

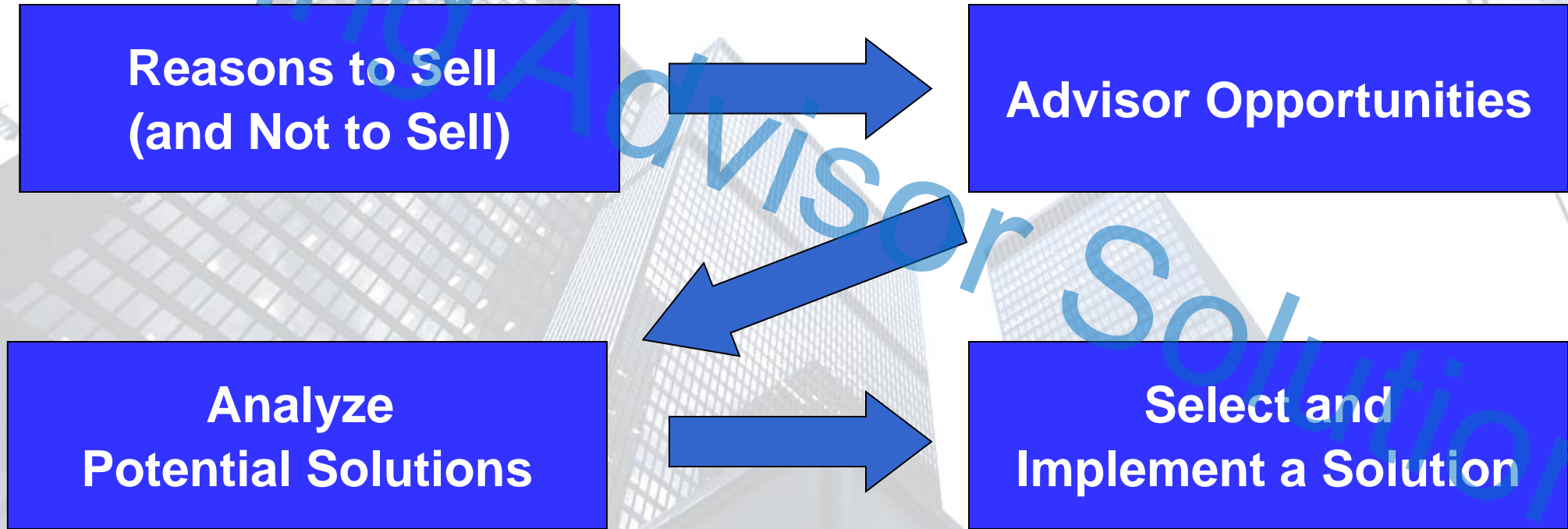


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**Appreciated Real Estate
Opportunities for Advisors**

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What You'll Learn

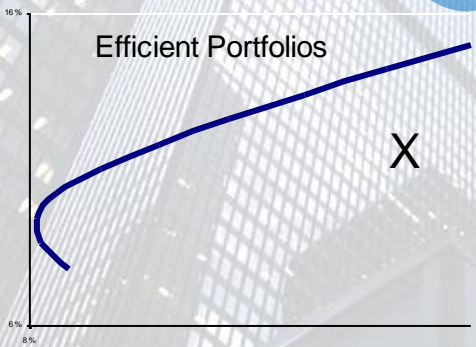


Reasons to Sell

\$ Financial

Person Icon Personal

- Lock in gains
- Reduce risk profile
- Poor performance
- Changing market




- Reduce management hassle
- Concession to aging
- Work less hard
- Not leave it for the kids to clean up

▶ Many valid reasons to sell, even when property is performing well

Reasons to Hold

 **Financial**

- Portfolio already risk optimized
- Hope for better property performance
- Hope for better market
- TAXES
- Myths


 **Personal**

- Enjoy the process
- Kids coming into the business
- Inertia
- Don't want to make a decision

