

Like-Kind Exchange Transactions Of REALTORS® In 2016-2019

July 2020

National Association of REALTORS®
Research Group



**NATIONAL
ASSOCIATION OF
REALTORS®**

LIKE-KIND EXCHANGE TRANSACTIONS OF REALTORS® IN 2016-2019

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Section 1031 of the Internal Revenue Code allows a real estate property used for business or held as an investment to be exchanged for another property that is of "like kind." IRS notes that "properties are of like-kind if they're of the same nature or character, even if they differ in grade or quality. Real properties generally are of like-kind, regardless of whether they're improved or unimproved. For example, an apartment building would generally be like-kind to another apartment building. However, real property in the United States is not like-kind to real property outside the United States."

The Tax Cuts and Jobs Act of 2017 limited Section 1031 only to exchanges of real property and not to exchanges of personal or intangible property. An exchange of real property held primarily for sale does not qualify as a like-kind exchange.

In a deferred exchange – an exchange that occurs when the property received in the exchange is received after the transfer of the property given up – the seller of the property that is being exchanged for a like-kind property must identify the replacement property within 45 days after the relinquished property is transferred. The replacement property must be received within 180 days.

This is a report on a survey conducted among NAR members about their transactions during 2016 through 2019 to gather information on the use of Section 1031 like-kind exchanges involving NAR members and to assess their views on the economic impacts of repealing Section 1031 as is being proposed by some current tax proposals. In 2015, NAR conducted a survey on the like-kind exchanges in which NAR members participated during the period 2011 through 2015, so this study updates that report. In 2015, slightly over 60% of NAR members reported being involved in at least one like-kind transaction, which is about the same as the current report's figure of 61%.

The results show that majority of properties that were sold in a like-kind exchange were held by small investors and that additional capital was invested in the property acquired nine times out of ten. REALTORS® expect a decrease in property values and an increase in the holding period if Section 1031 were repealed. The deployment of capital to its best use, especially at this time when market opportunities are changing, is an important economic benefit of like-kind exchange transactions,

SURVEY RESULTS SUMMARY

On average, 12% of sales transactions of REALTORS® were part of a like-kind exchange during 2016-2019, with half of members reporting 5% or less of sales transactions were part of a like-kind exchange

61% of REALTORS® had at least one like-kind exchange transaction during 2016-2019

84% of the properties that were exchanged for like-kind properties were held by small investors in sole proprietorships (47%) or in S-corporations (37%)

52% of properties sold in a like-kind exchange were residential properties: (27% single-family homes for rent, 15% apartment buildings, and 10% condominium units)

8.5 years was the median holding period before properties were sold in a like-kind exchange transaction

37% was the mean deferred gain as a fraction of the value of the real estate sold in a like-kind exchange transaction

89% of REALTORS® reported their clients invested additional capital in the replacement property

75% of REALTORS® reported that the additional investment was at least 10% of the fair market value of the replacement property

94% of REALTORS® expect property values to decline if Section 1031 were repealed

87% of REALTORS® expect longer holding periods if Section 1031 were repealed

68% of REALTORS® expect higher rent in the acquired property (to be rented out) if Section 1031 were repealed

50% of REALTORS® expect an increase in debt financing if Section 1031 were repealed

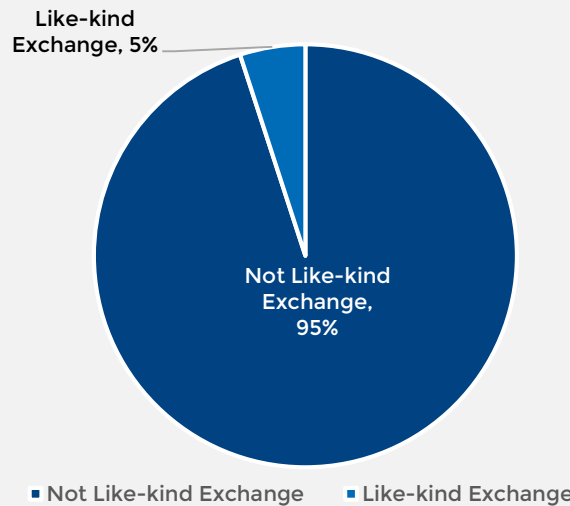
LIKE-KIND TRANSACTIONS OF REALTORS®

➤ Among members of the National Association of REALTORS® who are primarily engaged in commercial transactions, like-kind exchange transactions were, on average, 12% of their sales transactions during 2016–2019, with half of members reporting 5% or less. Among residential members, like-kind exchange transactions were, on average, 5% of their sales transactions, with half of members reporting no like-kind exchange transactions.

