# The Ultimate Guide to **Using Royalties in a 1031 Exchange.**

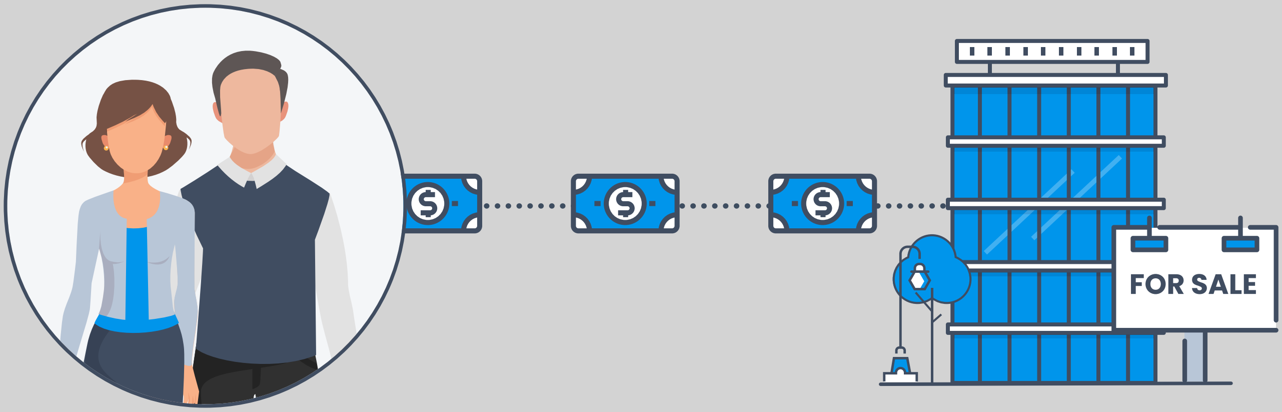
RESOURCE ROYALTY LLC

UNCONVENTIONAL ROYALTY

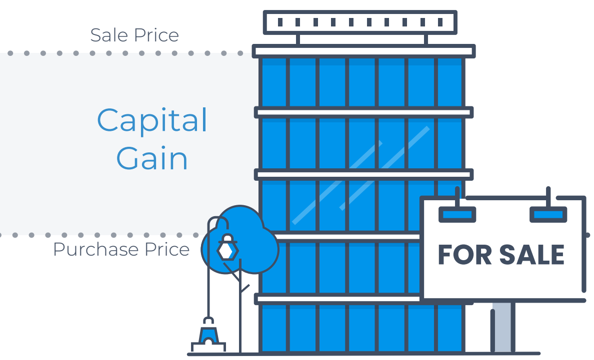
# Meet the Masons.

They've recently accepted an offer an office complex they own and would like to defer their taxable gain.

They have consulted with their Tax and Financial Advisors, and rather than paying the tax on the gain; ***they may utilize a 1031 exchange.***



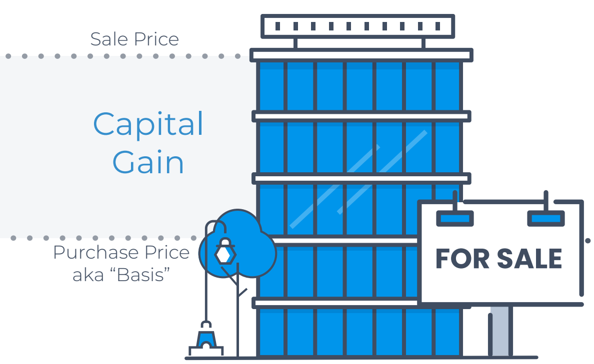

## Option 1: Traditional Sale




Taxes May exceed **20-35%** of the capital gain.


May include:
- Federal Taxes
- State Taxes
- Depreciation Recapture
- Net Investment Income Tax

## Option 2: 1031 Exchange




**Defer 100%** of capital gains tax!


Benefits include:
- Tax Deferral
- Wealth Preservation
- Attractive Income Potential
- Efficient Estate Planning

★ **PLUS,** the Mason's can continue the 1031 process until it is time to pass their assets to their heirs.