▶ Many poor reasons to hold, fewer good reasons

Mythical(?) Reasons to Hold

- Lower risk 
- Inflation hedge
- Real estate always goes up 

 Many poor reasons to hold, fewer good reasons

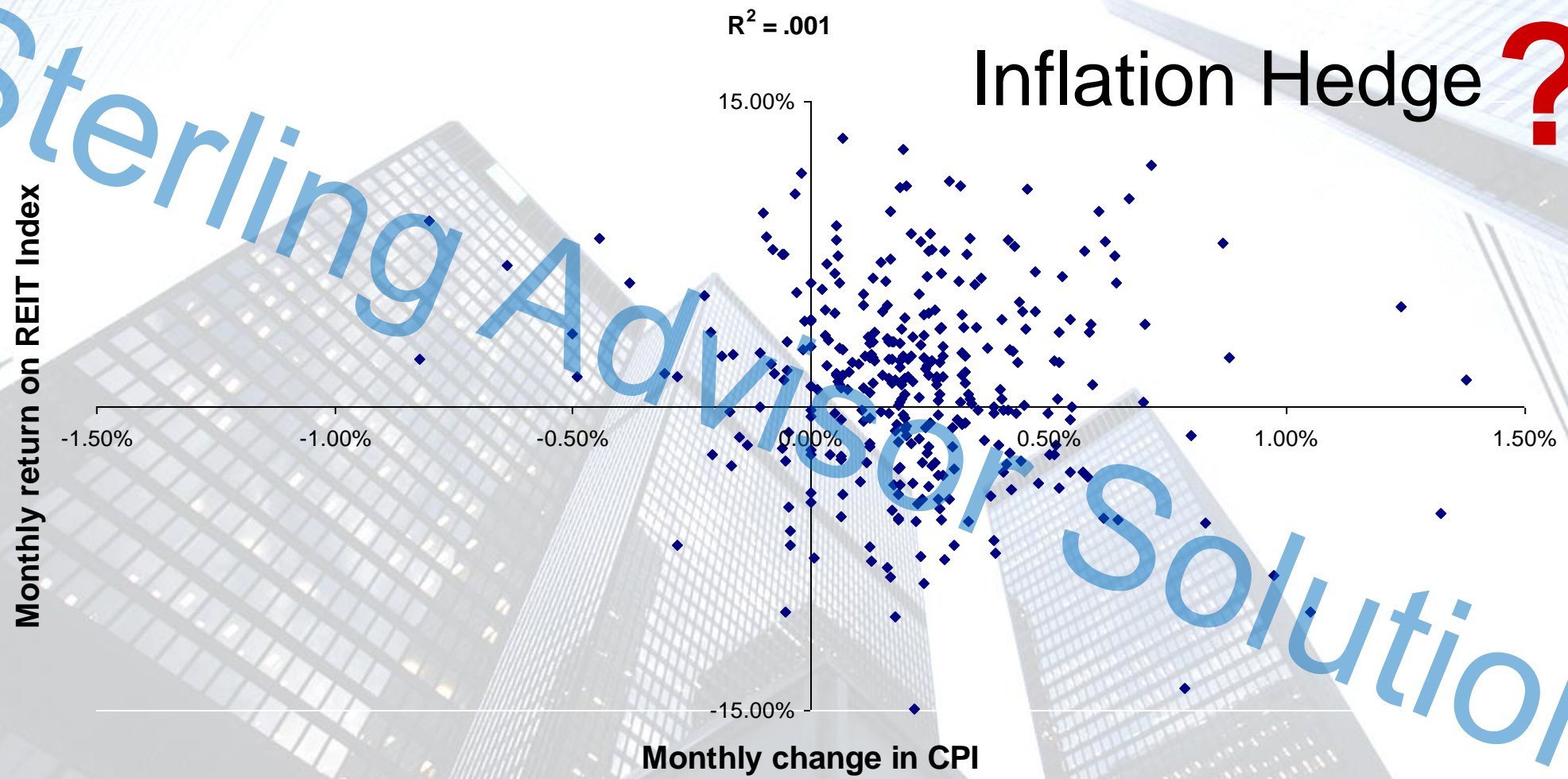
S&P 500 vs NAREIT All-Equities Index



The NAREIT is ~36% more volatile than the S&P 500

Monthly CPI Inflation vs Monthly Return on REIT Apartment Index

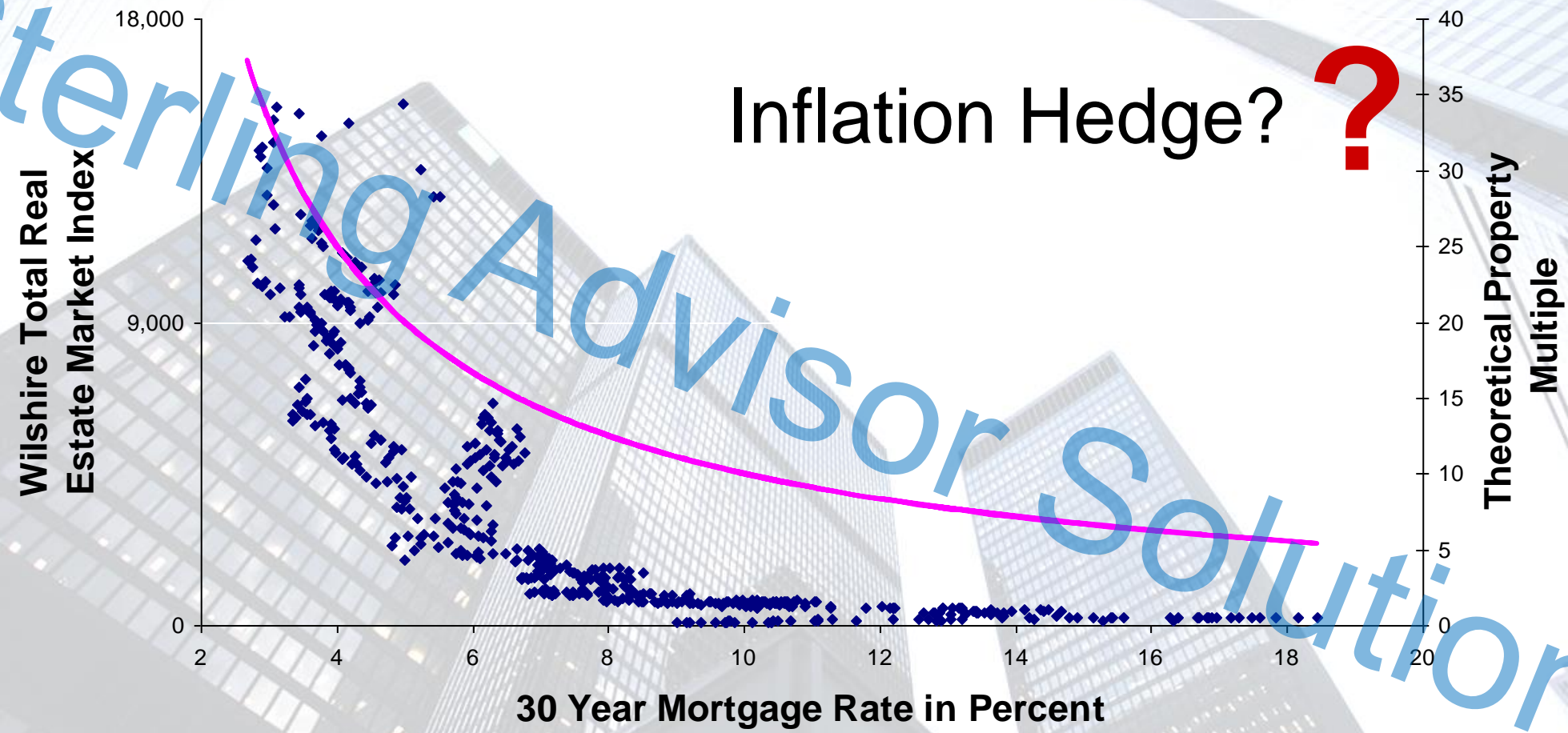
Inflation Hedge ?



▶ Last 30 years show no correlation between inflation and REIT returns

Interest Rates and Real Estate Values

Inflation Hedge? ?



