2025 does look like a promising year - by Brendan Greene

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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 “like kind” property within 180 days of the sale.

It is a difficult time to forecast the overall real estate market and the utilization of 1031 real estate exchanges in 2025. The housing market continues to be a difficult one for both buyers and sellers. Residential real estate prices remain at historic highs and inventory is still relatively low. However, certain sectors of the commercial real estate market have decreased in value for various reasons, most notably remote workers. There has been a push by corporations in the second half of 2024 to bring more workers back to the office, and newly re-elected President Trump recently ordered all federal workers to end remote work arrangements. This trend could become more popular and help stabilize the commercial office market. Interest rates have gone up and down a bit but have remained stubbornly high when compared to rock bottom rates of the recent past. Many investors with low rates on their mortgages are a bit reluctant to sell investment properties and buy into another investment property and take on a higher interest rate.

President Trump has talked about tariffs on incoming goods and products from Mexico, Canada and China. This would be in addition to the tariffs former President Biden placed on Canada’s lumber and China’s steel. Many real estate professionals don’t think this is a good idea. “Overly broad and poorly designed tariffs could increase housing costs for millions of renters and home buyers,” said CEO Jeffrey DeBoer, president and CEO Real Estate Roundtable. Imported materials like lumber, glass, steel and concrete increase construction costs which increase the values of properties in general as less new construction is happening.

However, the new Trump administration is suspected to be very supportive of new tax and other programs to boost the real estate market and to protect tax favorable programs such as 1031 real estate exchanges.

2021 and 2022 saw historically low interest rates, which in turn caused historic demand for investment properties and 1031 tax deferred exchanges despite the high price of such properties for sale. Even though investors sometimes feel like they are swimming upstream, the last two years have been healthy for the 1031 tax-deferred exchange market. There has been a steady increase the last ten or so years in 1031 exchanges with the peak coming in 2021 and 2022. Part of the steady flow has been due to an increase in investor knowledge of 1031 exchanges and the various kinds of exchanges, like reverse and improvement/construction exchanges. Also, the ability to invest in Delaware Statutory Trusts (DST’s) as replacement property has caused DST’s to become more mainstream.

Although there was a decrease in volume of 1031 exchanges in 2023 and 2024 from the peak of 2021 and 2022 , there are a few factors that carry over from the last couple of years that will aid in the continued growth of 1031 exchanges: (i) property owners facing significant capital gains taxes upon sale due to the appreciation investors real estate, (ii) the repurposing of real estate due to changes in certain segments of the real estate market, (ii) the sale of investment properties in colder climates and the purchase of investment replacement properties in warmer climates or parts of the country typically known as vacation areas, (iii) the availability of reverse and construction improvement exchanges, (iv) the ability to invest in DST's as replacement property, and (v) baby boomer retirement and estate planning

Despite the negative impacts COVID-19 has caused on parts of the real estate industry, like increasing remote workers, the increase in property values throughout New England and specifically in Massachusetts over a long period of time has given investors large equities in their properties subjecting them to higher capital gains taxes on the sale of such properties.

In summary, we anticipate (i) the supply of investment replacement properties to continue to increase, (ii) Trump's pro real estate agenda to have a positive impact on 1031 exchanges, (iii) the return of more workers to offices will help stabilize the commercial office sector, and (iv) the overall awareness of various planning options by investors like reverse/improvement exchanges, DST's and consolidation/diversification. Let's hope that tariffs, if imposed, do not throw a wrench into what looks like a promising year for the real estate market and 1031 exchanges in particular.

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