CASE STUDY

De-Leveraging a 1031 Exchange

How One Investor Reduced Debt Exposure While Preserving Income Potential

Following the sale of a highly leveraged investment property, the client faced a challenge common among many 1031 exchange investors: how to satisfy debt replacement requirements without taking on more leverage than they were comfortable carrying long term.

While the exchange generated substantial proceeds, the client's priorities had evolved. Rather than maximizing borrowing capacity, he wanted to reduce financing exposure, increase portfolio stability, and improve the predictability of future income.

The goal was not simply to complete the exchange. The goal was to reposition a significant portion of his net worth into investments that better aligned with his long-term objectives while maintaining full tax deferral.

Client Background

- Completing a 1031 exchange following the sale of a leveraged property
- Investment priorities had shifted toward stability and income
- Desired less financing exposure and simpler ownership
- Sought greater predictability and long-term portfolio resilience

The Challenge

- Approximately $2 million of debt needed to be replaced to satisfy exchange requirements
- Many debt-free income-producing options did not provide sufficient leverage
- The client wanted to avoid unnecessary debt while preserving full tax deferral
- A solution was needed that addressed the debt requirement without increasing overall portfolio risk

Transaction Summary

Sale Price	Equity	Existing Debt
$5,000,000	$3,000,000	$2,000,000

CASE STUDY

Strategy Implementation & Outcome

THE STRATEGY

$250,000
ZERO DST

Small allocation to debt replacement

→

$2,000,000
DEBT CREDIT

Generated approximately $2 million of debt replacement credit

→

$2,750,000
DEBT-FREE DSTS

Majority of exchange equity remained in income-focused properties

THE OUTCOME

The debt replacement requirement was fully satisfied while allowing most of the exchange proceeds to remain invested in lower-leverage, income-focused properties.

Instead of carrying financing risk across the entire portfolio, leverage was concentrated in a relatively small portion of the exchange structure.

The result was a portfolio more closely aligned with the investor's actual priorities rather than the mechanical requirements of the exchange.

THE RESULT

- ✓ Debt replacement requirement satisfied
- ✓ Greater allocation to debt-free properties
- ✓ Reduced financing exposure
- ✓ Improved income potential
- ✓ Simplified ownership structure
- ✓ Portfolio aligned with long-term objectives

INVESTOR INSIGHT

A 1031 exchange does not always require replacing debt throughout an entire portfolio. In certain situations, a relatively small allocation to a debt replacement solution can allow the majority of capital to remain invested in properties that better align with an investor's income goals, risk tolerance, and long-term objectives.

General Disclosure:

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- **There is no guarantee** — that any strategy will be successful or achieve investment objectives.
- **Potential for property value loss** — All real estate investments have the potential to lose value during the life of the investments.
- **Change of tax status** — The income stream and depreciation schedule for any investment property may affect the property owner's income bracket and/or tax status. An unfavorable tax ruling may cancel deferral of capital gains and result in immediate tax liabilities.
- **Potential for foreclosure** — All financed real estate investments have potential for foreclosure.
- **Illiquidity** — These assets are commonly offered through private placement offerings and are illiquid securities. There is no secondary market for these investments.
- **Reduction or Elimination of Monthly Cash Flow Distributions** — Like any investment in real estate, if a property unexpectedly loses tenants or sustains substantial damage, there is potential for suspension of cash flow distributions.
- **Impact of fees/expenses** — Costs associated with the transaction may impact investors' returns and may outweigh the tax benefits.
- **Stated tax benefits** — Any stated tax benefits are not guaranteed and are subject to changes in the tax code. Speak to your tax professional prior to investing.