Real Estate is MUCH more sensitive to interest rates than to inflation

Case-Shiller Nominal Home Price Index

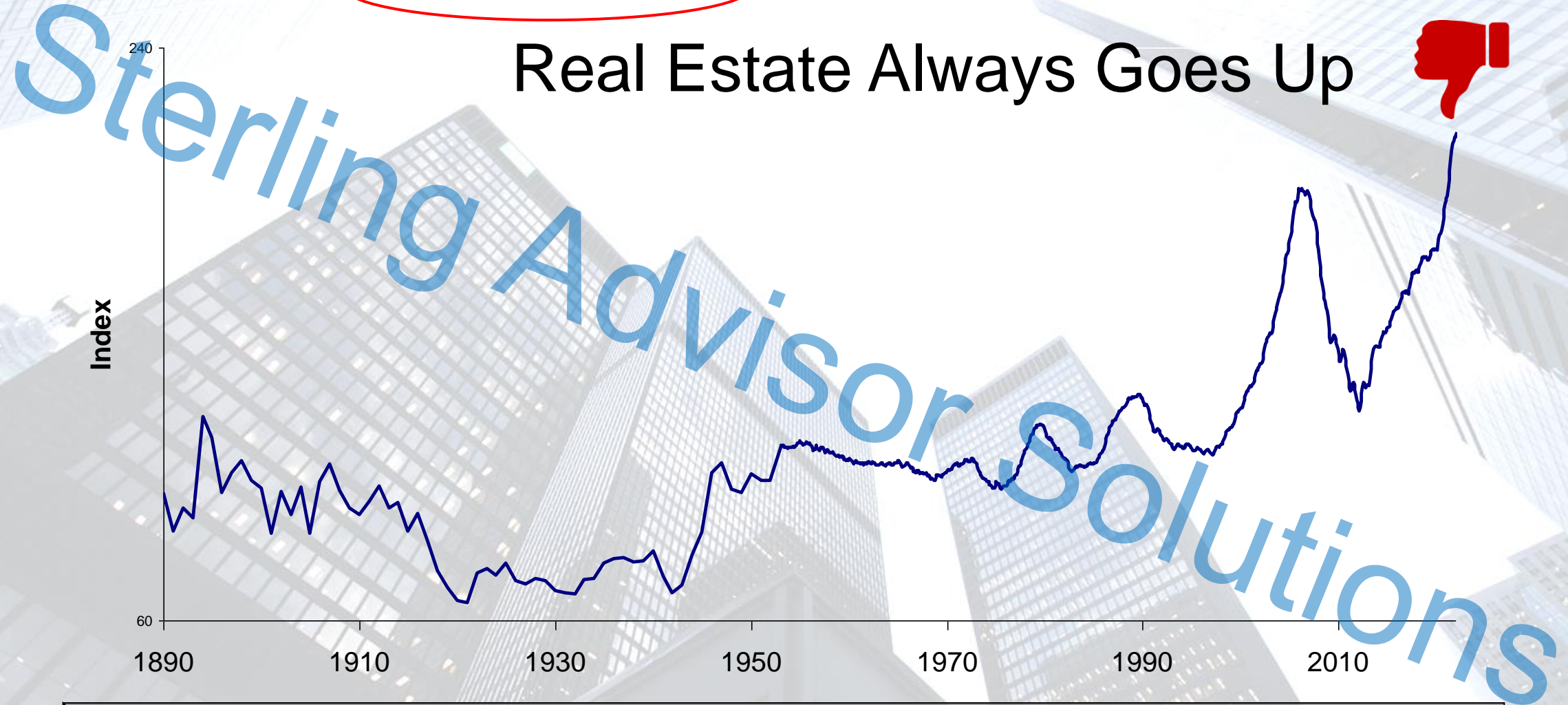
Real Estate Always Goes Up



▶ Lots of periods when real estate has not gone up, or has gone down

Real (Inflation Adjusted) Case-Shiller Home Price Index

Real Estate Always Goes Up

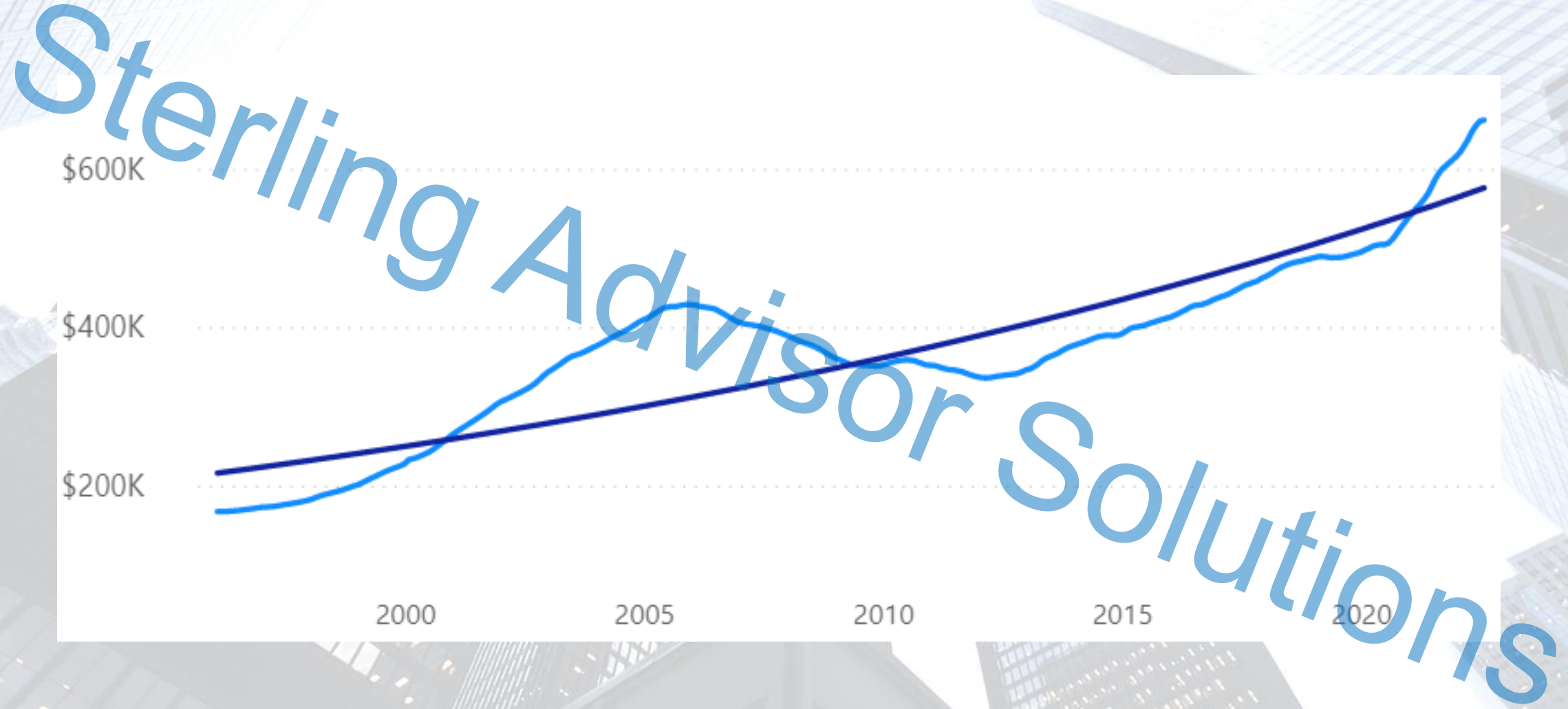


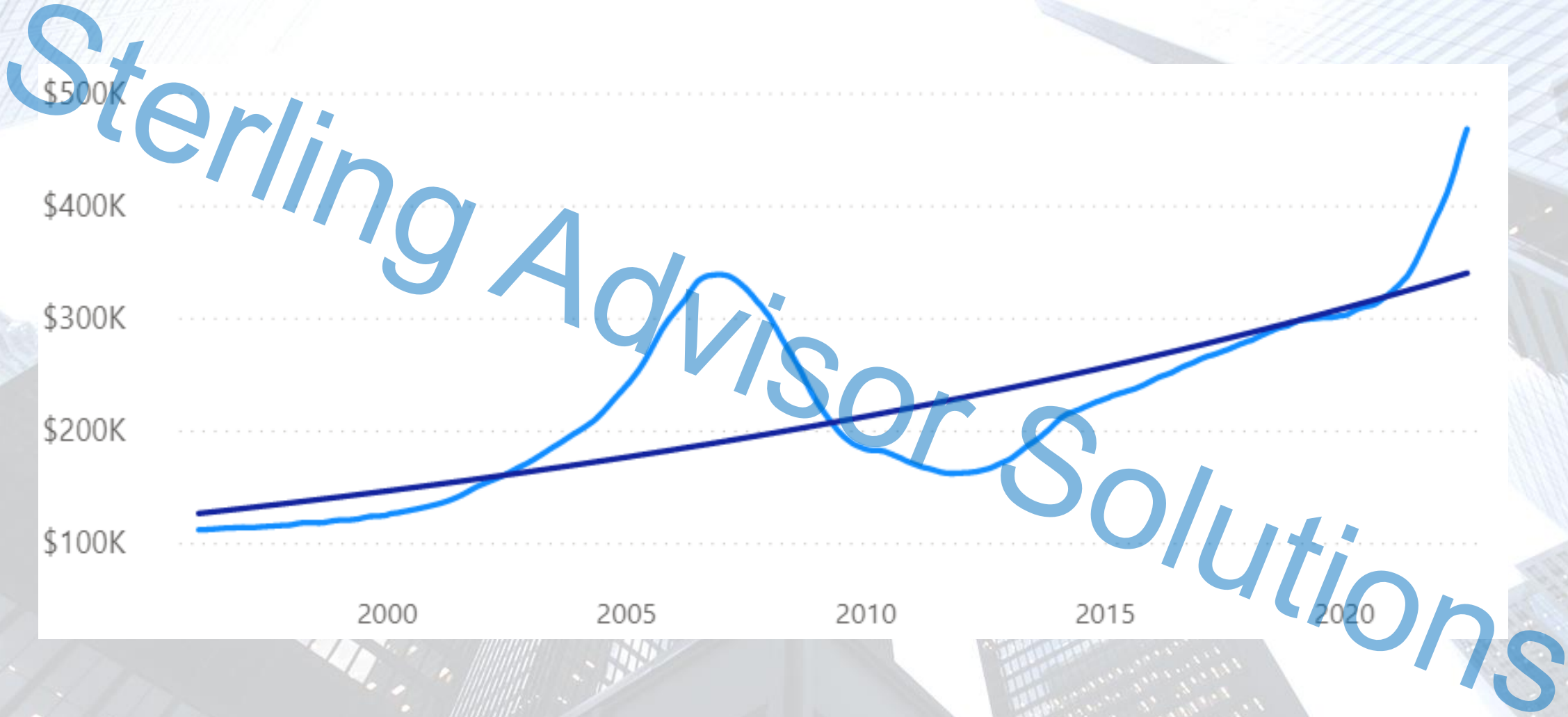
▶ The long run real return has averaged 0.57% per year

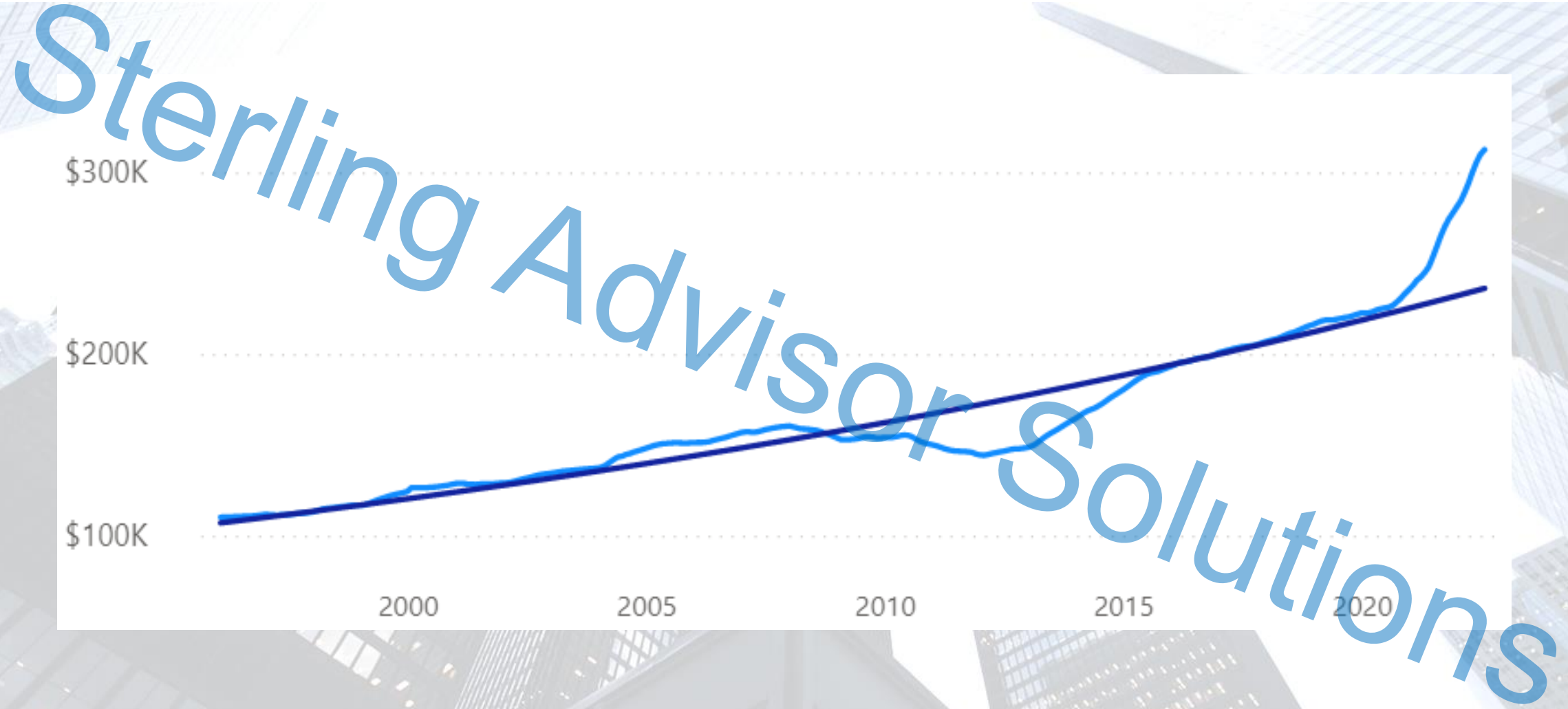
Case Shiller Real Estate Index, with Trend

