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1031 EXCHANGE SERVICES LLC

The Lifecycle of Your 1031 Exchange Funds: From Receipt to Disbursement

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Would you hand a stranger hundreds of thousands or even millions of dollars with no assurance that a regulator, an auditor, or a single set of internal controls stands between your money and financial disaster?

That is precisely what many real estate investors and their advisors do every day when they select a 1031 exchange qualified intermediary. And most of them never realize the significant hidden risks they are taking.

Here is the uncomfortable truth: the 1031 exchange qualified intermediary industry has no licensing body, no regulatory authority, and no audit requirements to provide independent oversight. Qualified intermediaries (also called accommodators or facilitators or QI) are not licensed, not regulated, and not audited or examined. They carry no mandated minimum insurance and no regulatory required equity capital reserves. Worse still, most hold client exchange funds in their own corporate name, exposing those funds to catastrophic loss if the firm ever fails.

This article pulls back the curtain on what actually happens to your 1031 exchange funds from the moment they arrive until the moment they are disbursed by the qualified intermediary and explains why the way those funds are held matters more than almost any other decision you will make in your tax-deferred exchange.

The Fund-Holding Problem No One Talks About

In a 1031 exchange, the taxpayer cannot take actual receipt or have constructive receipt of the net proceeds from the sale of their relinquished property. If they do, the like-kind exchange fails, and the transaction becomes a taxable sale rather than tax-deferred. To prevent this 1031 failure, a qualified intermediary must receive and hold your exchange proceeds throughout your transaction. This should also include significant policies and procedures used to safeguard and protect your exchange funds.

This makes the qualified intermediary the temporary custodian of enormous sums of client money. And yet, in an industry with no national licensing framework or regulated requirements, the protections surrounding that money can vary dramatically from one 1031 to the next.

The consequences are not hypothetical.

A Cautionary Tale: LandAmerica 1031 Exchange Services

In the LandAmerica 1031 Exchange Services bankruptcy case—one of the industry's largest failures—the bankruptcy court ruled that clients' 1031 exchange funds were corporate funds, not client trust funds. Because those funds had not been held in qualified trust accounts or qualified escrow accounts, they were subject to general creditor claims in bankruptcy.

The court went a step further, noting that had the funds been held in qualified trust accounts or qualified escrow accounts as the Treasury Regulations permit, it would have ruled otherwise, since the funds would have clearly been held as client trust funds.

The lesson is stark. When a qualified intermediary holds your funds in its corporate name and then fails, your exchange proceeds can be swept into the bankruptcy estate alongside the firm's own creditors. The more important lesson, however, is this: most qualified intermediary failures could have been prevented in the first place through regulatory oversight.

The Life Cycle of Your 1031 Exchange Funds

Understanding how a best-practices qualified intermediary handles funds requires following those funds through the entire transaction. Here is the step-by-step journey your exchange proceeds should take.

Step 1: Receipt of Your Exchange Proceeds

When the sale of your relinquished property closes, the net proceeds are wired directly from the escrow company or settlement agent to the qualified intermediary—never to you. This preserves the exchange structure by preventing your actual or constructive receipt of the funds. At this stage, the critical question is not whether the funds arrive, but where they land and how they are protected.

At Exeter 1031 Exchange Services, LLC (Exeter1031™), incoming funds are deposited into separate, segregated, dual-signature, restricted qualified trust accounts established through Exeter Trust Company (ExeterTrust™) for each individual 1031 exchange. Your funds are never commingled with corporate operating capital.

Step 2: Holding and Safeguarding Your Funds

Once received, the funds must be held in a manner that legally protects them as client trust funds. This is where the difference between qualified intermediaries becomes most consequential.

Exeter1031™ deposits, holds, and safeguards clients' 1031 exchange funds in separate, segregated, dual-signature, restricted qualified trust accounts with ExeterTrust™. The dual-signature requirement means that both the client and authorized exchange representatives must sign any disbursement request. Exeter1031™ and ExeterTrust™ cannot move a single dollar without the client's written authorization.

This structure directly addresses the failure exposed in the LandAmerica 1031 case. Funds held in 1031 qualified trust accounts are clearly classified and treated as client trust funds and not corporate funds in the event of a bankruptcy filing by the qualified intermediary.

Step 3: Managing and Protecting the Funds While Held

Holding funds safely is not a passive activity. It demands rigorous best practices, including tight internal controls, dual-controlled disbursement processes, continuous reconciliation, and layered financial protections.

ExeterTrust™ uses a sophisticated trust accounting system that tracks, monitors, and accounts for client exchange funds in real time. The entire client trust fund position is reconciled to the penny every single day.

The internal controls governing any movement of 1031 funds are deliberately stringent:

It takes four (4) separate Exeter team members, acting together, to request, authorize, process, and complete any transfer or disbursement of client funds. Those four team members must also have the client's written authorization through the dual-signature requirement.

A telephone call-back to a trusted phone number is always used to verbally verify and confirm wire transfer instructions before any funds are sent out.