At that time, the basis, aka the purchase price of their asset, "steps-up", which means their heirs can sell the asset at current value and recognize **ZERO** capital gains!

*FINRA reviewed*

# The 1031 Exchange Process

| | | |
|---|---|---|
| STEP 1. | **Sell Your Property** | Relinquish your investment property and utilize a 1031 exchange. |
| STEP 2. | **Engage Qualified Intermediary** | When you sell your property, you cannot receive the sales proceeds, or you will have to pay the taxes. In order to complete a 1031 exchange, the proceeds must be held by a Qualified Intermediary. |
| STEP 3. | **Identify Replacement Property** | Once the Q.I. has possession of your funds, you will work with your trusted investment advisor to identify appropriate replacement properties. |
| STEP 4. | **Purchase Property or Properties** | Once you have identified which properties you would like to purchase, the Q.I. will forward the funds for closing and complete the 1031 Exchange. |

## The Three Simple Rules

### Replacement properties must be "like-kind".

Like-Kind" is a designation made by the IRS, which includes all deed, real property that is used for commercial or investment use. An individual and purchase any "like-kind" real estate and comply with 1031 guidelines. *Their personal residence or vacation property* *__does not__* *qualify for a 1031.*

### All funds must be reinvested.

You must use all the proceeds from the sale of your relinquished property. You must reinvest all proceeds in order not to pay the capital gains. As a result, the replacement property, or properties, must be equal or greater in value.

### You must find a home for your debt.

If your relinquished property has remaining leverage on it, you must find a home to service that debt. If you have remaining exchange proceeds after the debt is serviced, you can purchase an "all cash" option and avoid a "cash boot." Mineral interests and royalties are often used as an all-cash solution.

# How to Identify Your Replacement Properties.

Investors have the choice of three different identification rules for identifying replacement properties. They **only need to comply with one of these rules** to conduct an exchange.

## 3 Property Rule

Investors can Identify three replacement properties regardless of their total value. Investors can then choose to exchange into one individual property or all three.


or

## 95% Rule

Investors can identify any number of replacement properties, regardless of their total value, if the replacement properties acquired amount to at least 95% of the total value of all the identified properties.