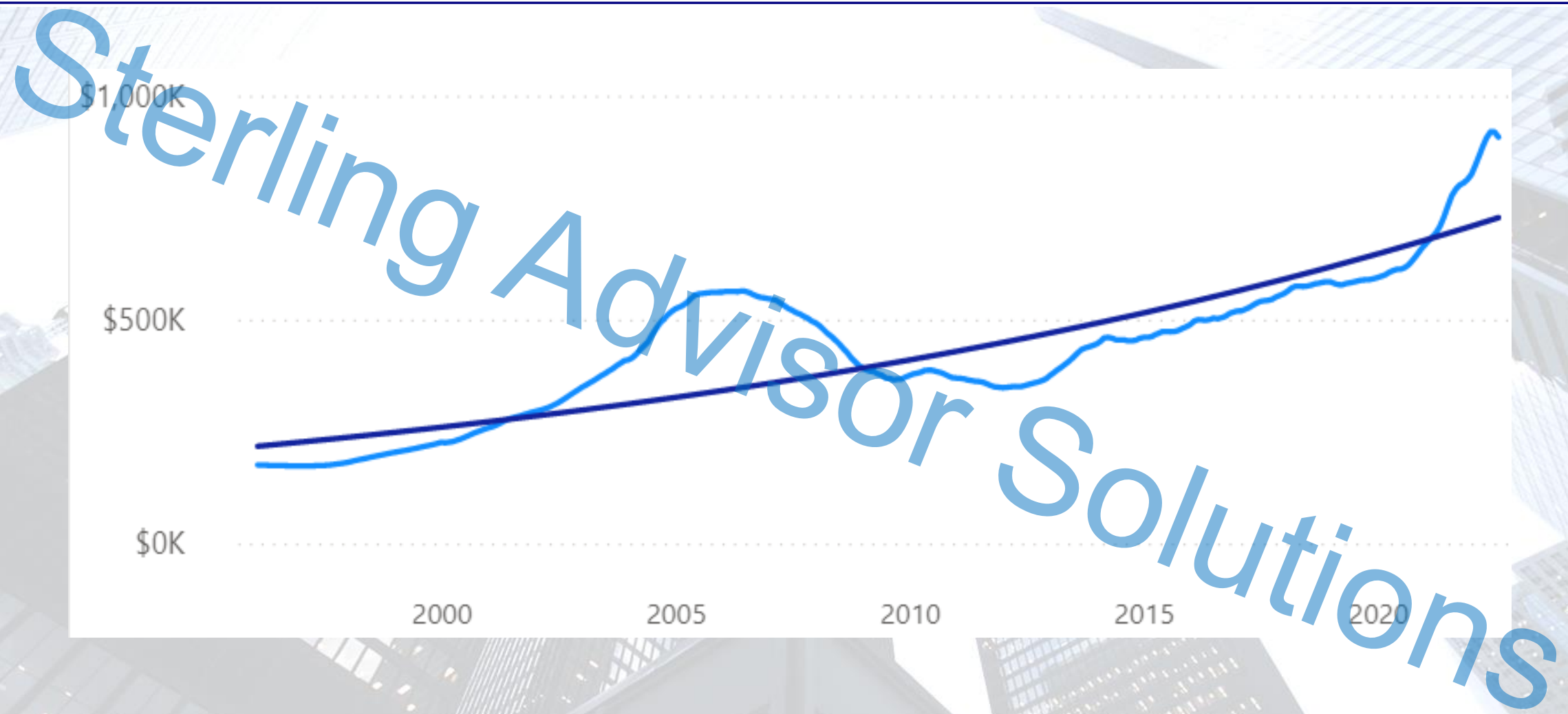


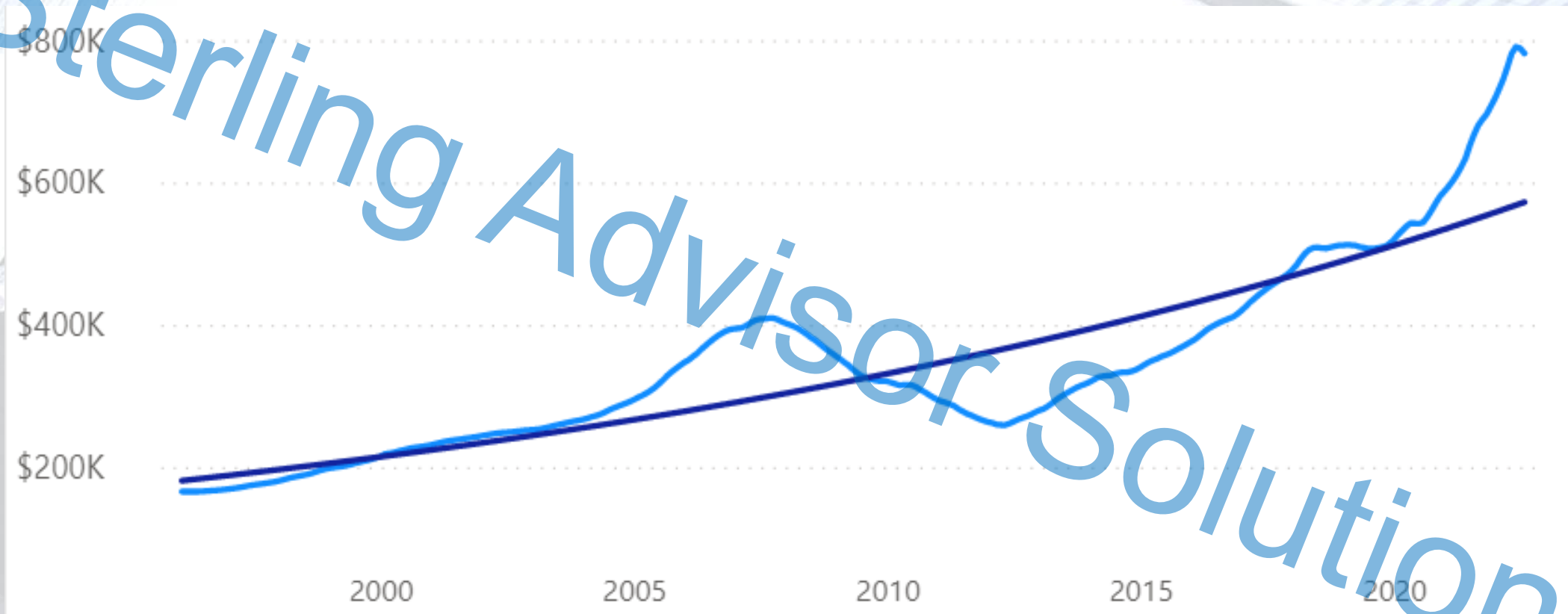
▶ A study by Moody's estimates that real estate is overvalued in 97% of US cities