Layered on top of these controls are substantial financial protections. The Exeter Group of Companies maintains:

- $15.0 million in fidelity bond coverage (crime insurance covering theft of funds);

- $10.0 million in errors and omissions insurance (covering administrative mistakes);
- $15.0 million in cyber fraud and wire transfer fraud insurance;
- A $15.0 million financial institution blanket bond; and
- More than $8.0 million in equity capital reserves

Step 4: FDIC Insurance and Where the Funds Actually Sit

Even a well-controlled account is only as safe as the bank holding it. That is why fund allocation across several banking institutions matters.

As a trust company, ExeterTrust™ automatically spreads clients' exchange funds across numerous commercial banks, providing FDIC insurance coverage far exceeding the standard $250,000 limit. For larger transactions, ExeterTrust™ offers an Insured Cash Sweep (ICS) vehicle that provides up to $150.0 million in FDIC insurance coverage.

The banks themselves are not chosen casually. Every potential bank must pass numerous due diligence tests, including a six-quarter trend-line analysis of its FDIC Call Reports and a review by Exeter Trust Company's compliance officer. That review is submitted to the Chief Executive Officer and then to the Board of Directors of Exeter Trust Company for final approval—and the entire review and approval process is repeated every calendar quarter.

Step 5: Investing the Exchange Funds

How exchange funds are invested while held by the qualified intermediary is a question every investor should ask and every reputable qualified intermediary should answer in writing.

A best-practices qualified intermediary operates under a formal 1031 exchange investment policy and provides a disclosure statement explaining how exchange funds are invested. This transparency ensures investors understand exactly how their proceeds are managed during the exchange period, with the safety and liquidity of principal treated as the paramount objective. Exeter provides this clarity so that investors and their advisors know precisely where their money is and how it is handled at every stage of the 1031 exchange.

Step 6: Disbursement of the Funds

When it is time to acquire the replacement property, the qualified intermediary disburses the funds to the escrow company, closing agent or closing attorney to complete the purchase. This is the moment when every internal control is tested.

At Exeter, no disbursement occurs without the coordinated action of four separate Exeter team members, the client's dual-signature written authorization, and verbal confirmation of the wire instructions through a telephone call-back. Only then are the funds released to complete the acquisition of the replacement property and finalize the tax-deferred exchange.

Why Regulatory Oversight Is the Rarest and Most Important Protection

Every safeguard described above is meaningful. But the single most reliable indicator that a qualified intermediary operates under industry best practices is something most firms simply do not have: independent regulatory oversight and audit.

Because the qualified intermediary industry has no licensing body of its own, a firm subject to genuine regulation has chosen to be. That choice speaks volumes.

Exeter 1031 Exchange Services, LLC took the rigorous, multi-year path of applying for and obtaining its own trust company charter. The result was Exeter Trust Company, which is licensed, regulated, and audited by the Wyoming

Division of Banking. This can be independently verified by searching the internet under State of Wyoming, Division of Banking, list of licensed trust companies.

Regulatory oversight delivers protections that unregulated firms cannot match:

- Regulatory examinations by the Wyoming Division of Banking
- Annual CPA audits of financial statements
- Annual CPA audits of policies and procedures to ensure they are being followed, including the 1031 Exchange Funds Investment Policy and Disclosure Statement
- Minimum equity capital reserve requirements enforced by a regulator
- Established banking standards and operational discipline

There is a further, often-overlooked benefit. Regulatory oversight tends to elevate the entire industry, because best practices learned from one regulated entity are pushed out to all regulated entities. If your qualified intermediary is regulated, it operates under best practices. Firms that are not regulated simply do not have that access.

Most qualified intermediary failures could have been prevented through regulatory oversight and independent annual regulatory examinations. Preventing the failure in the first place is far more valuable than litigating over who gets paid after a failure occurs.

What Every Investor Should Verify Before Handing Over a Dime

It is not the size of the qualified intermediary that matters but how the 1031 company manages your funds and controls risk. Before you transfer your exchange proceeds, verify the following in writing:

- Is the firm licensed and regulated, and by whom?
- Does it undergo regulatory examinations and independent CPA audits?
- Are funds held in separate, segregated, dual-signature, restricted qualified trust accounts or qualified escrow accounts?
- What bonding and insurance coverage is in place (i.e., fidelity bond, E&O, cyber fraud, wire transfer fraud, and financial institution blanket bond)?
- How much equity capital does the firm maintain?
- How is FDIC insurance coverage maximized across banking institutions?
- What internal controls govern the disbursement of funds?
- Is there a formal investment policy and disclosure statement for how exchange funds are invested?

A reliable, best practices qualified intermediary should answer every one of these questions directly, factually, and in writing.

Protect Your Exchange with a Best-Practices Qualified Intermediary

Your 1031 exchange funds represent the equity of a lifetime of investment. They deserve more than a promise; they deserve regulatory oversight, independent audits and exams, robust internal controls, substantial bonding, insurance and capital reserves, and the protection of separate, segregated, dual-signature, restricted qualified trust accounts.

Exeter 1031 Exchange Services, LLC delivers all of this, backed by Exeter Trust Company's license, regulation, and audits from the Wyoming Division of Banking, making Exeter1031™ one of the safest and most secure qualified intermediaries in the industry today.

Before you close on the sale of your relinquished property, consult with the 1031 specialists at Exeter 1031 Exchange Services, LLC. Our exchange specialists are available any time during the day or night to answer your questions and ensure your exchange funds are received, safeguarded, invested, and disbursed with the care and discipline they deserve.