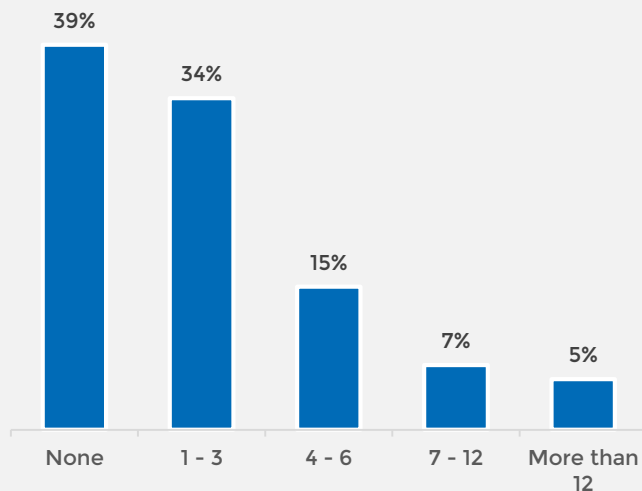
➤ Sixty-one percent of all members had at least one like-kind exchange transaction during 2016–2019. Among commercial members only, 68% had at least one like-kind transaction.

➤ The median number of like-kind exchange transactions was two transactions during the four-year period.

Fraction of Transactions of NAR Commercial Members During 2016–2019 That Were Part of a Like-kind Exchange



Number of Real Estate Transactions (Purchase or Sale) During 2016–2019 That were Part of a Like-kind Exchange

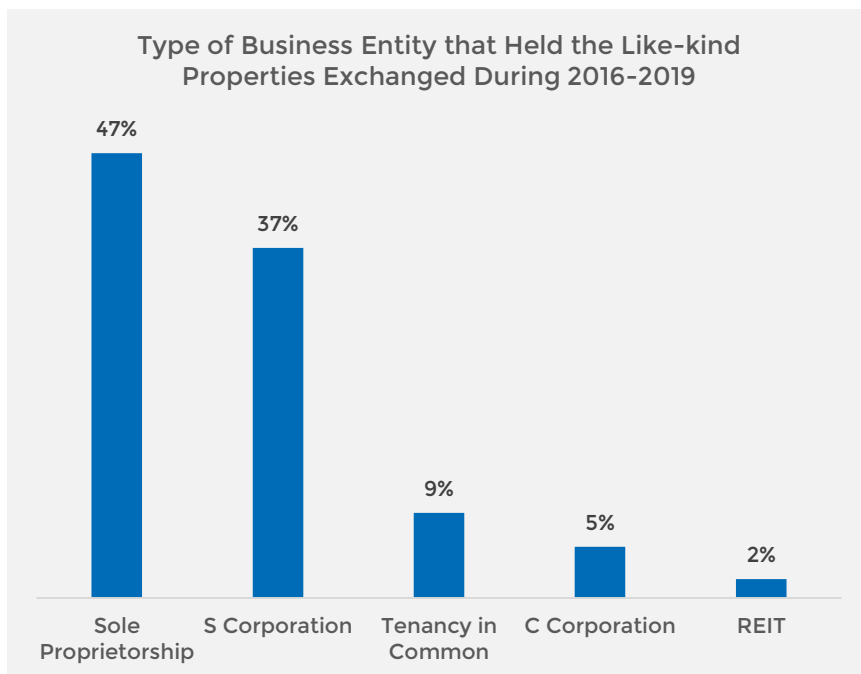
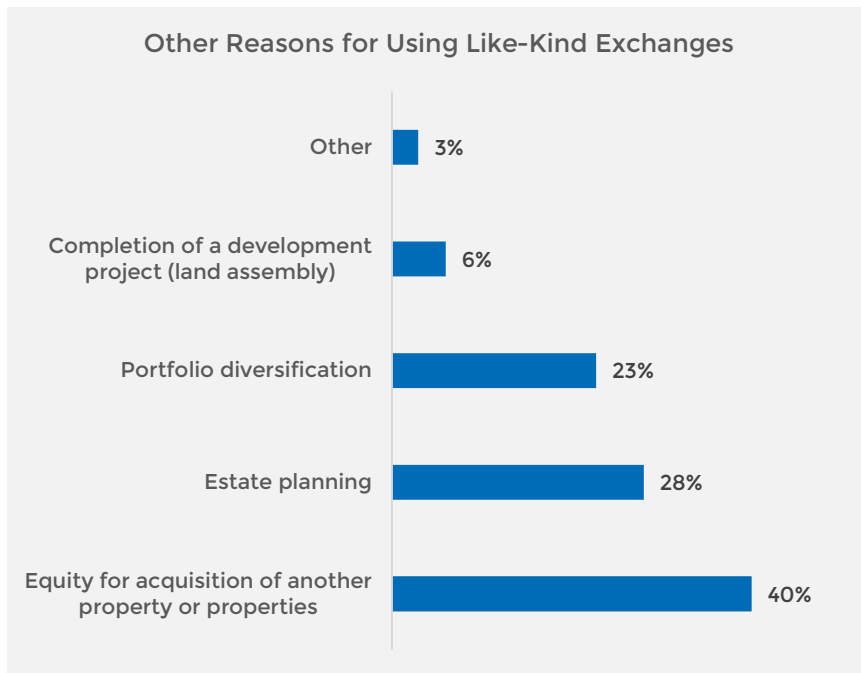


