping and keep deferring and then God willing your descendants can benefit from the property as well without the estate taxes. Incredible.

Margo McDonnell (14:07)

Exactly.

Helena Carmel (14:11)

So, okay, so going back to the process, I know you mentioned that 1031 Corp manages all of the deadlines and the details. And I know there's some important time limits that people need to be aware of. Can you review those for us again, Margo?

Margo McDonnell (14:28)

Absolutely.

So from the day they transfer their property to the buyer, they will have 45 days to identify in writing the properties they're interested in purchasing and running concurrently, they have 180 days to actually wrap up the exchange, buy everything they want, and use all of the necessary funds. They're based on calendar days, not business days. And remember they're running at the same time.

When it comes to identifying, the rules say you have till midnight of the 45th day to send a letter to the qualified intermediary and you can list out a number of different properties. If you want to identify one, two or three properties, you don't have to buy all. You just really need to buy one, assuming it's enough money to cover the amount you need to reinvest. But the rules say the combined fair market value of all one, two or three properties can be anything. The sky's the limit.

But if you identify four or more, all of those properties cannot have a total value of more than 200 % or twice the value of your old property. So depending on the size of the property that you sold, that may not be a very advantageous rule. The three property rule is the way that most people go.

So for example, if someone sold a property for $500,000, they can identify three properties that total $30 trillion if they want it. But if they identified four properties, they're capped at $1 million, which is 200% or twice the value of that old $500,000 property.

You know, I think it's a remnant of when 1031 allowed you to exchange tangible and intangible personal property assets, like the furniture, fixtures, equipment, an airplane, a rental car, things like that. While you can no longer do that, there are plenty of times we see people identify multiple properties. They want to really diversify.

Gosh, I had a farmer one time sell a property and buy 53 single-family rentals.

Helena Carmel (16:59)

Ha! Holy moly!

Margo McDonnell (17:01)

I know we used to joke with him and say or ask, *isn't the farm easier to run than all of those single-family homes?* [Laughter]

Helena Carmel (17:07)

Gosh, I guess he was ready for a change?

Margo McDonnell (17:14)

I think that I think he thought it would be fun during his retirement years. But the cool thing about 1031 is that you could do that. Everyone talks about like-kind is being really restrictive when in reality any property held for business use or investment qualifies. So you can sell that farm and buy single-family rentals or sell a single-family rental and buy an office building or sell those 146 single-family rentals to buy one large industrial park.

Helena Carmel (17:48)

I'm so glad you really are spelling that out. Cause I feel like that's like a common misconception. And I'm so glad we're able to debunk it now, you know? So many times people think, nope, if I had a triple net lease fast food place, then I just gotta get a triple net lease fast food place. And obviously nothing could be further from the truth.

Margo McDonnell (18:06)

That's exactly right.

Helena Carmel (18:09)

Are there any other myths while we're on this subject? Is there anything else that we should just debunk right now?

Margo McDonnell (18:20)

That the exchange is only for commercial property would be one of those. Or that if you sold commercial, you had to buy commercial. When we just talked about the flexibility, you can go from commercial to residential.

Another misconception is that it's very complicated when it's really a pretty easy process. And when you're working with a qualified intermediary, they're experts, they know the process and they're going to keep it really easy for you.

Another misconception is it's an all or nothing. If I sold a property for $500,000, if I only wanted to reinvest $400,000, people think that doesn't work. And *it could work* in that situation. If you sold for $500,000 and you buy for $400,000, you'll have a $100,000 trade down that you would have to pay taxes on.

But let's assume that that seller had a $100,000 basis on their old property. So without a 1031 exchange, they would pay gain of $400,000. So in this situation, they could defer $300,000 and pay tax on $100,000. So they're still in a better place.

And a little-known fact is, if you really want to pull cash out of the 1031 exchange, you can do that and pay tax when you file your tax return. But there's nothing that prohibits you from reinvesting everything and refinancing afterwards to be able to pull some of that cash out without triggering a taxable event.

Helena Carmel (20:11)

I feel like flexibility is the word of the day, honestly. I don't think I realized the extent to which people can be flexible and be creative with the exchange. So that's very, very helpful to me. I know there are some kind of unusual exchanges. Do you ever have reverse exchanges, Margo?

