Attention Shore Homeowners – Know ALL of your Options

Do you own a shore home that has significantly appreciated in value since buying it? Are you ready to take advantage of this great market by selling it, but something's holding you back? Let me guess…

The obvious solution is to simply sell now and wait for a better time to buy again. But, that could result in a significant tax liability. An option that would avoid the tax issue would be to do a 1031 exchange from your existing shore home into another investment property. That would defer the taxes, but force you to find another home for a better price, and within a short amount of time…easier said than done…not to mention, you're not exactly thrilled at the prospect of being a landlord again.

Good news, you have a third choice that may solve all of your problems. Let me explain using a recent case I helped solve. John Walton (name changed to protect the innocent) has owned a shore home for almost 30 years. He has depreciated the property down to the land value. Sales proceeds are expected to be about $1,500,000. But, he was expecting to have to pay total taxes of $500,000! For a retired guy to safely generate income on his after-tax proceeds of $1,000,000 at today's rates, he could only expect about $30,000 per year. That's terrible considering he was collecting net income of over $75,000 before he sold. We encouraged him to consider a 1031 exchange, but rather than finding another property to privately own, we identified a Class A apartment complex professionally-managed and owned within a Delaware Statutory Trust (DST for short). And, by owning beneficial shares of this DST exactly matching his sales proceeds, we deferred 100% of the taxes due. More importantly, with 100% of his proceeds invested in the DST, we were able to generate a tax-favorable income of $60,000 (4.0% yield) and eliminate all the hassles of being a landlord.

So, what's the catch you ask? Well, all the same rules apply to a 1031 using a DST as they do with any other 1031 exchange. However, there are some differences between DST ownership and private ownership.

1. Due Diligence - If you are using a good advisor, the due diligence during the acquisition process is second to none. This certainly beats conducting your own search, worrying about inspections and going through the painful task of mortgage underwriting.
2. Professional Management. Acquisition, management, and disposition decisions are made for you by a highly experienced real estate investment firm. All you do is cash the monthly rental checks.
3. Diversification and scale. Most DST's are buying commercial properties valued at over $50 million. A DST gives you access to more sectors of real estate and at a price point usually reserved for institutional money.
4. Control. This is where a DST greatly differs from your own property. The DST maintains control and makes all decisions to buy, manage, and sell property. Although you lose that control, each real estate investment firm clearly explains their investment plan and the expected time horizon of ownership. Quarterly financial reports are also provided to keep you apprised of the real estate operations.

5. Flexibility of Investment Amount. If you are exchanging $2 million of property, you may buy one DST or diversify across two or three properties. However, if you are exchanging into your own property, but have decided to downsize, now you can exchange the difference (boot) into a DST to avoid 100% of the tax, as DST fractional ownership can be customized to your need as low as $100,000.
6. Income and Estate Planning. 5% of 100% is always better than 5% of 50%. So, if you can defer the taxes and generate real estate rental income on your entire sales amount, this could be the answer for you. Additionally, if you are simply interested in the income, but planning to leave the property value to your next of kin, this strategy works perfectly as 100% of the capital gains taxes will be eliminated on the day you die, due to the step-up in cost basis on the date of death.
7. Future Exchanges. Upon the sale of the property by the DST, usually targeted in the first 7-10 years of ownership, you will always have the option to exchange again.

I used the example of my client buying apartment complexes. But DST's are not limited to a single sector of real estate nor a specific geographic area. At any given time, we have inventory in student housing, triple-net retail, office, industrial, self-storage, and hospitality.

Time is of the essence for two reasons. First, demand for high quality, well-priced commercial real estate is higher than supply, much like the residential market. So, when a good property comes along, you have to be prepared to move quickly. Secondly, the repeal of tax-free 1031 exchanges is one of many tax policies possibly on the chopping block as the Biden administration looks to uncover more revenue streams. So, the sooner you are educated on your options, the better!

One last thing! If cash flow isn't your primary objective, and appreciation is of more importance, we may have another tax-friendly solution, but rather than explain it here, we'd be happy to schedule a time to educate you on ALL of your options.

If you have ever considered selling your investment property at the shore, but something has stopped you in your tracks, please consider reaching out to our team to discuss your specific situation. We can bring a team of real estate, financial planning, tax, and legal advisors to you or we are happy to work in tandem with your existing advisors. Either way, knowledge is power. And power leads to a lifetime of financial freedom.