at least 95%

or

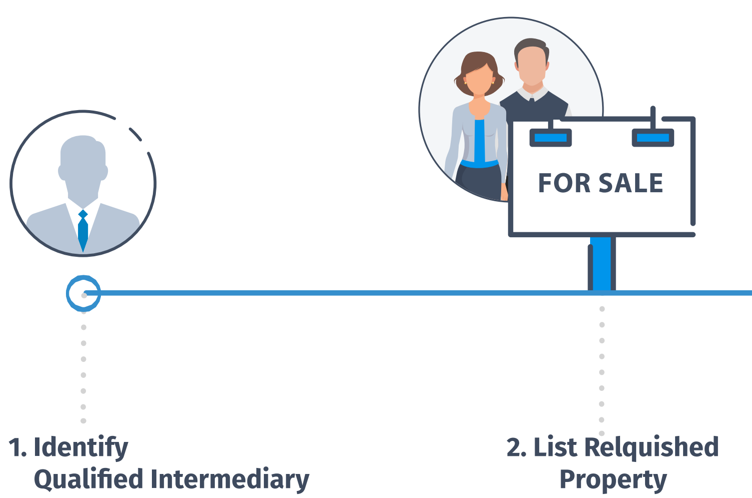
## 200% Rule

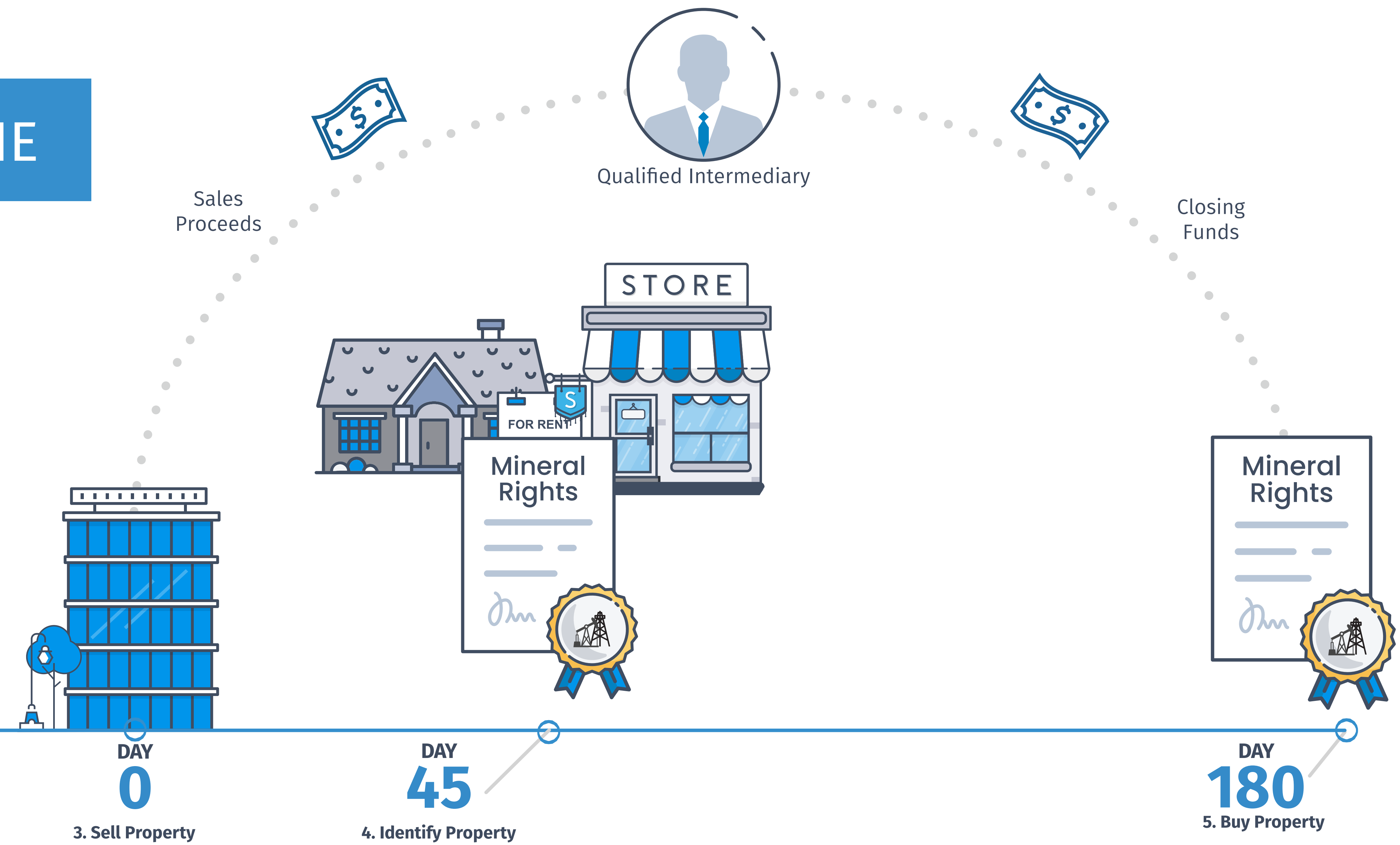
Investors can identify any number of replacement properties so long as their total value does not exceed 200% of the total value of the relinquished property.

not more than 200%

## 1031 EXCHANGE TIMELINE

The 1031 Exchange process follows a strict timeline. Once you sell your property, you have 45 days to identify your replacement properties and 180 days to purchase them. Remember, you cannot receive receipt of the proceeds of your sale; you must use a Qualified Intermediary.

