A Basic Guide to a 721 Exchange

WHAT IS A 721 UPREIT EXCHANGE?

Section 721 of the Internal Revenue Code provides an alternative strategy to a Section 1031 exchange for property owners who are interested in selling their real estate assets but who no longer wish to find replacement property as part of a 1031 exchange without paying any tax at the time of the initial Section 721 transaction ("721 Exchange").

Rather than exchanging ownership in real property that has been held for productive use in a trade or business or for investment for another like-kind property, a 721 Exchange allows an investor to contribute such ownership in real property directly to the operating partnership of a real estate investment trust ("REIT") – the entity through which the REIT acquires and owns its properties – in exchange for the option to receive cash or operating partnership units ("OP Units"). This transaction is commonly referred to either as a **"721 Exchange"** or an **"UPREIT transaction"** and is referred to herein as a "FMV Option" and is **frequently used by property owners seeking passive ownership, increased diversification of their holdings while continuing to defer capital gains taxes during the period where the investor holds OP Units[1].**

Upon conversion, the OP Units received will generally have an equivalent value as the contributed property and possess many of the same tax benefits of owning real estate, such as depreciation and mortgage interest deductions, and the owners can benefit from the REIT's capital appreciation and distributions of operating income[2]. Further, UPREITs commonly feature a conversion option which allows the owner to convert their OP Units into common shares of the REIT ("REIT Common Shares") at a later point in time. However, the conversion of OP Units into REIT Common Shares will be a taxable transaction.

Owning shares in a professionally managed REIT also provides investors with a low-maintenance real estate investment vehicle with the benefits of a diversified real estate holding portfolio and can provide eventual liquidity needs to the holder or their heirs at their discretion to the extent a public market exists for such REIT Common Shares.

721 Exchange Tax-Deferral

Section 721 of the Internal Revenue Code states that no gain or loss will be recognized when property is contributed to a partnership in exchange for an interest in the partnership.

1) Section 721 of the Internal Revenue Code of 1986, as amended, contains specific requirements that must be met in order to qualify for the tax deferral provided by such provision. Nothing contained in this brochure constitutes tax advice, and individuals should consult their own tax and other advisors when considering such transactions.
2) Any fees and/or expenses may reduce the value of the OP Units relative to the property value.

THE 721 EXCHANGE PROCESS AND OVERVIEW

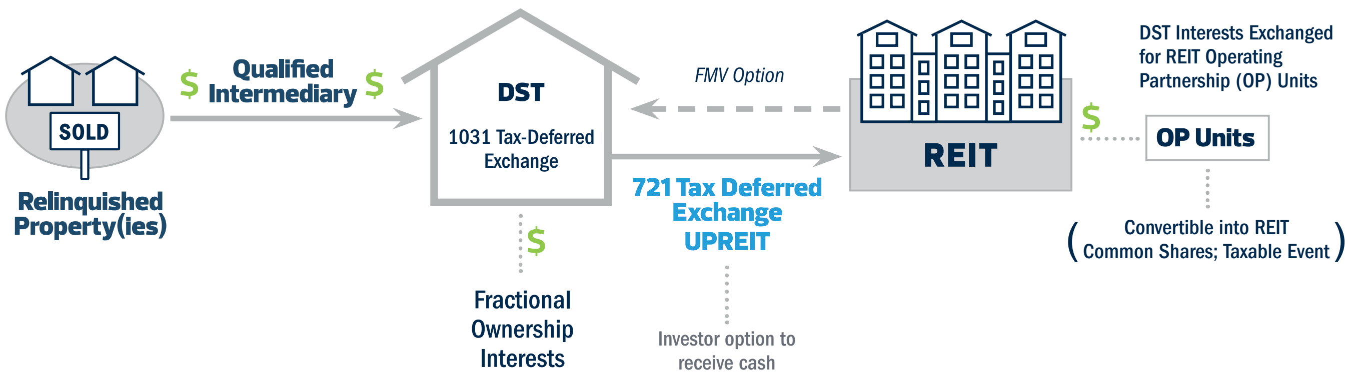
The following represents the two-step process of a Section 721 exchange in a DST/UPREIT platform:

1. DST Phase: The investor sells the relinquished property and completes a section 1031 exchange by acquiring fractional ownership interest in a Delaware Statutory Trust ("DST") which serves as their replacement property.

2. OP Unit Phase: Beginning after a two-year holding period, the REIT's operating partnership will have the option to compel the investors to contribute their fractional ownership interest in the DST through a 721 exchange for OP Units in a REIT's operating partnership, known as an UPREIT, or Umbrella Partnership Real Estate Investment Trust.

A More Complete STEP-BY-STEP example is presented below:

1031 EXCHANGE TO 721 EXCHANGE



STEP 1 — 1031 EXCHANGE INTO A DST

Investor sells their real property(ies) and completes a Section 1031 exchange receiving fractional beneficial ownership interests in a Delaware Statutory Trust (DST) with passive ownership and anticipated receipt of quarterly distributions from the DST.

Investor holds ownership of the DST for at least 2 years after which time a REIT's Operating Partnership (OP) may exercise its purchase option to acquire the investor's beneficial ownership interests in the DST.

STEP 2 — RECEIVE OP UNITS

If the OP elects to exercise the FMV Option, the investor receives OP Units from the OP. Via the ownership of OP Units, the investor now owns an interest in the REIT's diversified portfolio of professionally managed institutional quality assets while benefiting from it's potential for capital appreciation and receiving monthly distributions.

