



nerej

Increased multi-family market values surpass the hike in capital gains tax

October 30, 2014 - Spotlights

The New England multi-family market experienced both an increase in market value and Federal taxes in 2013. Between 2012 and 2013, the combination of high investor demand, limited inventory, and low interest rates fueled rapid appreciation in the region. Values increased 8.4% in Massachusetts, 9.2% in New Hampshire, 23% in Rhode Island, and a staggering 27% in Connecticut. Despite the large increase in building value, owners remained timid to sell due to a 5% increase in the capital gains tax and a new additional 3.8% increase from the Affordable Care Act. While multi-family sales were driven by the fear of these new taxes in 2012, a sense of general acceptance has grown over investors that these taxes will be here for some time and business must go on. Fortunately for building owners the surge in multi-family property value has trumped the rise in taxes and has created a strong seller's market.

With the limited inventory of mid-level deals (10-100 units) on the market, investors are now turning to smaller 4 to 8 unit multi-family properties. In 2013 there was a 16% increase in the 4-8 unit transactions in Massachusetts as compared to a 20% decrease in 10 plus unit sales. Many of these 4 to 8 unit properties were purchased during the last market's peak from 2004 to 2007. Only a couple years ago many of these properties would have been lucky to sell for the debt owed. Today they are now selling at prices higher than paid during the last boom.

In addition to moving to smaller buildings, investors are looking towards secondary markets to capture increased rates of returns. Transactions recently closed by United Multi Family (UMF) in Greater Boston have resulted in CAP rates of 3.4% for a 27 unit sale in Allston-Brighton and 3.36% for a 12 unit in Cambridge. With lesser returns found in the Greater Boston and New York City market, investors are now migrating to the Providence, Southern New Hampshire, and Connecticut markets. A transaction recently closed by UMF on 87 units in Manchester, N.H. resulted in a CAP rate of 6.8%. For the most part these secondary markets can earn investors double digit returns on their investment. In addition to the increased rate of return, the investor also benefits from both a principal reduction of the loan and the ability to shelter part of the cash flow through depreciation allowed under IRS guidelines.

With a shifting landscape of the multi-family market across New England, one thing that was consistent across all property types and locations was an increase in taxes resulting from property sales. This increase in taxes may have scared some owners away from selling in 2013. Yet with the surge in property values, the negative influence of property sale taxes is mitigated through the use of a 1031 tax deferred exchange. A 1031 exchange allows you to sell investment property and defer the capital gains and depreciation recapture taxes, assuming reinvestment of 100% of equity into "like kind" property of equal or greater value. Besides purchasing a multi-family property there are other choices for an investor that wants little to no management at all. One of these alternatives is a

DST or Delaware Statutory Trust co-ownership.

Recently, DSTs have been gaining in popularity for a number of reasons including the ability to secure financing more easily and attract more investors with lower minimum investment threshold amounts. A DST is a separate legal entity created as a trust under the laws of Delaware. Each owner has a "beneficial interest" in the DST for Federal income tax purposes and is treated as owning an undivided fractional interest in the property. A chief advantage of the DST structure is that the lender views the trust as only one borrower (rather than having up to 35 borrowers as in many TIC arrangements) which makes it easier and less expensive to obtain financing.

In 2004, the IRS released a ruling that allows the use of a DST to acquire real estate where the beneficial interests in the trust will be treated as direct interests in replacement property for purposes of a tax deferred exchange. Due to the restrictions for DST qualification, the best attributes for a DST are generally single-tenant occupancy, an investment-grade tenant with a long-term lease to avoid turnover costs, and triple net lease terms which require the tenant to pay all property expenses.

UMF has specialized in the sale of multi-family properties throughout New England since its inception in 1998. We track every multi-family sale and know the most active and aggressive Buyers in the market today. In addition, we have access to information regarding DST properties as potential replacement for your 1031 exchange.

Rich Cawley is president of United Multi Family, Quincy, Mass.

New England Real Estate Journal - 17 Accord Park Drive #207, Norwell MA 02061 - (781) 878-4540