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# Royalties Are “Like-Kind”

Since 1954, millions of real estate investors across the country have taken advantage of 1031, tax-deferral “like-kind” exchanges. It is commonly thought that is this the IRS “like-kind” designation only qualifies for traditional, brick-and-mortar real estate, such as an apartment building, office building, or retail property. But what is not widely known, and maybe the best-kept secret of some of the country’s wealthiest families and institutions is that this “like-kind” designation includes Mineral Rights & Royalties!

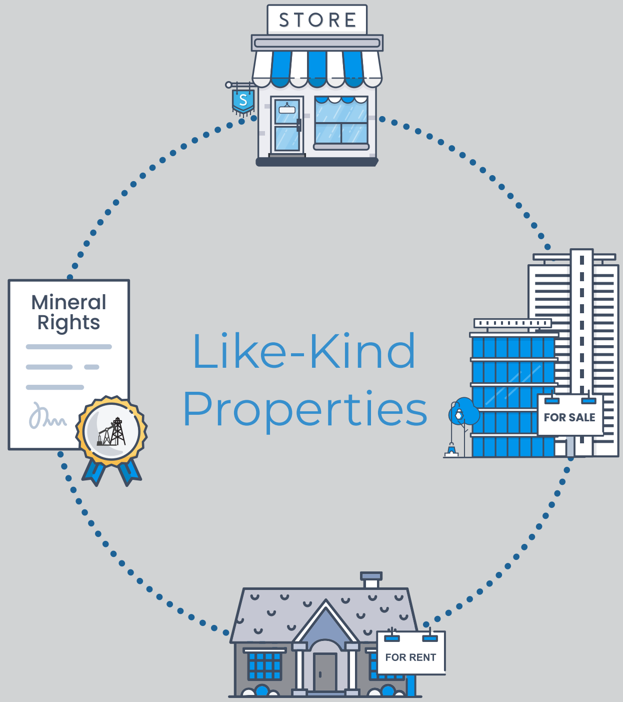

Retail


Residential & Multi-Family Properties


Mineral Rights & Royalties

Office

Which means the Mason’s can “1031” out of their office complex and purchase mineral rights, and vice versa!