*A transaction that involves (1) a seller beginning a deferred like-kind exchange or (2) a buyer completing a like-kind exchange.

REASON FOR USING LIKE-KIND EXCHANGES

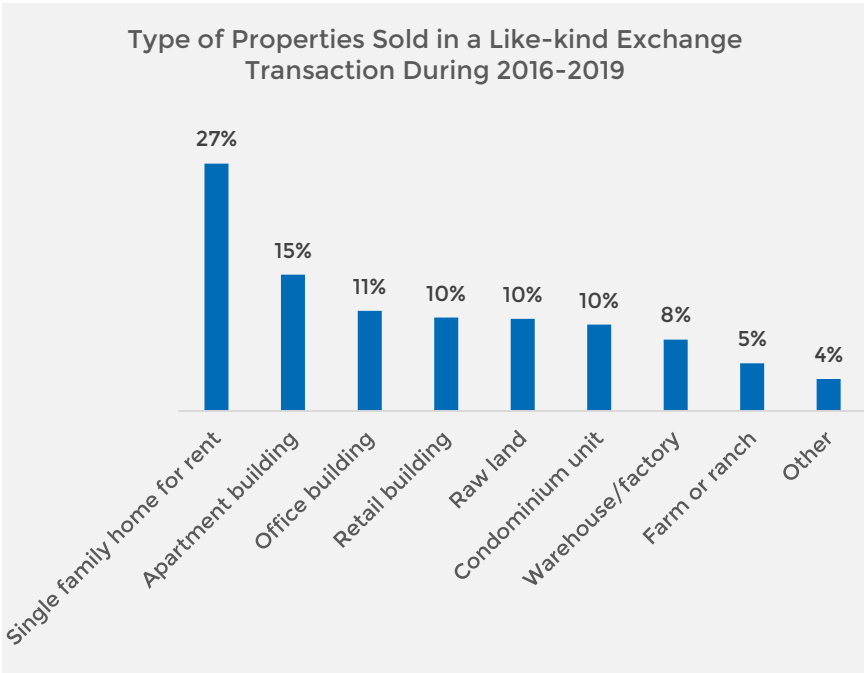
➤ Apart from using Section 1031 for tax deferral, the primary reason clients engaged in a 1031 exchange was to use the equity from the exchanged property to acquire another property, accounting for 40% of reasons cited. Other reasons were estate planning, portfolio diversification, and using the equity to complete a development project.

➤ Forty-seven percent of the properties that were exchanged for like-kind properties were held by sole proprietorships and another 37% were held by S-corporations. Only 7% were held by C corporations and REITs. Nine percent were held in tenancy in common arrangements.