Margo McDonnell (20:30)

We do. A reverse exchange comes into play for a couple of different reasons. One might be that you have not been able to sell your old property, but you have the perfect property that you want to buy. And that closing date is coming up. Just last week, I talked to someone who was building new construction, thought he had more time than he did. And now all of a sudden it's going to be ready in two months and he has not even listed his property. And this was last week we talked and I said, well, let's list it, you know, go ahead and list the property and see what happens because if you can get a buyer, especially with cash and they can close quickly, you could avoid that. And lo and behold, he called me this morning to say that they did do that, but that's not usually the case. Usually they don't have a buyer, they need to wait to sell the property, but they have to buy. Maybe there's some great financing that's going to expire. Maybe the seller isn't willing to wait any longer. Maybe the buyer was in place, but just fell apart at the last minute. And we certainly don't want someone to miss out on that.

But there was a revenue procedure that was issued in 2000 that allows us to do these reverse exchanges. And unfortunately, someone can't just buy the new property and then sell the old property because an exchange involves giving up one to get another. If you have two, you don't actually have an exchange. So in a reverse exchange, 1031 Corp, through our affiliate company, Reverse 1031 Corp, we actually create a brand-new entity with our company as the sole member, and we can buy that replacement property using funds that are loaned to us from the exchanger and/or a third-party lender, usually a bank, and we acquire the property and we can hold it for up to 180 days. During that time, the taxpayer has a promissory note from us. They have a qualified exchange, an accommodation agreement that states we cannot sell the property to anyone else. We can not make a profit on it, that they have to take it back from us, because we don't really want to keep it. [Laughter]

And we can hold title for up to 180 days. So that would give them 180 days to find a buyer, transfer the old property to the buyer. And then we would either deed that parked property to the taxpayer or the exchanger, or we would assign the membership interest in the LLC to the exchanger. And that's the way we usually do it if there's any financing in place because then it doesn't affect any of the financing documents. It's just the sole member of that LLC is no longer the qualified intermediary or we call it an exchange accommodation title holder, but now it's the actual owner of the property, the taxpayer.

These are a little bit more complicated. They take a little bit more work to put together and they are, like I said, a little bit more expensive. And depending on where you're located, you could have double realty transfer taxes. So sometimes the cost outweighs the benefits. And that's why it's so important to talk to your tax advisor. But one of the great things about reverse exchanges is while the property is parked with us, we can make improvements to it.

So if the exchanger was selling their property for a million dollars and this new property, maybe they were thinking it was going to be $900,000 and they were buying something for $900,000. But when they actually got the price because of the way the market is, it ended up being a million dollars they got for that property. Now they have a trade down so they could actually use some money to make a hundred thousand dollars of improvements to increase the value of the replacement property so they could defer all of the gain.

Helena Carmel (24:52)

Wow. Again, flexibility, flexibility.

Margo McDonnell (24:57)

It really is. And so many people think that 1031s are very restrictive and that is not the case at all.

Helena Carmel (25:07)

Wow. And I mean, speaking of flexibility and in a different scenario, like let's say you're getting close to your 45 days and you haven't been able to find a suitable replacement property. We just recently started hearing about people who are using DSTs, Delaware Statutory Trusts, as the replacement property in exchange. Do you see that, Margo?

Margo McDonnell (25:48)

Yes, DSTs are becoming much more popular. So a Delaware Statutory Trust is really just a beneficial trust that owns a really large piece of property or most commonly they have a number of properties in there. So an example might be five Walgreens or a student housing complex or three assisted living communities. It could be a giant Amazon warehouse.

And what happens, there's a DST sponsor that goes out, buys these properties. They do any necessary improvements. They put financing in place. They put tenants in place with master leases, and then they package it in a way that it's actually treated as a security, not as real estate, even though you're buying a piece of real estate. And they open it up for buyers.

So a DST broker dealer would go out and find people like you or I doing 1031 exchanges and say, *okay, Margo, you don't want to manage properties anymore. This is a passive investment.* It's a long-term investment. You know, assume you're going to hold it for seven years or so, but you'll buy a little piece of that pie. Maybe if I had $500,000, I end up with an 8.7% piece of that portfolio that has three student housing communities in there. And I get that much of the income and expenses and depreciation. And when the property eventually sells, which they call full cycle, then I get that much of the profit made on the property during those, you know, five to seven years that it's owned.

Helena Carmel (27:41)

And it's hands off. I mean, you own whatever fraction of it, but you're not dealing with tenants and you're not dealing with maintenance.

Margo McDonnell (27:53)

Exactly. And we see a lot of people think of that as their, you know, real estate retirement account, if you want to call it that. And they're still benefiting from real estate. And it’s usually types of industrial or institutional grade properties that we wouldn't have access to otherwise. You know, it's the insurance companies and the REITs that generally buy these types of properties. So it allows us to get that stability.