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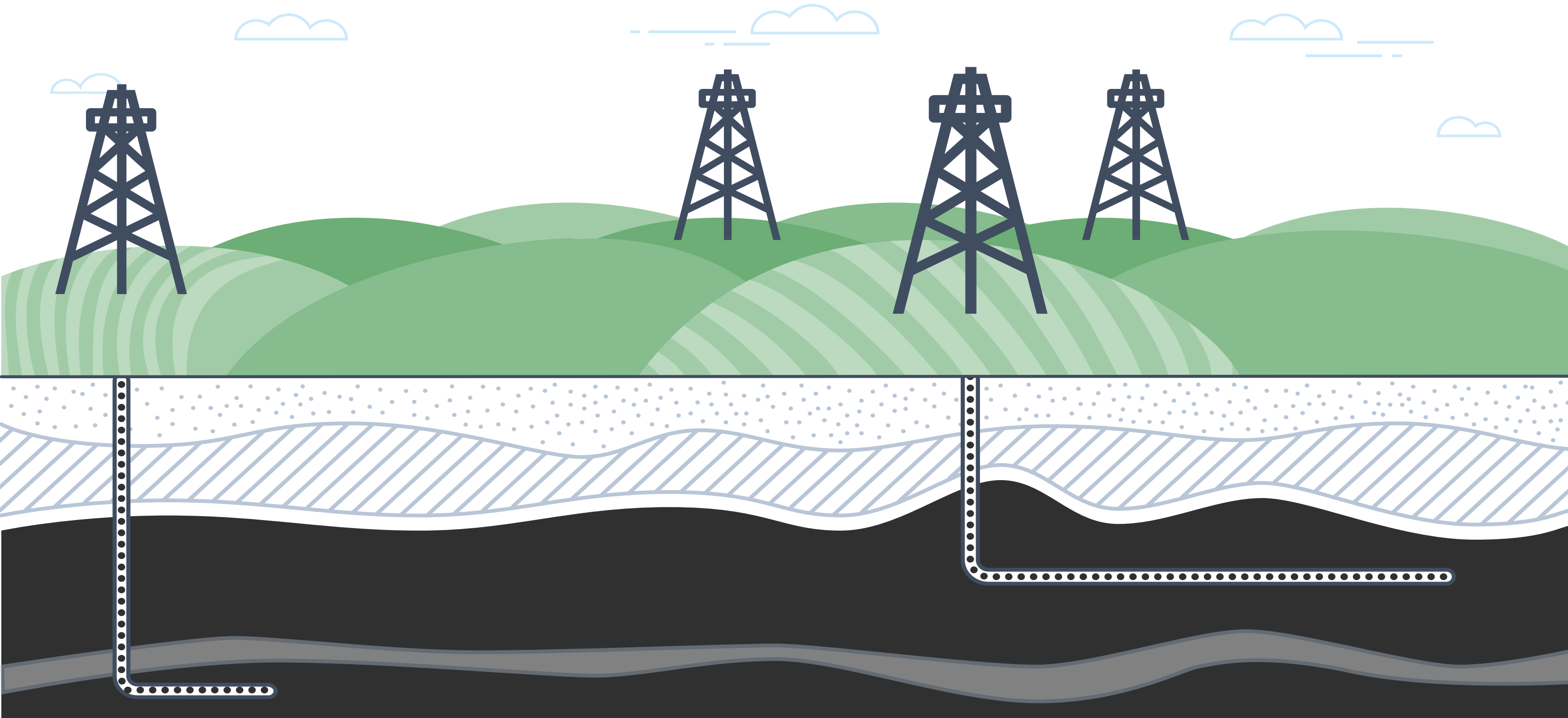
# What Are Mineral Rights?



**Mineral Rights are the deeded real estate beneath the surface.**

**Mineral Owners hold interest in this subsurface real estate—from the crust to the core—and are entitled to compensation for everything produced from their land.**

***Mineral owners do not partake in the drilling of wells and are free and clear of any drilling costs or liabilities.***