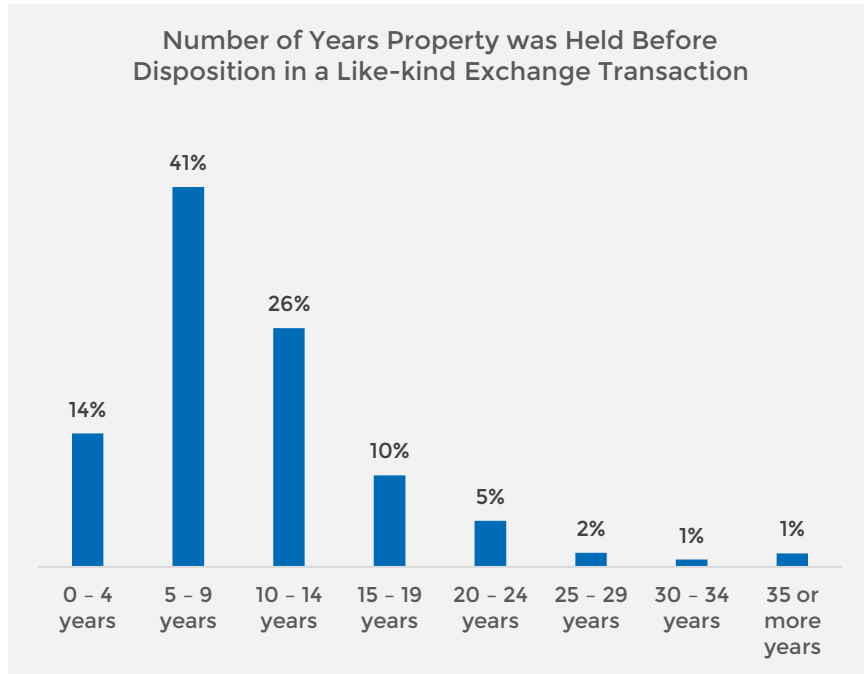


TYPE OF PROPERTY, HOLDING PERIOD, AND DEFERRED GAIN

➤ Fifty-two percent of properties sold in a like-kind exchange were residential properties: (27% single-family homes for rent, 15% apartment buildings, and 10% condominium units). Twenty-nine percent were office, retail, and warehouse/factory buildings. Raw land, farm, or ranch lands accounted for 15%.



➤ The median number of years properties were held before disposition in a like-kind exchange was 8.5 years.



➤ Pertaining only to 2019 transactions, the median deferred gain accounted for 37% of the value of the property sold in a like-kind exchange transaction.

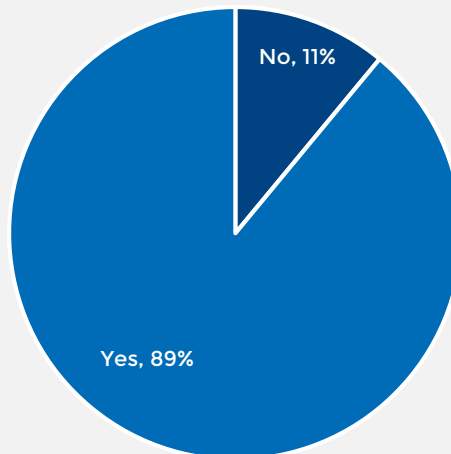
37%

Median Deferred Gain as a Fraction of the Value of the Real Estate Sold in a Like-kind Exchange Transaction

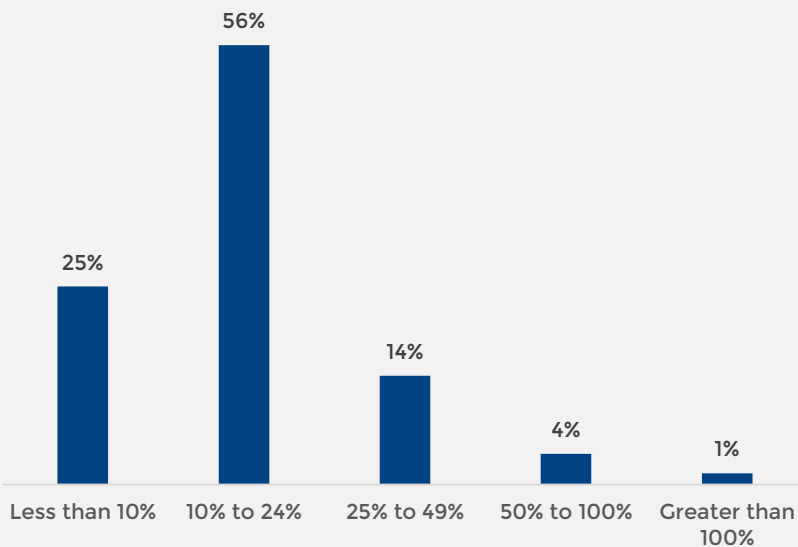
INVESTMENT IN THE ACQUIRED PROPERTY

- Eighty-nine percent of respondents reported that their clients invested additional capital in the acquired property.
- Seventy-five percent of members reported that the additional investment was at least 10% of the fair market value of the replacement property. The median additional capital invested was 18% of the fair market value of the replacement.

