

# THE LANDLORD MONTHLY

## UNDERSTANDING THE BASICS OF A **1031 EXCHANGE**

Exclusive Interview with a  
Local 1031 Exchange  
Intermediary

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# A MESSAGE FROM JAMES

PRINCIPAL | JR ASSOCIATES

As a broker, landlord, and investor myself, I know firsthand how much goes into owning and managing rental property — and how often valuable opportunities go unnoticed simply because no one ever pointed them out.

That's why I created **The Landlord Monthly**. My goal is to give the landlord community I serve real, actionable insights that help you make smarter decisions, increase your property's performance, and ultimately maximize the return on your investment — whether that means saving on taxes, reducing turnover, or just knowing when it's time to raise rents (or not).

You won't find fluff here — just strategies, tools, and ideas I'd want in my own inbox.

Thanks for reading — I hope this monthly distribution gives you something to think about. If it sparks a question, reach out anytime.

Sincerely,



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# 1031 EXCHANGES IN PLAIN ENGLISH

WHAT MOST LANDLORDS GET WRONG — AND HOW TO USE THEM STRATEGICALLY

1031 exchanges are one of the most talked-about — and least understood — tools in real estate investing.

Most landlords I work with know the term. Many know it defers taxes. Very few understand how it actually works, when it makes sense, or where people get into trouble. I see the same misconceptions come up again and again:

**“I only have to reinvest the profit, right?”**

**“I need to buy the same type of property, don’t I?”**

**“I’ll figure out the exchange part after I sell.”**

In 2026, with shifting interest rates, aging portfolios, and a growing number of long-term owners sitting on highly appreciated assets, these misunderstandings can be costly.

To help clear the air, I sat down with John Starling of Northern 1031 Exchange, a Qualified Intermediary who has spent decades guiding investors through exchanges of all sizes — from small residential properties to complex, multi-property transactions.

My goal was simple: create a practical, plain-English explanation of how 1031 exchanges actually work, when they’re useful, and how landlords should be thinking about them before they list a property for sale.

What follows is a distilled version of that conversation — focused on the questions landlords ask most, and the mistakes that derail exchanges unnecessarily.

## Section 1: What a 1031 Exchange Actually Is (and Isn't)

At its core, a 1031 exchange allows a property owner to sell an investment property and reinvest the proceeds into another investment property without immediately paying capital gains taxes. The key word there is exchange — not sale.

A common misconception is that a 1031 exchange simply means selling a property, holding the cash, and then reinvesting it later. That is not how the IRS views it. The IRS only allows tax deferral if the transaction is structured as an exchange of property for property — which is why a Qualified Intermediary (QI) is required.

In practice, the Qualified Intermediary temporarily steps into the transaction so the seller never takes possession of the sale proceeds. The money from the sale is held by the intermediary and then used to acquire the replacement property on the investor's behalf. This structure is what keeps the exchange compliant.

If the seller touches the money, even briefly, the exchange fails.

### What Must Happen for a Full Tax Deferral

To fully defer capital gains taxes in a 1031 exchange:

1. **All net sale proceeds must be reinvested**
2. **The replacement property (or properties) must be of equal or greater value**
3. **The exchange must follow strict IRS timelines**

If any of those conditions aren't met, the portion that falls short becomes taxable.

This is where confusion often starts. Many investors assume they only need to reinvest their profit. In reality, the IRS treats any cash taken out as taxable first, regardless of how much equity was originally invested.

“ The biggest misconception is that you only have to reinvest the profit. That's simply not how a 1031 works. — John Starling

The important takeaway: a 1031 exchange is not a loophole. It's a very specific, rule-driven strategy that rewards planning and punishes shortcuts.

## Section 2: Like-Kind Property — The Biggest Misunderstanding

If there's one phrase that confuses landlords more than any other, it's "like-kind property."

Many investors assume this means selling a two-family and buying another two-family, or selling a multifamily and buying something similar. In reality, like-kind has nothing to do with property type.

When it comes to real estate, like-kind simply means investment property exchanged for investment property. That's it.

### A landlord can sell:

- A two-family in Cambridge
- and buy:
- A single-family rental
- A mixed-use building
- A commercial property
- Raw land
- Property in another state

“ Like-kind doesn't mean the same property type. It just means investment property for investment property. — John Starling

As long as both properties are held for investment purposes, the exchange can qualify.