Investor must hold the OP Units for at least one year and then the investor has the option to have their OP Units redeemed in exchange for REIT Common Shares or cash.

STEP 3 — HOLD OP UNITS OR SHARES OR SELL

Investors may hold their OP units or REIT Common Shares in perpetuity and continue to receive income or sell OP Units / REIT Common Shares and pay tax on the amount sold in that tax year. OP Units are fully divisible and a decendent's estate will receive a step-up in basis upon death.

POTENTIAL BENEFITS OF A 721 EXCHANGE

Contributing a single real estate asset for OP Units may provide investors with the following benefits[2]:

Tax Deferral	A 721 Exchange allows an investor to defer capital gains taxes on the sale of real property at the time of the transaction. Capital gains and deprecation recapture are deferred until the investor sells the OP Units or converts the OP Units to REIT Common Shares.
Income	REITs typically pay cash distributions to their shareholders, a portion of which may also be tax deferred.
Diversification	A 721 Exchange enables an investor to significantly diversify their initial Section 1031 investment by exchanging interests in one DST for interests in a larger portfolio of properties by realizing the benefits of the REIT's entire portfolio of assets.
Increased Liquidity	A 721 Exchange allows an investor to potentially increase liquidity by converting some or all of the OP Units into REIT Common Shares, which can then be sold and converted to cash more easily than DST interests, thereby managing the capital gains they receive over time.
Passive Investment	A 721 Exchange allows investors to trade out of an actively managed real estate asset and passively take advantage of a diversified portfolio of real estate assets that are professionally managed by the expertise of an institutional asset management firm. The REIT's OP Units are passive investments, structured to provide acquisitions, property management, dispositions, investor communication, and the distribution of income produced from the underlying portfolio.
Estate Planning	A 721 Exchange provides an investor with a tailored solution to pass their assets to their heirs. Upon death, REIT Common Shares are easily divisible and can either be held or liquidated by the beneficiaries. Because these shares are passed through from the estate or by a trust, the beneficiaries receive a stepped-up basis to current market value for taxation purposes resulting in permanent tax deferral of capital gains and depreciation recapture.

2) The advantages of a 721 Exchange are contingent upon the OP electing to exercise the FMV Option.

There can be no assurance that any investment strategy will achieve its objectives, generate profits or avoid losses.

When is the End of Tax Deferral/Can an Investor Perform a 1031 Exchange After a 721 Exchange?

If the OP elects to exercise the FMV Option, the completion of the 721 Exchange transaction marks the end of an investor's 1031 exchange capabilities, as REIT shares themselves are not eligible to be used in a 1031 exchange. The OP Units they receive as part of the 721 Exchange can be converted into traditional REIT Common Shares which can then be sold or converted to cash. This transaction would cause a taxable event and investors will be required to recognize any capital gain or loss and any depreciation recapture in the year the liquidation of shares occurs, but it demonstrates how OP Units are much more liquid than traditional real estate ownership.

A Popular Estate Planning Tool

A 721 Exchange is a popular estate planning tool because taxes can be spread out over time (capital gains taxes are paid only on the amount of shares sold at any given time) and upon death, assets can be passed through to heirs at a stepped-up basis with permanent tax deferral of capital gains.

BVEX is a national sponsor of syndicated 1031 exchange offerings with a focus on institutional quality residential and industrial properties in high growth markets that can deliver stable cash flows and have the potential for value creation with more than $2 billion in prior syndicated 1031 exchange programs. BVEX is an affiliate of Bluerock Real Estate, L.L.C., a leading institutional alternative asset manager based in New York with regional offices across the U.S. Bluerock principals have a collective 100+ years of investing experience with more than $48 billion real estate and capital markets experience and manage multiple well-recognized real estate private and public company platforms. Today Bluerock has more than $14 billion in acquired and managed assets and offers a complementary suite of public and private investment programs, with both short and long-term goals, to individual investors seeking solutions aimed at providing predictable income, capital growth, and tax benefits.

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Potential Risks

There is no guarantee of success. Investors could incur a loss of all or a portion of their investment.

- No public market exists for DST Interests, and one is highly unlikely that any such market will develop.
- There is no guarantee that an investor will be able to exchange their DST Interests for OP Units in an 721 Exchange.
- There is no specified time that any property held by a DST will be liquidated and the DST may not be able to sell any or all of the properties at a price equal to or greater than the purchase price paid for the DST Interests.
- Delaware statutory trusts are a relatively new vehicle for real estate investment and are inflexible vehicles to own real property.
- If a property is transferred (or the DST is converted) to a Springing LLC, investors will likely lose their ability to participate in a future Code Section 1031 Exchange with respect to the transferred property or properties.
- Investors typically have no voting rights and will have no control over management of the DST or the properties.
- There is no guarantee that investors will receive any return.
- There is no guarantee of success. Investors could incur a loss of all or a portion of their investment.
- As a partner in a partnership, a holder of OP Units may be allocated taxable income in excess of cash distributions it receives. Such holder may need to find alternative sources of cash to pay the tax liability on its allocated income.
- The qualification requirements for a REIT are complex. There is no guarantee that, after a 721 Exchange, such REIT will continue to qualify as a REIT, which could adversely affect its operations and its ability to make distributions.

Specific 1031 Exchange Risks

1031 Exchanges are highly complex and failure to comply with the stringent requirements may result in a complete loss of the desired tax deferral. Investors should carefully consult with independent tax and legal counsel prior to initiating, and while performing, a tax-deferred exchange.