QuickFacts

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A Summary of The New Tax Reform (And What it Means for Real Estate)

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The new federal tax codes signed into law this past December bode well for the real estate industry, overall. These improvements include lower tax rates for property owners that will spur new investments and increase demand for real estate investors. The Tax Cuts and Jobs Act bill will cut tax billings more than $1.2 trillion over ten years. Depending on your income, income taxes will drop from 37% to 29.6% - and this 6% difference can add up to serious savings for most real estate investors that invest using a pass-through business or limited liability company (LLC.) The bill itself creates a huge incentive for investors to organize their investments as an LLC or other pass-through business (sole proprietorship, partnership, or S-corporation.)

MORTGAGE INTEREST DEDUCTIONS

The final bill reduced the limit on deductible residential mortgage debt from $1 million to $750,000 (or $375,000 for married taxpayers filing separately) for all new loans, and eliminates deductions when using home equity loans, unless the money was used for renovations or home improvements. Interest continues to be deductible on second homes, but is still subject to the $750,000 limit. Currently, taxpayers can deduct what they pay in state and local property, income, and sales taxes from their federal returns, but the new law caps these deductions at $10,000 per year for any combination of property, income, and sales tax.

Existing homeowners are grandfathered into the previous deduction cap of $1 million, but if a homeowner moves and takes out a new loan – then they would lose that $250,000 in savings. If a person sells their primary residence – they will not need to pay taxes on the proceeds – that's up to $250,000 for a single or $500,000 for married homeowners – provided that they have lived in that home long enough (5 out of the past 8 years.) Homeowners in costly residential markets may choose to stay put rather than risk the loss of deductions with the purchase of a new home.

As far as commercial real estate is concerned, this tax plan could be beneficial to retail Landlords – with lower taxes for tenants, which in turn leaves consumers with more extraneous cash to spend. These tax benefits could also lead to office tenants choosing to stay in the US, rather than moving their headquarters overseas, and deductions are tied to the amount of wages a business pays, so ownership structures with more employees like Real Estate Investment Trusts (REITs) will benefit from larger savings.

ITEMIZING MORTGAGE INTEREST DEDUCTIONS

Most people don't take mortgage deductions into account when they are purchasing a home – more likely they are tired of renting, need more space or a yard, or are starting a family. Only homeowners who itemize their taxes receive mortgage interest deductions (in 2014, that was only about 30% of Americans.) With this new tax plan – the standard deduction amount has actually doubled. The standard deduction was raised from $6,350 to $12,000 for single homeowners, and from $12,700 to $24,000 for those filing as a married couple. To benefit from these interest deductions, a homeowner's itemized deductions must total more than the max standard – which will likely only be true for the top tier high-income taxpayers.

ESTATE PLANNING & 1031 EXCHANGE

Another thing to consider with the new tax laws is estate planning. Starting January 1, 2018, the estate, gift, and generation-skipping transfer (GST) tax exemptions double to $11.2 million per person (or $22.4 million for a married couple), and will continue to adjust for inflation for the next 7 years.

This adjustment however, expires in 2025 - when the exemptions revert back to the $5,000,000 level per individual, so some people may want to take advantage of this generous increase to gift their properties to beneficiaries now rather than later.

The final bill retained 1031 like-kind exchanges of *real property* – as in real estate in the form of a building, land, etc. – but repealed the use for personal property such as art, automobiles, or heavy machinery.

RENT INSTEAD?

These tax law changes have the potential to scare off homebuyers, and subsequently lower home prices, but demographically millennials will continue to create demand for housing as they marry and have children. (Note: With the current administration reducing the inflow of immigrants, a reduction in rental demand might be felt in the residential rental market in twenty-four (24) months.)

Since those tax deductions aren't quite as appealing as they used to be – potential homebuyers could choose to rent instead, which in turn might lead to an increase of renters. But, past generations have embraced the American dream of owning a home and for many homeowners, owning and paying off the family home is a step towards planning for retirement. In other words, we expect millennials to be buying homes (if they can afford them) - after they have paid off their student loans. Remember that many of these millennials are children of the baby boomers, who have cash and can now gift their children money to fund a down payment for a new home.

In summary, it will take time to see how these changes will affect the investment marketplace as a whole. What remains clear is that real estate investors stand to make more money under this administration. For a more detailed overview of the taxes, we refer you to your tax attorney, CPA and to this article from the National Association of Realtors.

https://www.nar.realtor/tax-reform/the-tax-cuts-and-jobs-act-what-it-means-for-homeowners-and-real-estate-professionals

Additional sources:

https://www.bloomberg.com/news/articles/2017-12-13/tax-overhaul-could-be-huge-win-for-u-s-real-estate-investors
https://www.mansionglobal.com/articles/85145-how-the-new-u-s-tax-law-impacts-property-owners

https://taxfoundation.org/who-itemizes-deductions/

Clifford A. Hockley is President of Bluestone & Hockley Real Estate Services, greater Portland's full service real estate brokerage and property management company. **Founded in 1972**, Bluestone & Hockley's staff totals nearly 90 employees, including 10 licensed brokers. The company's property management division serves commercial buildings, apartments, condominium associations and houses in the Portland / Vancouver metro area, while the brokerage division facilitates both leasing and sales of investment properties throughout Oregon and Washington.

Cliff earned a degree in Political Science from Claremont McKenna College and holds an MBA from Willamette University. He is a Certified Property Manager and has achieved his Certified Commercial Investment Member designation (CCIM). Bluestone & Hockley Real Estate Services is an Accredited Management Organization (AMO) by the Institute of Real Estate Management (IREM). Cliff is a member of the Institute of Real Estate Management and was named Certified Property Manager of the year in 2001 and 2003. Cliff is a frequent contributor to industry newsletters.

Bluestone & Hockley offers **customized brokerage, property and asset management, as well as maintenance services** to property owners and investors throughout the Portland/Vancouver metro area. The company's full-service approach benefits busy property owners and investors, who know they can count on Bluestone & Hockley for high quality real estate services start to finish.