Buy Land, They're Not Making It Anymore

As much of the residential real estate market struggles to comeback from its 2006 drubbing, the commercial real estate market has never been so strong. Witness an unprecedented number of mergers, acquisitions and buyouts: SL Green taking over Reckson, Blackstone and Vornado publicly duking it out for Equity Office, and Simon Property Group fighting Brookfield for Mills Corp. Setting aside the multi-billion dollar price tags and fevered bidding, the overwhelming message is this: real estate is still king.

In addition to cap rates, cash on cash returns and the search for the ever-elusive perfect property manager, Internal Revenue Code Section 1031 like-kind exchanges are never far from the mind of most savvy real estate investors. Once believed to be a benefit available only to corporate America and high net worth individuals, the 1031 exchange is now the tax-deferral technique of choice for thousands of individual taxpayers who have found themselves, particularly in recent years, to be real estate rich.

How quickly those riches disappear though if you choose to cash out and not exchange into other property. In California alone the state capital gains tax is 9.3%, in Minnesota you pay an extra 7.85%, and if you're seeking warmer climates, New Mexico will hit you for 8.2%. And don't forget that accumulated depreciation will be recaptured not at the favorable federal capital gains rate which tops out at 15% for individuals, but rather is subject to a 25% recapture rate.

In addition to the very compelling tax deferral, through Regulatory guidance and a series of pro-taxpayer Revenue Procedures, the federal government has engendered an environment where Taxpayers can easily, and with little risk, effectuate a tax-deferred exchange.

Don't know anything about Section 1031? No problem. There are several hundred Qualified Intermediaries ("QIs") scattered across the country ready to walk you through the transaction. For a modest fee, your QI will provide you with all of the documentation needed to make sure your exchange falls squarely within the safe harbors outlined by the Treasury Regulations.

Don't have any replacement property in mind? No problem. There are several hundred syndicators who specialize in replacement property solutions for the 1031 buyer. For a modest fee, a syndicator will offer you anything from a triple net leased fee interest in real property, to a tenancy in common interest (TIC) in an urban office building, to an oil and gas interest. Many syndicators hold legal opinions that conclude what they're selling is real property for purposes of Section 1031.

Can't sell your relinquished property before you have to acquire your replacement property? No problem. You can engage the services of an Exchange Accommodation Titleholder ("EAT") to avoid what would otherwise be a reverse exchange. The EAT can acquire and hold your intended replacement property for up to 180 days, during which time you'll need to sell your old property and trade into the property held by the EAT. These parking arrangements have gained increasing popularity in the last few years as the market has tightened and investors have been forced to go to contract and to close quickly in order to get their desired property.

As is true in every important financial decision, interview your professional service providers. Choose a provider that's right for you and your individual circumstances. And in the words of Mark Twain, "Buy land, they're not making it anymore."

By: Mary Cunningham, President of Chicago Deferred Exchange Corporation