### What Does Not Qualify

There are two clear exclusions:

- **Primary residences**
- **True second homes** (properties held purely for personal use)

However, many properties fall into a gray area — especially vacation homes. A beach or ski property can qualify if it is legitimately treated as an investment: rented out regularly and not used excessively for personal purposes.

The IRS generally looks at how the property was used **in the two years before the sale and the two years after the purchase**. If the property was rented and personal use was limited, it may qualify as investment property even if the owner enjoys it occasionally.

This flexibility is powerful — but it requires discipline and documentation.

### Why This Matters Strategically

Understanding like-kind rules opens the door to portfolio optimization. Investors aren't locked into the same type of property forever. They can:

- Trade management-heavy assets for simpler ones
- Shift from appreciation-focused markets to cash-flow markets
- Move closer to where they live or plan to retire

The exchange isn't just about taxes — it's about repositioning a portfolio without unnecessary friction from the IRS.

## Section 3: The Timelines That Quietly Kill 1031 Exchanges

Even investors who understand the basics of a 1031 exchange often underestimate how unforgiving the **timing rules** are.

There are two deadlines that matter — and neither is flexible.

### The 45-Day Identification Period

Once the sale of the relinquished property closes, the clock starts immediately. From that day, the investor has **45 calendar days** to formally identify potential replacement properties.

Not make offers.

Not start looking.

**Identify — in writing.**

The IRS allows several identification methods, but most investors rely on the “three-property rule,” which permits identifying up to three potential replacements regardless of price.

Miss the 45-day deadline, and the exchange is over — even if the investor intended to reinvest every dollar.

Importantly, the 45-day window doesn’t exist in isolation. In most cases, investors already have time **before the closing** of the sale — while the property is under contract — to begin searching and even negotiating replacement opportunities. Waiting until after closing is one of the most common and avoidable mistakes.

### The 180-Day Closing Deadline

The second deadline is the one that truly ends exchanges: **180 days from the sale closing to complete the purchase of the replacement property.**

There are no extensions.

There are no exceptions.

There are no hardship allowances.

If the replacement property doesn’t close by day 180, the exchange fails — regardless of intent or effort.

This becomes especially important with **new construction or properties under development.** While it’s possible to exchange into a newly built property, the construction must be far enough along that closing is realistically achievable within the deadline.

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Any real estate can qualify as investment property — as long as you’re not buying it to live in. — John Starling

For investors considering properties still under construction, the safest approach is identifying projects that are already substantially complete — not speculative timelines that assume perfect execution.

### Why Planning Early Matters

The takeaway here is simple: **1031 exchanges reward preparation.**

Investors who begin planning during the listing or pre-listing phase have significantly more flexibility than those who wait until after the sale closes.

Early planning allows:

- Broader replacement searches
- Better negotiation leverage
- Less pressure-driven decision-making

The exchange clock does not care whether the market is tight, construction is delayed, or inventory is thin. Planning ahead is not optional — it's foundational.

“

The 180-day deadline is absolute. If you miss it, the exchange is done.

— John Starling

## Section 4: Cashing Out, Debt, and Partial Exchanges

Another area where confusion is common is **how much cash an investor can take out** during a 1031 exchange.

The short answer:

You can take cash out — but it's expensive.

Any cash not reinvested becomes **taxable “boot”**, meaning it is taxed immediately at capital gains and applicable recapture rates. Because the IRS treats all cash received as coming from profit first, there's no way to designate a distribution as a return of original investment.

This is why many investors are surprised when they see the actual tax cost of pulling money out at closing.

### Partial 1031 Exchanges

Not every exchange has to be all-or-nothing. Investors can complete partial exchanges, reinvesting most of the proceeds while intentionally cashing out a portion.

This can make sense in situations where liquidity is needed — but it should be done with eyes wide open. The tax cost often leads investors to reduce the amount they planned to withdraw once they see the numbers.

In many cases, what starts as a plan to pull out \$300,000 becomes a much smaller distribution after factoring in taxes.

### A Smarter Way to Access Cash

For investors who want liquidity without sacrificing tax efficiency, there's often a better alternative:

- **Complete the exchange using all sale proceeds**
- **Acquire the replacement property**
- **Refinance the new property after closing**

By refinancing post-exchange, investors can access cash without triggering capital gains taxes — effectively borrowing against the new asset instead of selling equity to the IRS.

### Debt Replacement Matters

One additional wrinkle many investors overlook is **debt replacement**. If the relinquished property had a mortgage, the replacement property must generally carry equal or greater debt — or additional cash must be added — to avoid taxable shortfalls.

