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IRS section 1031 tax deferrals –2019 and roaring in terms of property values and exchange volume - by Greg Hill

September 06, 2019 - Northern New England

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This calendar year is shaping up to be a banner year in terms of property values and exchange volume. Real estate currently is extremely frothy – good if your selling, terrible if you're trying to find a replacement property that's an economic "good deal." If your personal circumstance allows you to incorporate securitized real estate as an exchange option, you have an impressive array of choices.

Current trends in asset selection

• Necessity retail real estate remains a favorite – owning the bricks and mortar and leasing to a credit-worthy tenant on a long-term basis. Walmart, Dollar General, CVS, Amazon, and many other familiar names frequently choose to lease their real estate rather than own. Medical office buildings and dialysis centers offer sector diversification that may prove to be a hedge somewhat resistant to an economic downturn.

• Multifamily residential remains a viable asset class. Forecasted rent growth for 2019 of 4%, coupled with other economic drivers, continue to make this an attractive component of a diversified portfolio. Be aware that this asset class is segmented into A,B, and C categories, each with a different business model designed to increase value and maximize cash flows. Risk/reward ratios vary dramatically within this asset class.

• Opportunity zones. I'd be remiss if I didn't mention these newly arrived investment programs. There are close to 9,000 designated opportunity zones nationally. It's very difficult to discover and price risk in this investment structure. These ventures are speculative and fraught with potential issues that are not readily known. A lot can go wrong in 10 years with limited, or no liquidly or defined exit strategy. The tax benefits seem quite modest and not commensurate with the risk. Clearly, not all opportunity zones and program sponsors are created equal. It's early in the game but tread carefully in the zone.

I work primarily with individual investors to help orchestrate and fund section 1031 tax deferred transactions. The exchange process is not something to be approached in a casual manner. Most are unique and cookie cutter solutions are not the norm. Below are some useful rules of the road to help your exchange run smoothly.

1. Ascertain your tax liability PRIOR to assuming any course of action.
It is pretty much the math – follow the numbers. Not every potential property sale lends itself to the exchange strategy…every transaction is unique. An analysis to include current adjusted cost basis, depreciation, cost segregation, and other metrics is essential. It may be more prudent to settle with the tax man and take the net after tax amount and shore up other weaknesses in your portfolio.

2. Don't cut corners. While your brother-in-law or bookkeeper may be nice people, chances are there are better ways to protect and secure your interests. Consult a competent professional with an expertise in real estate and tax law.
You'll want a specialist, not a general practitioner. Ask questions and find out if he or she knows the drill. Ask for client references, and contact them. It's always good to verify ahead of engaging them.

3. Quarterbacking the chain of custody and other required procedures.
Sometimes the devil is indeed in the details. To be compliant, the trust or qualified intermediary needs to be a "disinterested 3rd party." Again, your family attorney or accountant is generally NOT a qualified entity in this instance. "Constructive receipt" issues can render your exchange noncompliant, and trigger an unwanted tax event. Exchange rules are very specific and not open to interpretation. Generally you'll need a longer runway to land a more complicated exchange – multiple properties with shifting close dates etc... Planning ahead is of paramount importance.

4. Finding a suitable replacement property solution – a world of choice.
Whether contemplating a fee simple 100% ownership interest or a securitized real estate offering…be it a Delaware Statutory Trust (DST) or the older tenant in common (TIC) structure…do your homework. You can delve into the real estate companies, as well as the salespeople who market the various programs. Clearly, past performance may not be indicative of future events, but is useful information nonetheless. The government's "FINRA - broker check" may provide valuable information to the consumer relative to the securities licensed salesperson's background, and the firms that supervise them. Diversification is the primary factor in determining investment outcomes…don't be seduced by unrealistic yield projections.

The aforementioned prep-steps are necessary in getting the exchanger started in the right direction, and can be critical to a productive and successful outcome by protecting your real estate portfolio. Sadly, we have seen firsthand…the results of not staying on point while going through the process. It may seem daunting…and sometimes can be...but a properly executed tax deferred exchange is a wonderful planning tool, useful in building and protecting your investment real estate portfolio.

Wealth preservation rather than wealth creation is what most of my clients tell me they're looking to accomplish. I'm always reminded, they want the perfect SWAN investment – the one that allows them to sleep well at night! They are out there, but you've got to do your homework. Happy exchanging.

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