And what's nice is if you sold for $500,000, you can spread that out over three or four DSTs. So maybe you have student housing and you have drugstores and you have industrial and maybe some multifamily and in different parts of the country. So that if something happens with the economy, you know, have a nice mix there.

Helena Carmel (28:54)

That is, well, flexibility. So Margo, I know it's really hard to predict, obviously, but oftentimes 1031s are on the chopping block. And thankfully, you know, they've been safe for a while. And obviously we have a new president, we have a new administration. Do you think that this is going to be, you know, a favorable environment for 1031 exchanges moving forward?

Margo McDonnell (29:22)

Yes, fortunately, I do believe that this will be a safe period of time for us. Of course, you never know, right? There's a lot of big tax cuts proposed and we all know that you have to pay for those tax cuts. So of course we always worry, but the Republicans demonstrated under the first Trump administration that they understand. the value of 1031, not just to real estate investors, but what that does to the economy as a whole.

On average, every time you do a 1031 exchange, there's 15 people employed in the transaction. Properties being 1031’d are generally held a shorter period of time. People that do 1031 exchanges at a higher percentage make improvements to the replacement property.

The cost, they estimate, and forgive me, I don't have a number in front of me, but they estimate, they have a score if you repeal 1031, the additional tax revenue would be some number. But when all of our studies have been completed, it found that you would lose 10 times that amount in GDP because of how 1031s really fuel the real estate market and the U.S. economy.

Helena Carmel (30:59)

Goodness, that is eye-opening. Now, Margo, I know you're so modest, but can I just go back to you for a minute as a person? You're just incredible. And I just, your credentials are amazing. And you were involved in launching the national certification for exchanges, for 1031s. Is that right?

Margo McDonnell (31:12)

Sure.

Yes, I was.

Helena Carmel (31:28)

Why was it so crucial? Like before, was it the Wild West?

Margo McDonnell (31:35)

Well, 1031 exchanges, or the 1031 industry, unlike so many others, is largely unregulated. And it was really important to give us the ability to tell clients that there's a way to evaluate qualified intermediaries. When you're looking at ABC Company or 1031 Corp or any other company out there, you know if someone has taken that CES examination that they had at least three years of full-time industry experience, that they passed the exam, and now they're bound by a code of ethics. And their knowledge of 1031 and its application are independently verified by a third party.

So you have a nice objective way to evaluate different qualified intermediaries and their knowledge. We make it a requirement for our team members once they hit that three year mark, we expect within the next year they will receive or earn that CES designation.

Helena Carmel (32:49)

And there's not very many. Like we said, there's like 200 or so in the entire country.

Margo McDonnell (32:53)

Right. I looked and there's 171 right now.

Helena Carmel (32:58)

Holy moly, there's less than 200. Oh my gosh. So then how, but it's so important to be sure that your professional has this designation. So what do you suggest that people do? How do they find the right person, is there a listing?

Margo McDonnell (33:14)

Yes, you can find that through our National Trade Association's website, which is just 1031.org. And then you'll see in the top right corner, CES designation, and you can access the directory of CESs right there.

Helena Carmel (33:33)

Yes, directory. That's the word I wanted. Thank you, Margp. Goodness, I have learned so much today. And I think what I really learned is that these exchanges are simpler than I realized. And also, they just have so much flexibility to them. There's a lot of creative and strategic things that people can do. If our listeners have questions, can they reach out to you?

Margo McDonnell (33:59)

Absolutely. They can call me or any member of our team, our toll free number. know we, you know, we don't really need toll free numbers anymore, but it's so ingrained in my head. It is just 800-828-1031. And you can email me directly at margo@1031corp.com. And Margo is just M-A-R-G-O@1-0-3-1-C-O-R-P dot.

I'm always happy to help you.

Helena Carmel (34:32)

Thank you. We'll put all of that in the show notes. I am delighted that you still have a toll-free number and that the last four digits are 1031. Very clever as a child of the 80s. Love it.

And I enjoyed speaking with you so much, Margo. You're quite humble considering that you're kind of the queen of your industry. Not to overstate, but it's really impressive.

Margo McDonnell (34:56)

I like what I do and I really take a lot of pleasure in educating people on 1031.

Helena Carmel (35:04)

Honestly, Margo, if I didn't know you have other places to go and people to see, I would just be like, *Margo, tell me more*. It's quite fascinating. So thank you so much. Thank you for making the time. We appreciate it, Margo. We enjoyed and Bruce Sends his best regards. And listeners, thank you. That does it for another episode of Spreadsheet. If you liked what you heard, why not subscribe?

Margo McDonnell (35:35)

Thank you so much.

Helena Carmel (35:41)

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