This doesn't mean investors must match loan terms exactly, but the overall equity and debt structure needs to be carefully planned with the lender and intermediary involved early.



If you need cash, refinance after the exchange — don't pull it out at the sale. —

John Starling

## Section 5: Cost Segregation and 1031 Exchanges — How They Actually Work Together

Cost segregation has become increasingly popular among higher-income landlords, especially those with W-2 income looking to accelerate depreciation and shelter cash flow. Naturally, many investors wonder whether doing a cost segregation study complicates — or even prevents — a future 1031 exchange.

The short answer: **cost segregation does not eliminate the ability to do a 1031 exchange**, but it does make the transaction more technical and narrows the pool of suitable replacement properties.

When a cost segregation study is performed, portions of the property are reclassified from standard real estate depreciation into accelerated categories. That reclassification follows the investor into the next property during a 1031 exchange.

In practical terms, this means the replacement property must have **enough depreciable components** to absorb what's being carried forward from the relinquished property.

### **Why This Matters for Planning**

Investors who perform cost segregation early in their ownership cycle often enjoy significant tax savings upfront — but they should understand that it can limit flexibility later if they plan to exchange into:

- Raw land
- Properties with minimal improvements
- Assets that don't lend themselves well to accelerated depreciation

That doesn't mean cost segregation is a mistake. In fact, when paired intentionally with a long-term exchange strategy, it can significantly accelerate portfolio growth. The key is **alignment** — making sure the tax strategy today doesn't unintentionally restrict tomorrow's exit options.

For investors considering both strategies, early coordination between their CPA, intermediary, and advisor is critical.

## **Section 6: Massachusetts-Specific Issues Landlords Should Know**

Cost segregation has become increasingly popular among higher-income landlords, especially those with W-2 income looking to accelerate depreciation and shelter cash flow. Naturally, many investors wonder whether doing a cost segregation study complicates — or even prevents — a future 1031 exchange.

While 1031 exchanges are governed by federal tax law, state-level rules can introduce complications — particularly in Massachusetts and other New England states.

### **Nonresident Withholding**

Massachusetts imposes a **nonresident withholding** tax on property sales by out-of-state owners. Without proper filing, a percentage of the sale proceeds may be withheld at closing — even if the seller intends to complete a 1031 exchange.

The good news: there is an exemption process for qualifying exchanges.

The bad news: **it must be handled correctly and on time.**

This is an area where sellers often assume the process is automatic. It's not. Coordination between the intermediary, closing attorney, and seller is essential to prevent unnecessary cash being tied up or delayed.

### **Why Local Knowledge Matters**

Different states handle withholding, reporting, and filing requirements differently. Investors exchanging out of Massachusetts into another state — or vice versa — need to understand that compliance doesn't stop at the federal level.

This is another reason why landlords benefit from involving professionals who routinely handle **Massachusetts-based exchanges**, rather than relying solely on national boilerplate processes.

## **Section 7: When to Start Planning — and Who Should Be Involved**

One of the most consistent themes throughout my conversation with John was timing — not just IRS deadlines, but when investors start thinking about an exchange at all.

Too often, landlords don't consider a 1031 exchange until:

- The property is already under contract
- The closing date is days away
- Or worse, after the sale has already closed

At that point, options are limited or gone entirely.

### **The Right Order of Operations**

For most landlords, the ideal sequence looks like this:

1. **Advisor / agent conversation — does an exchange even make sense?**
2. **Qualified Intermediary consultation — structure, timing, feasibility**
3. **CPA involvement — basis, tax exposure, long-term implications**
4. **Listing and sale execution**

Starting early doesn't obligate an investor to exchange — it simply preserves the option.

## Final Thoughts

A 1031 exchange isn't just a tax tool — it's a **portfolio strategy**.

Used correctly, it allows landlords to:

- Reallocate capital more efficiently
- Improve cash flow
- Reduce management burden
- Defer significant tax exposure
- Scale portfolios faster than traditional buy-and-sell cycles

Used incorrectly, it creates stress, rushed decisions, and avoidable tax bills.

If you own investment property and expect to sell within the next 12–24 months, the most important step isn't choosing a replacement property — it's **starting the conversation early**.

If you'd like to discuss whether a 1031 exchange makes sense for your situation, I'm always happy to talk through it before any decisions are locked in.

**Please feel free to reach out to John directly if you have questions on the process, or scope of what you like to do in 2026 and beyond.**

### John Starling

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