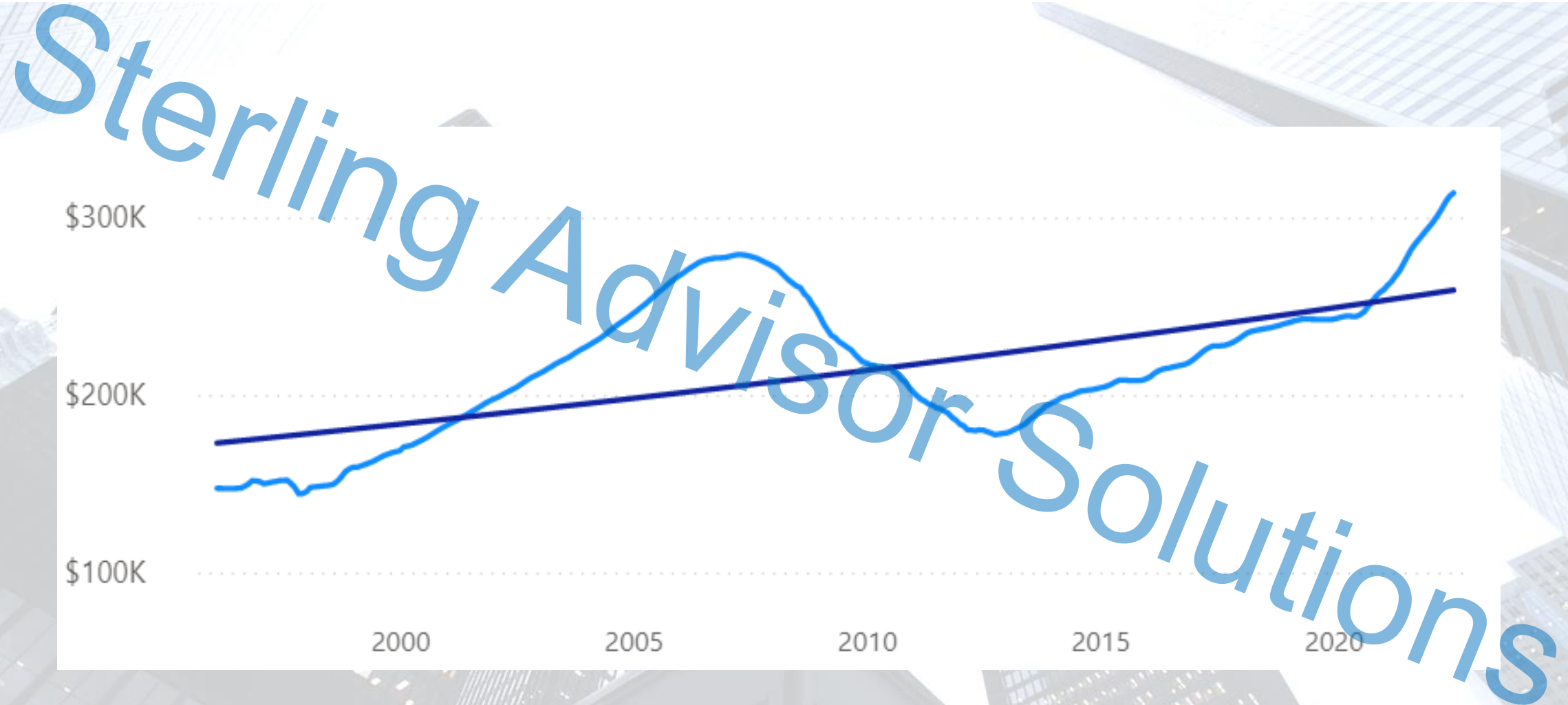




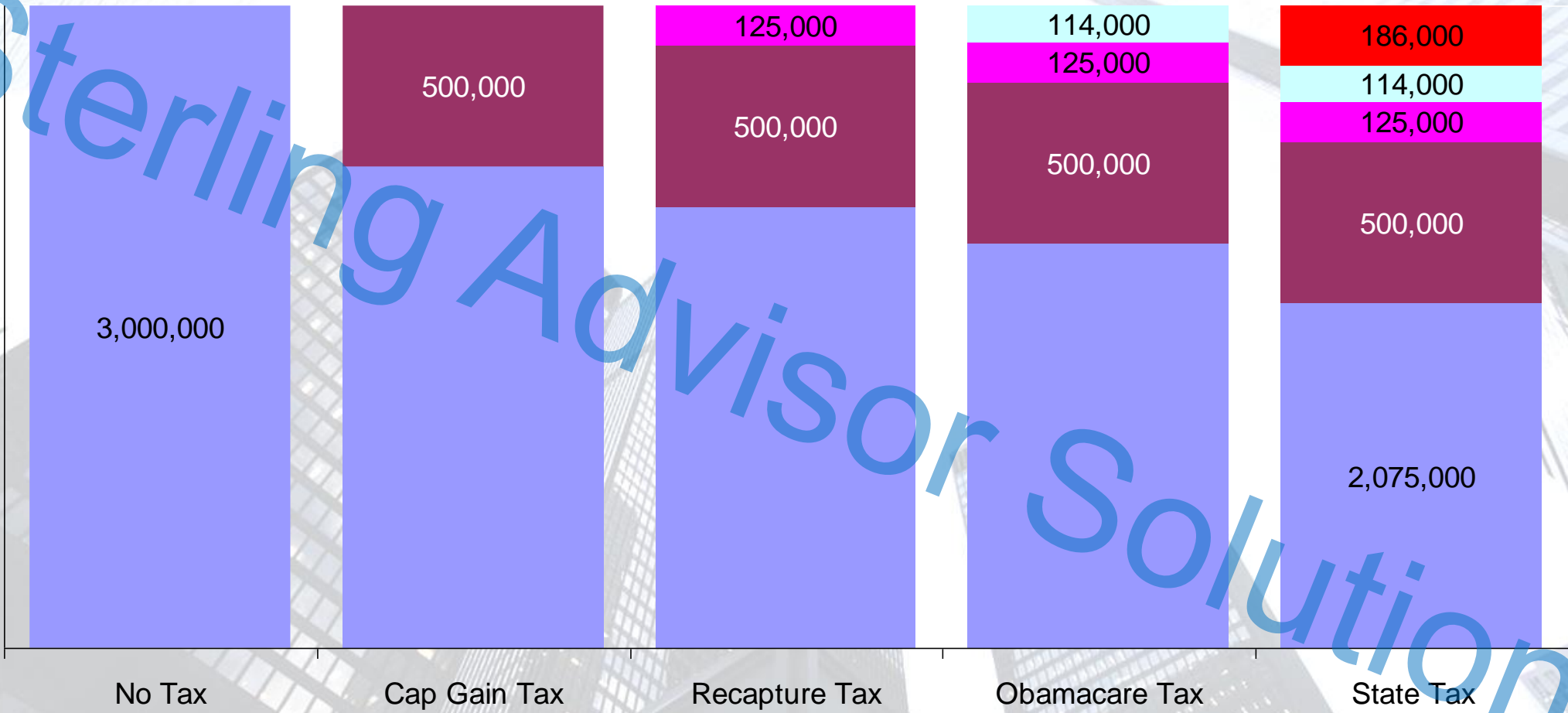




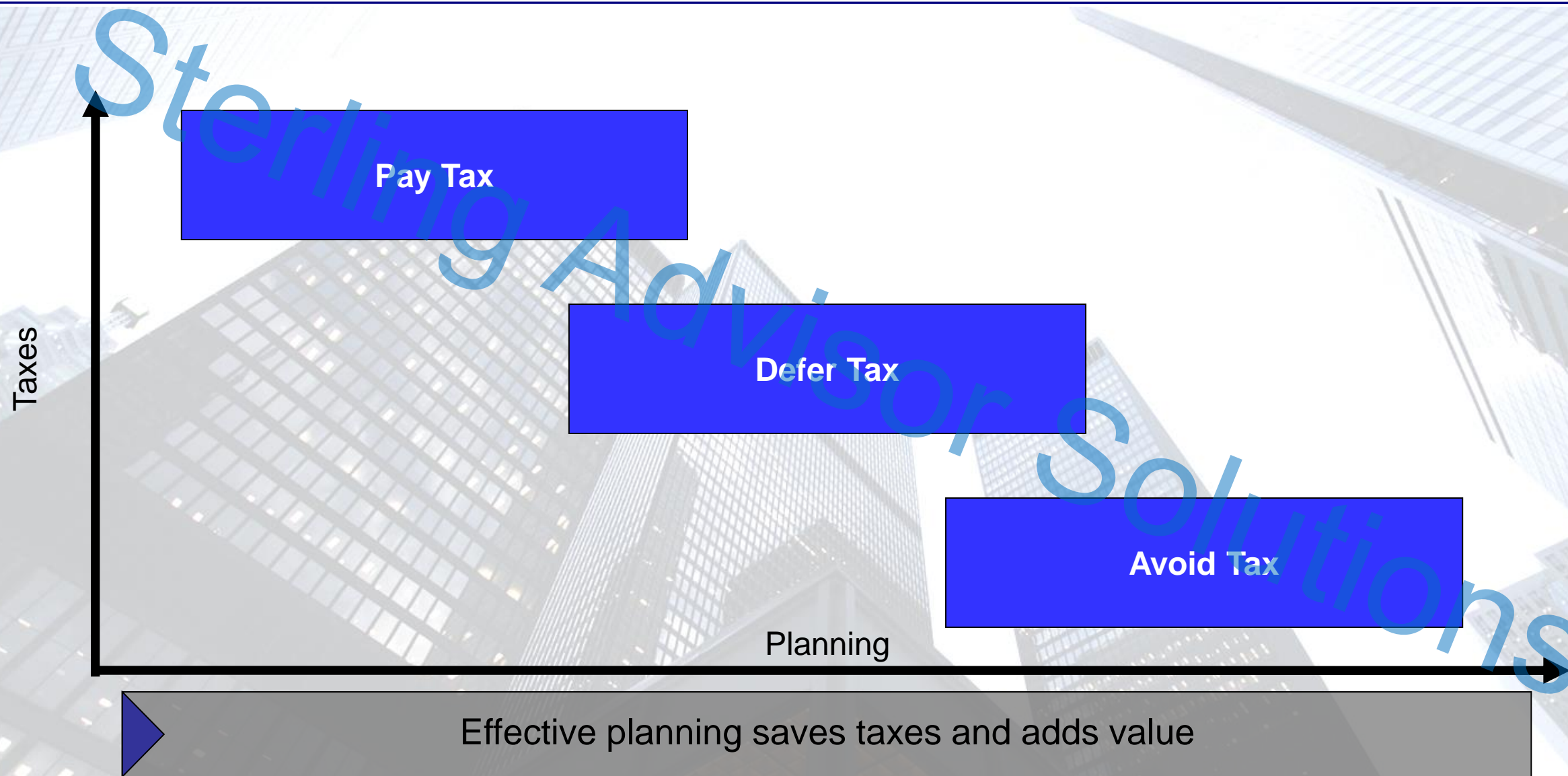
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Taxes on Sale of Real Estate



▶ Taxes are a major reason people don't sell





Federal 23.8% Plus State:

State	Top Rate	Gross	Tax	Net
California	13.30%	3,000,000	1,113,000	1,887,000
New York (City)	12.70%	3,000,000	1,095,000	1,905,000
Hawaii	11%	3,000,000	1,044,000	1,956,000
New Jersey	10.75%	3,000,000	1,036,500	1,963,500
Oregon	9.90%	3,000,000	1,011,000	1,989,000
Minnesota	9.85%	3,000,000	1,009,500	1,990,500
District of Columbia	8.95%	3,000,000	982,500	2,017,500
Vermont	8.75%	3,000,000	976,500	2,023,500
Iowa	8.53%	3,000,000	969,900	2,030,100
Wisconsin	7.65%	3,000,000	943,500	2,056,500
Average*	6.53%	3,000,000	909,900	2,090,100

