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1031 tax-deferred exchanges will continue to trend upward in 2019 - by Brendan Greene

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While it is nearly impossible to predict what the future holds for the real estate market and 1031 exchanges, we believe that the low interest rates will help keep the real estate market strong for investors and developers for the second half of 2019. The real estate market in the Greater Boston Area and throughout New England over the past several years has led to an increase in 1031 tax-deferred exchanges by both domestic and foreign investors. We believe that trend will continue in the second half of 2019.

Internal Revenue Code (IRC) Section 1031 allows a property owner, who holds property for “the productive use in a trade or business or for investment”, to defer paying capital gains taxes if the property owner sells such property, identifies “like kind” property within forty-five days of the sale, and acquires other “like kind” property within one hundred eighty days of the sale.

The increase in property values throughout New England and specifically in Massachusetts has given investors large equities in their properties subjecting them to higher capital gains taxes on the sale of such properties. Consequently, more investors, both U.S. and foreign, are using 1031 tax-deferred exchanges in order to defer paying capital gains taxes. Investors enter into exchanges for a number of different reasons. They may want to diversify (sell one large property and buy multiple smaller properties), consolidate (sell multiple smaller properties for one large property) or purchase other investment property that has a better income stream, is easier to manage or has more upside than the property they currently own.

The real estate market nationally has also seen steady growth. For instance, following the housing market decline in 2007, single-family rental properties became favorable options for investors, saving in construction or refurbishment prices. The quick turnaround for an owner to rent out their property means cash flow is almost immediate. Single-family rental homes have grown up to 30% within the last three years.

CoreLogic, a leading provider of consumer, financial and property information and analysis, reports that “U.S. single-family rents increased 3% year over year in May 2019, up from a 2.8% increase in May 2018, according to the CoreLogic Single-Family Rent Index (SFRI). The index measures rent changes among single-family rental homes, including condominiums, using a repeat-rent analysis to measure the same rental properties over time. Single-family rents climbed steadily starting in 2010, and annual rent increases have stabilized, fluctuating between 2.9% and 3.2% for the past 12 months.”

Locally, there is room for more optimism. Greater Boston has some of the best universities, hospitals, and tech companies in the world which will continue to drive demand for rental properties. While a price slow-down or small correction seems inevitable, there is still plenty of evidence that the real estate market remains strong in the Greater Boston area. While many urban areas in the U.S. are losing residents, Boston continues to add new housing and new residents year after year. This is very attractive for investors.

Most economists continue to predict an increase in incomes. With rents expected to slowly continue rising or stabilizing, and with interest rates remaining relatively low, the purchase of rental properties in Massachusetts and New England continues to be an attractive investment. As rental rates stabilize and incomes rise, these factors will lead to an increase in rentals. The resulting increases in the rental real estate market will then further the upward trend in 1031 tax-deferred exchanges.

With the very active and rising real estate market in the area, we see many investors looking to act quickly on exchanges and as a result we have seen a significant increase in reverse and improvement exchanges where investors have acquired replacement property before selling their existing investment properties. This allows investors much greater flexibility to accomplish an exchange and if properly structured, will have a successful result in deferring capital gains taxes.

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