Percent of Respondents Who Reported that Clients Invested Additional Capital in the Replacement Property



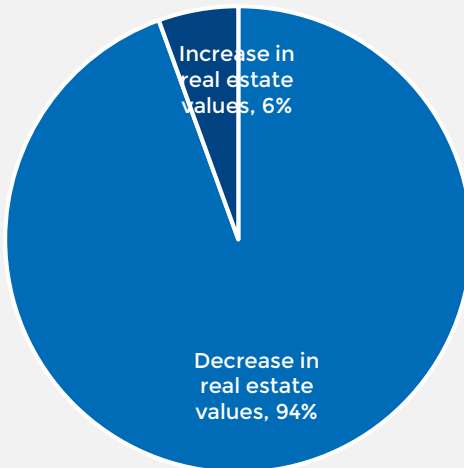
Additional Capital Invested as a Percent of the Fair Market Value of the Replacement Property



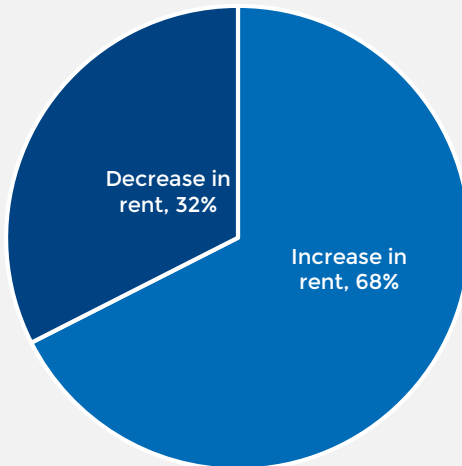
IMPACT ON PROPERTY VALUES AND RENT IF SECTION 1031 WERE REPEALED

- When asked about the impact on property values if Section 1031 were repealed, 94% of respondents reported that the repeal would lower property values.
- Sixty-eight percent of respondents expect an increase in rent in the acquired property if Section 1031 were repealed.

Percent Distribution of Responses on the Impact on Real Estate Values if Section 1031 Were Repealed



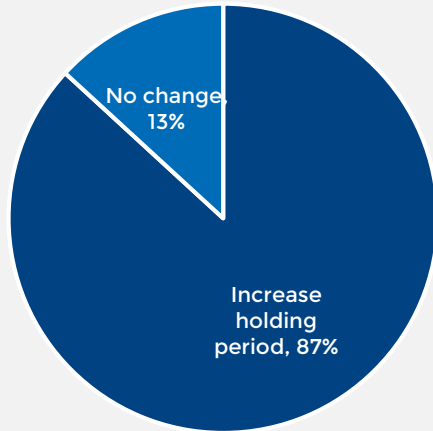
Percent Distribution of Responses on Rent Impact if Section 1031 Were Repealed



IMPACT ON HOLDING PERIOD AND DEBT FINANCING IF 1031 WERE REPEALED

- When asked about the impact on the holding period of if Section 1031 were repealed, 87% said the holding period will increase.
- The repeal of Section 1031 is also like to lead to some increase in debt financing, with 25% of respondents reporting such possible outcome.
- Half of respondents reported an increase in refinancing if Section 1031 were repealed.

Percent Distribution of Responses on Holding Period if Section 1031 Were Repealed



Percent of respondents who reported the following effects if Section 1031 were repealed:

25%

increase in leverage

50%

increase in refinancing

Methodology

Objective



This survey seeks to gather information on the use of Section 1031 like-kind exchanges among NAR members and to assess the economic impacts of repealing Section 1031 as is being proposed by some current tax proposals.

Dates



The survey was deployed on July 15 10 a.m. and was closed on July 21, 11:59 p.m..

Respondents



NAR has approximately 1.4 million members. The online survey was sent to approximately 76,000 NAR members who are primarily engaged in commercial real estate and to a random sample of 50,000 NAR members who are primary engaged in residential real estate. Of the commercial members who received the survey, 2,417 responded to the survey, and of the residential members, 1,516 responded to the survey, or a total of 3,933 respondents.

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The National Association of REALTORS®, “The Voice for Real Estate,” is America’s largest trade association, representing 1.4 million members, including NAR’s institutes, societies and councils, involved in all aspects of the real estate industry. NAR membership includes brokers, salespeople, property managers, appraisers, counselors and others engaged in both residential and commercial real estate.

The term REALTOR® is a registered collective membership mark that identifies a real estate professional who is a member of the National Association of REALTORS® and subscribes to its strict Code of Ethics. Working for America’s property owners, the National Association provides a facility for professional development, research and exchange of information among its members and to the public and government for the purpose of preserving the free enterprise system and the right to own real property.

NATIONAL ASSOCIATION OF REALTORS® RESEARCH GROUP

The Mission of the National Association of REALTORS® Research Group is to collect and disseminate timely, accurate and comprehensive real estate data and to conduct economic analysis in order to inform and engage members, consumers, and policymakers and the media in a professional and accessible manner.

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