*Simple average of states that have an income tax

State income taxes add to federal pain

Benefits

- Gain is spread across years**
- Tax is deferred**
- Tax may be paid at lower rates**

Limitations

- Full depreciation recapture in first year**
- Gain is partly converted to ordinary income**
- Seller exposed to risk of buyer's credit**
- Seller still exposed to risk of property (as collateral)**
- Cash received only over time**
- Exposure to potential tax rate increases**

Can work in selected situations; Not a general solution

Source of Benefit

Allocate income to lower brackets

Works best for taxpayers who have little income other than the sale

Capital Gains Amounts & Rates		
From	Up To	Federal Rate
-	80,801	0.0%
80,802	250,000	15.0%
250,000	501,600	18.8%
501,600	>501,600	23.8%

Hypothetical "Best Case"

\$3 Million Gain

Seller has no other income; no recapture; no state tax

	<i>Straight Sale</i>	<i>Four Installments</i>	<i>Six Installments</i>
Approx. Tax	\$667,300	\$568,000	\$484,000

Best when no recapture, and seller has no other income

1031 Exchange

Hudson Waterfront Associates

Qualified Third Party

Qualified Third Party

Riverside South, NYC,
Bought \$100 Million
Sold for \$1.76 Billion



555 California St., SF

1031 works brilliantly in the right situations

Benefits

Tax can be completely deferred
Property can be mortgaged

Limitations

Cannot be used for personal residence
Complex
Only works for investment real estate
Does not facilitate diversification outside of real estate
Cash or debt relief is taxable
Short time horizon for exchange

1031 works best for active, professional real estate investors

1031 Exchange – “DST”

Delaware Statutory Trust →

Fractional, Undivided interest in property



Qualifies as 1031 replacement property

Very limited flexibility “7 deadly sins”

Complex

No control

Lockup usually 5 to 10 years

“Black box”

Illiquid – no market for DST interests

May be hard to measure costs

Small market

DST is probably best used to rescue 1031 that would otherwise fail

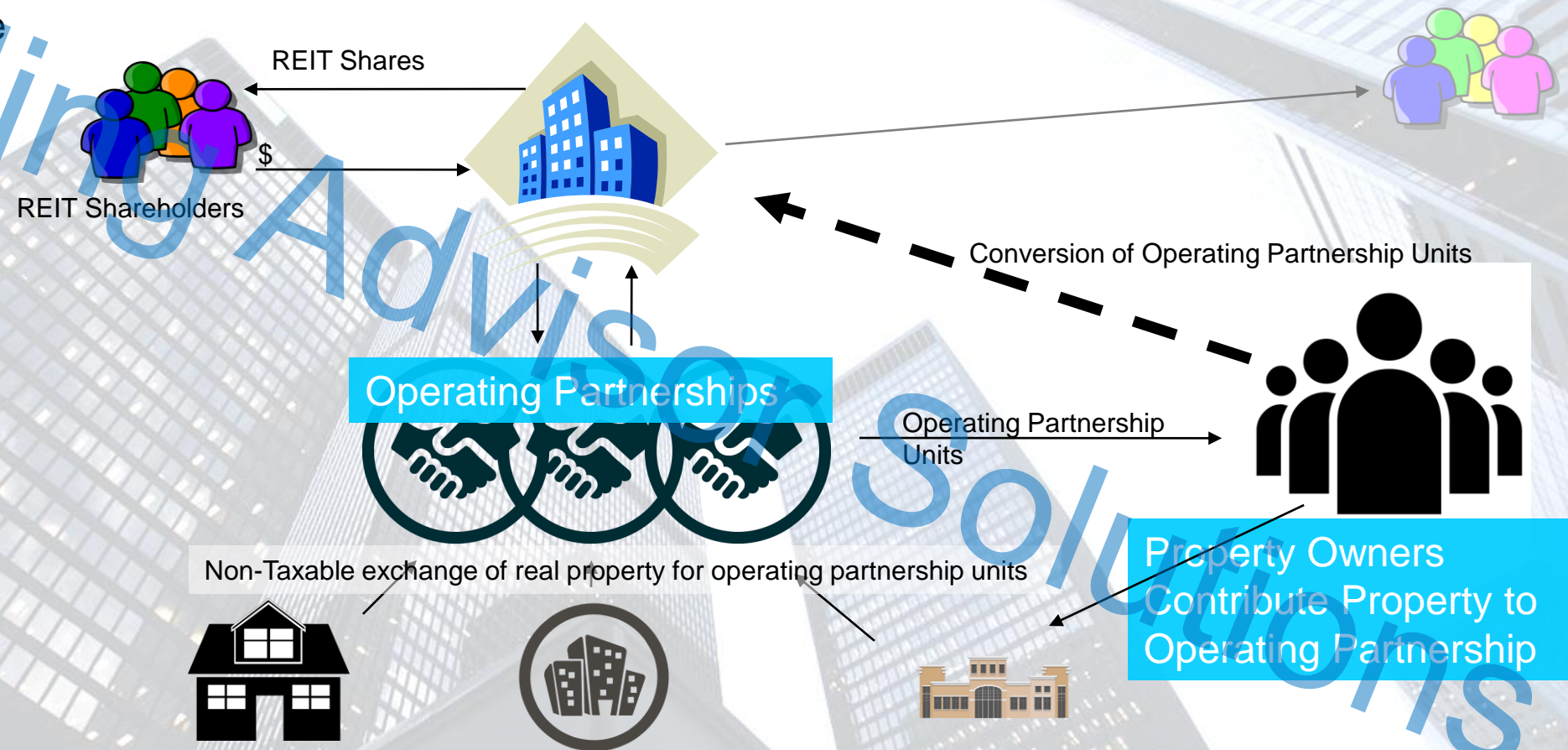
UPReit (721 Exchange)

Owner exchanges a property for operating partnership units in a REIT

No Tax on exchange

Owner can later convert operating partnership units into REIT shares.

Taxable



UPReit is complex, and requires expert advice

Benefits

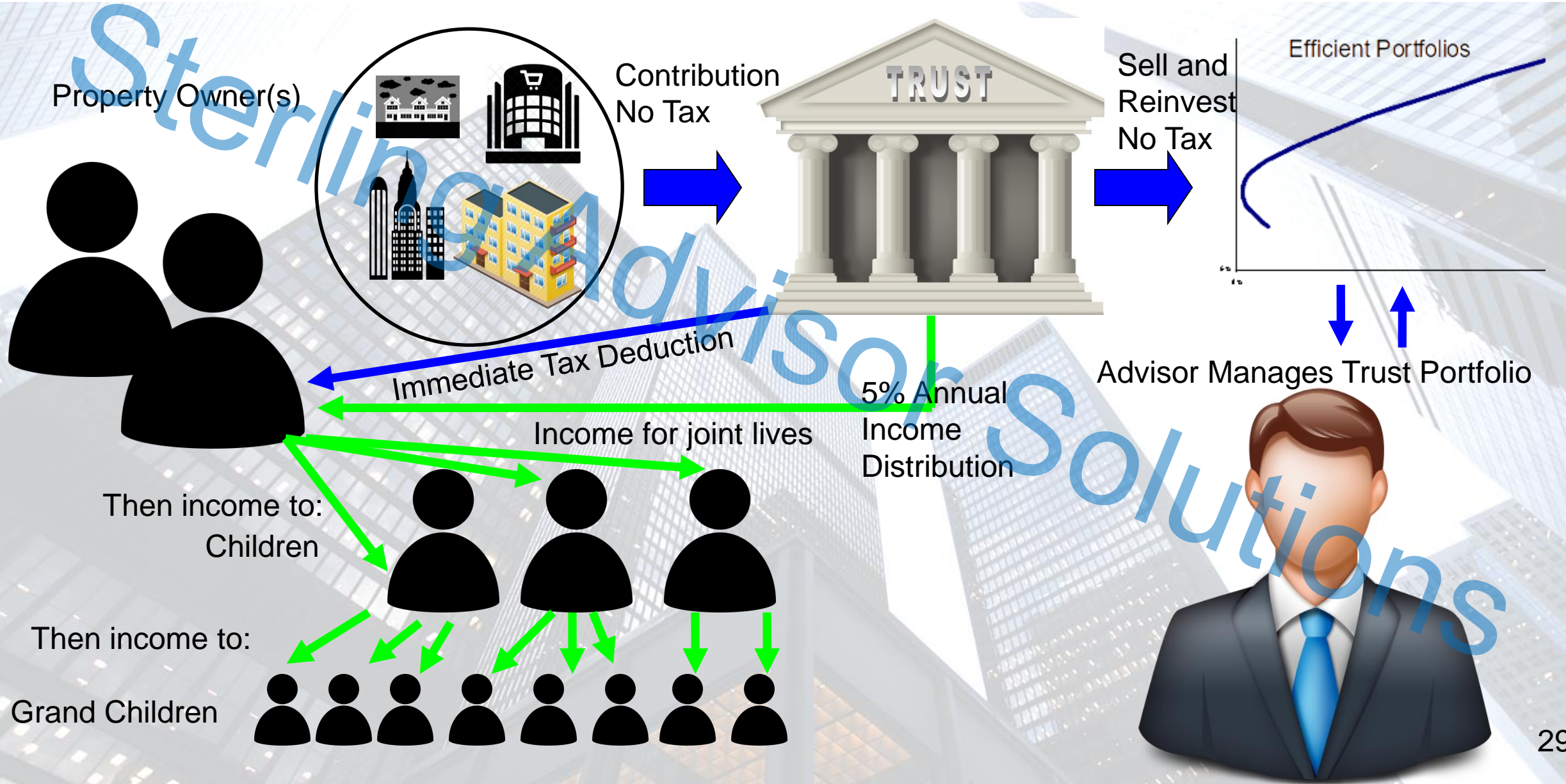
- Tax can be completely deferred**
- Property can be mortgaged**
- Diversification within the REIT**
- Cash flow**
- Liquid if REIT is publicly traded**