# 0

## drilling costs

## operational expenses

## operational liabilities

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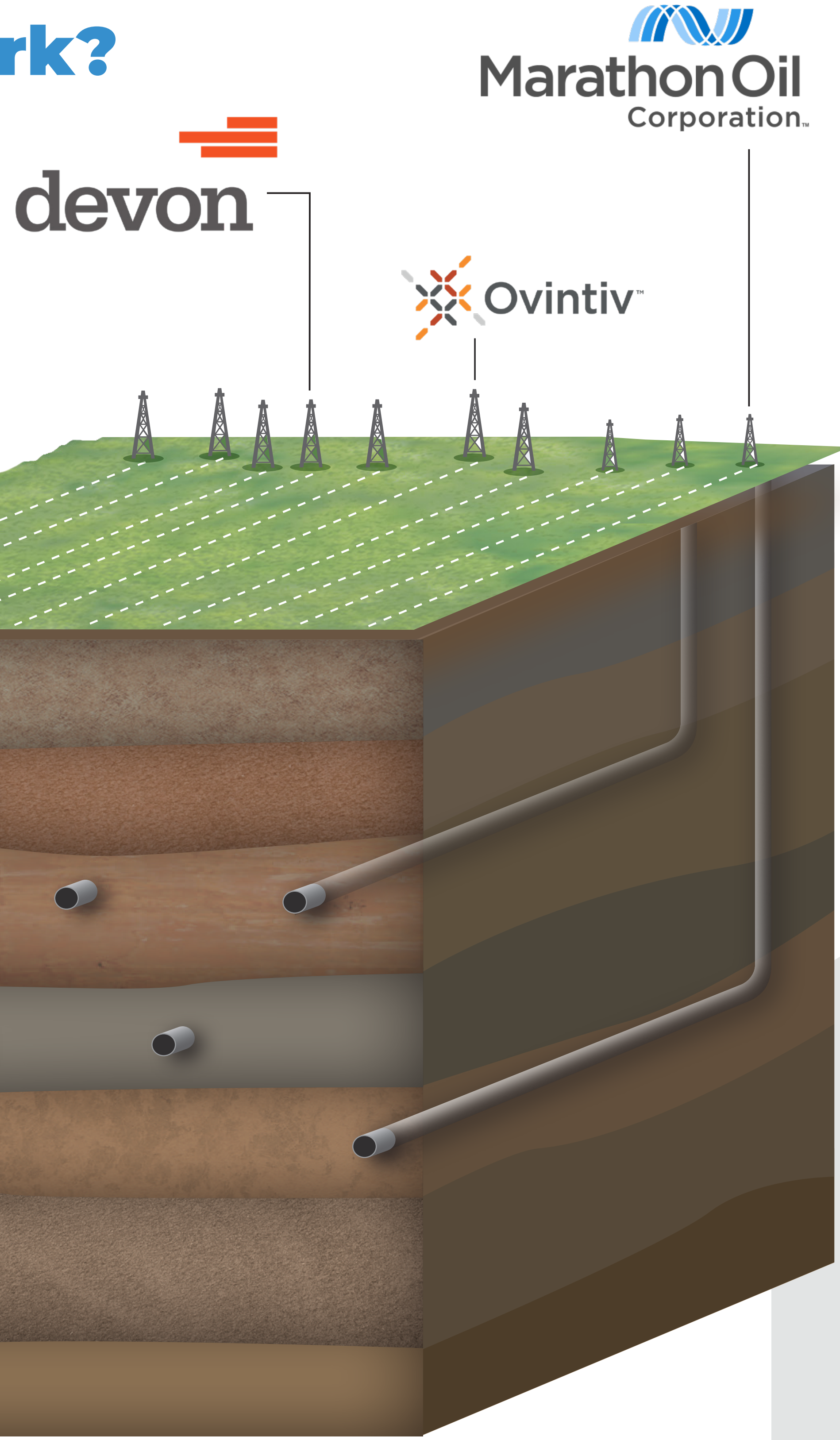
# Royalties.
# How Do They Work?

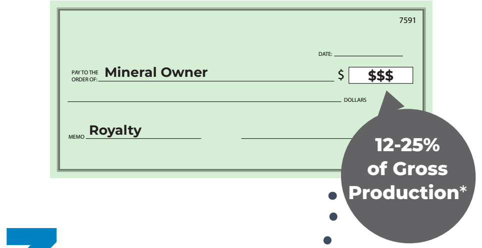
## 1.
### Mineral Owners Do Not Drill Wells.

Mineral Owners hold interest in the real estate beneath the surface, known as the mineral interest, and are entitled to compensation for everything produced from their land.



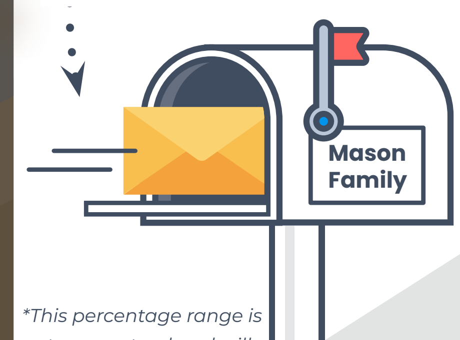

## 2.
### Energy Companies must pay a percentage to the Mineral Owners.

As energy companies, such as Devon Energy and Continental Resources, drill wells and produce hydrocarbons, they are required to pay a percentage of gross revenue to the Mineral Owners. This is called a Royalty. The energy companies, known as operators, pay all drilling and operating expenses in addition to assuming all drilling risks and liabilities.




## 3.
### Mineral Owners receive monthly royalty checks.

Mineral Owners receive monthly royalty payments from the energy companies based on the oil and gas produced on their property.




*This percentage range is not guaranteed and will vary based on individual lease agreements.

Royalty Owners are entitled to a ***15% tax depletion allowance*** on their income received.

The Mason's will not only receive income from the wells that pass through their acreage; ***they will receive income from every producing well within their drilling section,*** which is typically 640 acres.

This is like owning in an office building downtown and receiving a portion of the income from every building in a square-mile radius!

A Comparison of

# 1031 EXCHANGE DST REAL ESTATE INVESTMENTS

# VS.

# 1031 EXCHANGE ROYALTY INVESTMENTS

## 1031 Exchange DST Real Estate Investments

### Leverage
Real estate is typically purchased using leverage. Debt opens the door for a variety of risks including interest rate, refinancing, sensitivity to occupancy, and valuation risks. Leverage is utilized to boost cash flow to investors, but if the property is impaired, there is risk of foreclosure.

### Income Characteristics
While known to provide stable & moderate cash flow over the investment horizon, investors forgo future upside potential in exchange for more stable returns.

### Concentration risk and Market Exposure
While there are many sub-categories available to investors, there is seldom significant diversification within a single DST offering.

### Control
Typical 1031 exchange eligible real estate offerings, such as DST's, provide investors limited ownership and limited control of their holding period or exit strategy. In addition, the trustee may have limited ability to recover an impaired property.

### Cash Boot
The value of a replacement property must be equal to or greater than the value of the relinquished property. Any remaining proceeds that are not invest will be encumbered by capital gains taxes. These proceeds are often referred to as a "Cash Boot".

## 1031 Exchange Royalty Investments

### Leverage
Royalties are purchased with zero leverage or debt. While income may be reduced during a down market, there is zero risk of foreclosure to the owners.

### Income Characteristics
Royalty portfolios may be structured to generate current income while additionally providing upside potential for increased income. Income levels will vary over time and are dependent on commodity prices & production levels.

### Concentration risk and Market Exposure
Historically, Mineral Rights and Royalties have proven to be uncorrelated to real estate assets and are sensitive to unique market conditions and risks, such as commodity price variability, production risks, and regulatory restrictions.  Royalties may be used as a hedge against rising energy, gas prices, or potential regulatory restrictions on new production.

### Control
While they do not have operational control, Mineral Owners directly hold the deeds and titles for their assets and have complete control and ownership of their holdings. They are untethered from other investors and are free to dictate their holding period and exit strategy, which may have limited liquidity.*

### Cash Boot
Royalties are a debt-free asset and can be used to avoid a "cash boot" by aligning the debt-to-equity ratio of a replacement property or properties.

*There can be no assurance there will be a reasonable market for the royalties owned if a royalty owner decides to liquidate.

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# Consider the Risks

- **Investment in oil and gas Royalties is speculative and involves a high degree of risk; investors should be able to bear the complete loss of their investment.**
- Oil and natural gas prices will fluctuate.
- Production levels will fluctuate.
- Operators are not obligated to drill or keep wells in production.
- Regulatory changes.
- There is no assurance that the Offering will achieve all or any of its investment objectives.
- Risks include dry wells, unpredictable oil and gas commodity prices.
- Production rates may be variable from region to region. Past performance is not indicative of future results.
- There is no assurance that these targets will be met.
- There is no assurance that additional drilling will take place or will achieve successful results.
- Risk factors including commodity prices and production can significantly impact the value of the asset and ability for an investor to get liquid.
- This material may contain forward-looking statements that are based on expectations and assumptions that are subject to risk and uncertainties.
- Actual results could differ materially because of changes to those expectations and assumptions.
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