Limitations

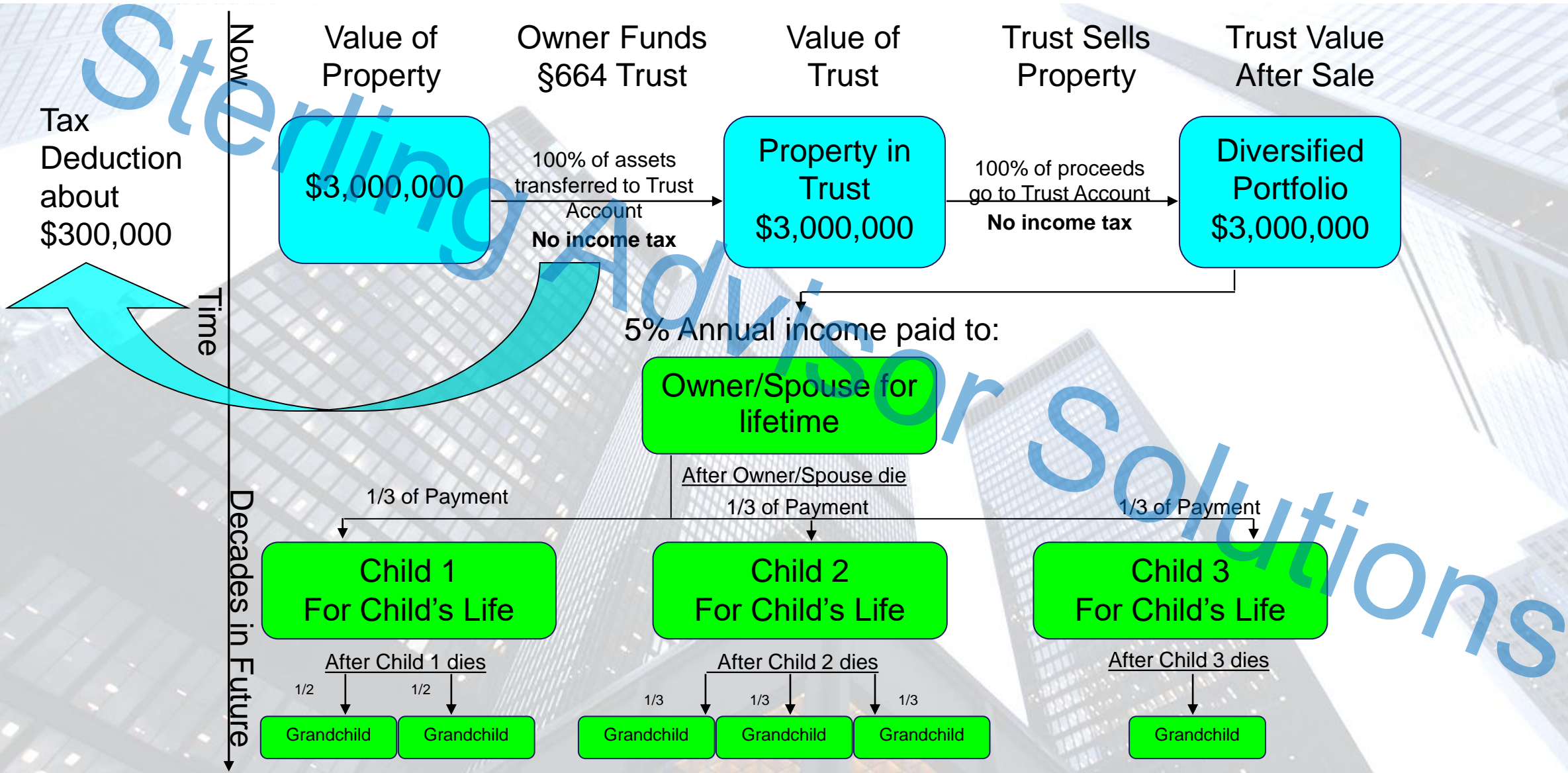
- Complex**
- No control**
- Taxation can be triggered by events out of investors control**
- Only works for investment real estate**
- Does not facilitate diversification outside of real estate**
- Cash realized is taxable**
- UPREITs won't accept just any property**
- Partner may be taxed in every state in which REIT has property**

UPReits can work when limitations are acceptable; typical deal size ~ \$15- \$30 million

§664 Real Estate Shelter Trust



§664 Real Estate Shelter Trust



This is an example only, and does not necessarily represent any specific client situation. At the conclusion of the life of the last beneficiary, or the final term of the trust, the remaining assets will go into a donor advised fund account. The term of each trust will be a function of the ages of the beneficiaries living at the time of the client's death, and the applicable IRS tables and rules.

Example

Total Wealth: \$664 Real Estate Shelter Trust vs. Sell, Pay Tax & Reinvest

Key Assumptions: Asset Value: \$3,000,000.; Basis: \$300,000.; Recapture: \$500,000.; Effective Cap Gain Tax Rate: 30.3%; Growth Rate: 7%; Trust Costs 0.5%; For Taxable Account, growth is taxed each year. Payout rate is 5%, Spending begins in year 1



Advisor: Advisor, Client: Client; Date Run: 08/07/22

This graph illustrating the implications of assumptions, some listed others not, is provided for the convenience of you and your advisors. It is not a forecast. It is based on assumptions and methods that are believed to be reasonable, but includes known simplifications including but not limited to the use of a single average annual rate of return and constant tax rates. No warranty explicit or implied. © Sterling Foundation Management, LLC

Can Function as a Deferral Vehicle

Total Wealth: **\$664 Real Estate Shelter Trust vs. Sell, Pay Tax & Reinvest**

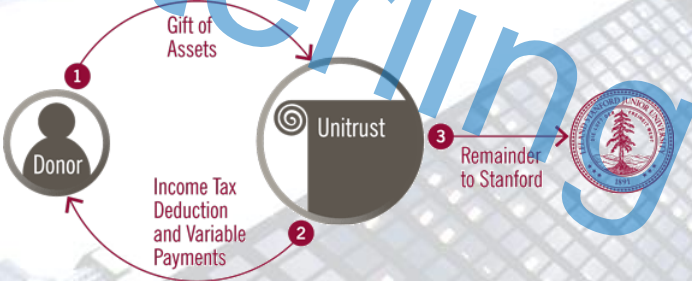
Key Assumptions: Asset Value: \$3,000,000.; Basis: \$300,000.; Recapture: \$500,000.; Effective Cap Gain Tax Rate: 30.3%; Growth Rate: 7%; Trust Costs 0.5%; For Taxable Account, growth is taxed each year. Payout rate is 5%, Spending begins in year 10



Advisor: Advisor, Client: Client; Date Run: 08/07/22

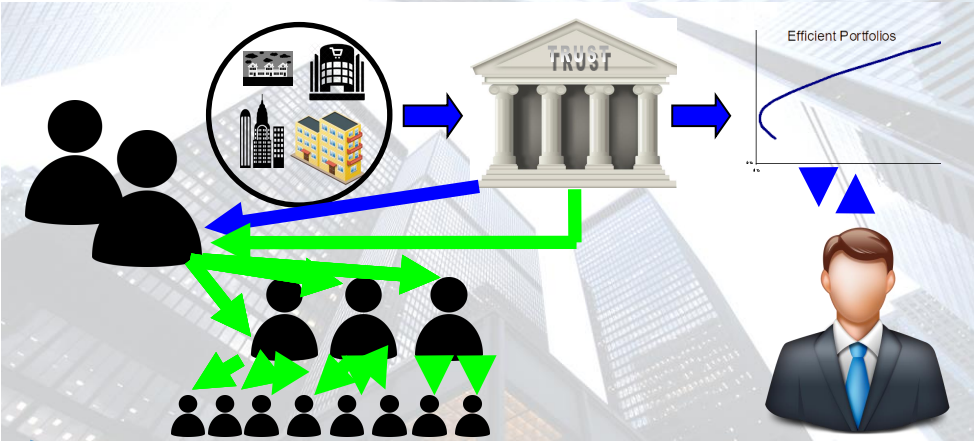
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A Traditional Charitable Remainder Trust



is to:

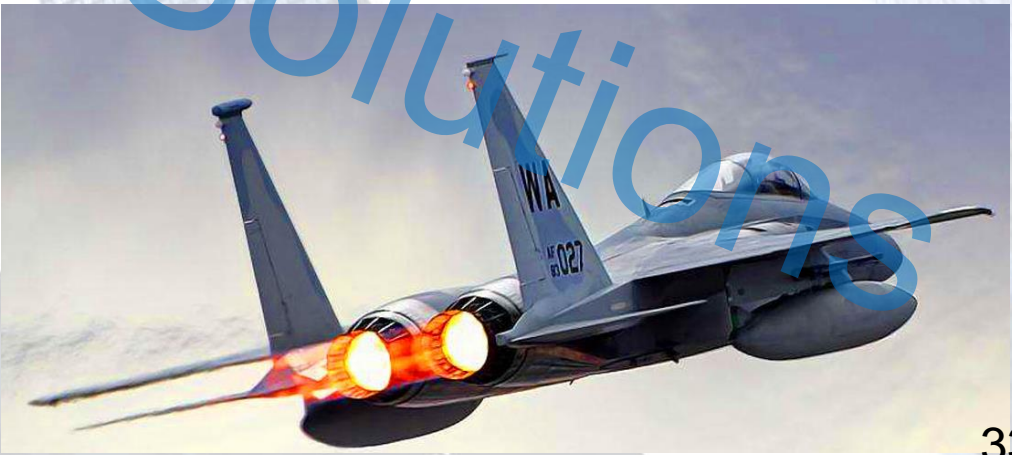
A §664 Real Estate Shelter Trust



AS



is to:



Benefits

- Tax free contribution of property**
- Property sold without tax**
- Assets can be reinvested in fully diversified portfolio**
- Annual cash distributions if desired**
- Indefinite deferral if desired**
- Can last for up to three generations**
- Assets protected from creditors**
- Easy and cost effective to implement**

Limitations

- Requires professional administration**
- Trust is irrevocable**
- Beneficiaries entitled to income only**
- Income is taxable when received by beneficiary**
- Leveraged property may need to be restructured**
- Not usually good for principal residence while principal lives there**

▶ A §664 Trust is often an excellent solution for property owners who want to avoid tax

Summary of Alternatives

	Outright Sale	Installment Sale	1031 Exchange	721 Exchange	664 Trust
Taxable	Yes	Yes	No	No	No
Tax Deduction	No	No	No	No	Yes
Investment Flexibility	Maximum	Limited by cash flow	Real Estate	Real Estate	Maximum
Access to Principal	Yes	Limited by cash flow	With sale and tax	With sale and tax	No
Asset Protection	No	No	No	No	Yes
Tax Free Deferral	No	No	No	No	Yes

Technique	Best Used When
<i>Outright Sale</i>	There is no concern about taxes
<i>Installment Sale</i>	Relatively small gain; no other income; low brackets
<i>1031 Exchange</i>	Investor wants to continue to be active in real estate
<i>721 Exchange</i>	1031 won't work, and investor wants REIT offered
<i>664 Trust</i>	Taxes, investment flexibility, diversification matters;

Real Estate

Examples:

Apartment buildings

Raw land

Old and wants to sell

Tired of managing strip mall

Selling business and building that houses it

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Real Estate

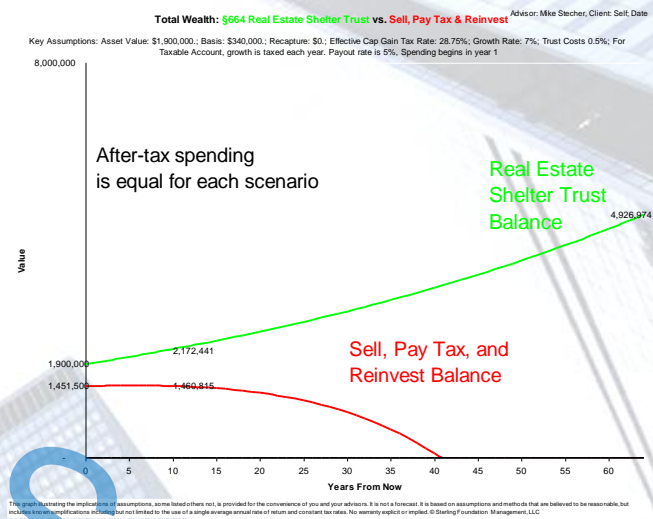
What to look for:

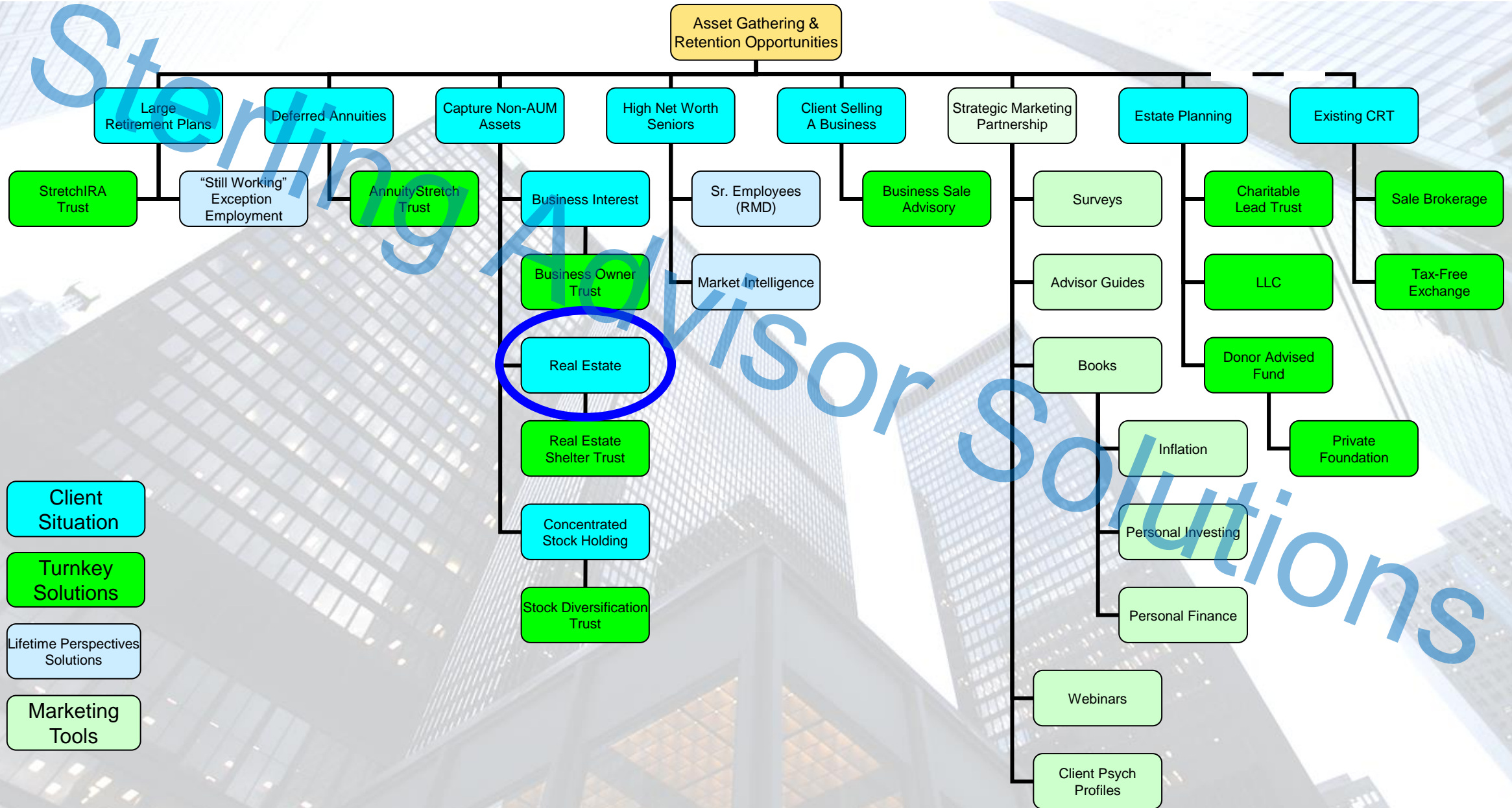
1. Clients with appreciated real estate
2. Info to put together
 1. Approximate market value of real estate
 2. Approximate basis
 3. Amount of debt, if any
 4. Ownership method (e.g. personal, LLC, partnership)
 5. Owner main goals (e.g. save taxes, diversify, cashflow)
3. Is there a spouse, children, grandchildren?

Real Estate

We'll Give You:

1. Individualized analysis
2. Consultation, discussion, review
3. Turnkey documents





- Client Situation
- Turnkey Solutions
- Lifetime Perspectives Solutions
- Marketing Tools

Appreciated Real Estate
A Sterling Advisor Guide
2022




2022

Author(s):
Roger Silk Ph.D., C.F.A., Chief Executive Officer
Ryan Whiting, Business Analyst
Connor Barth, Business Analyst




Selling a Business
A Sterling Advisor Guide
2022




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Concentrated Stock Positions
A Sterling Advisor Guide
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Large Retirement Plans
A Sterling Advisor Guide
2022



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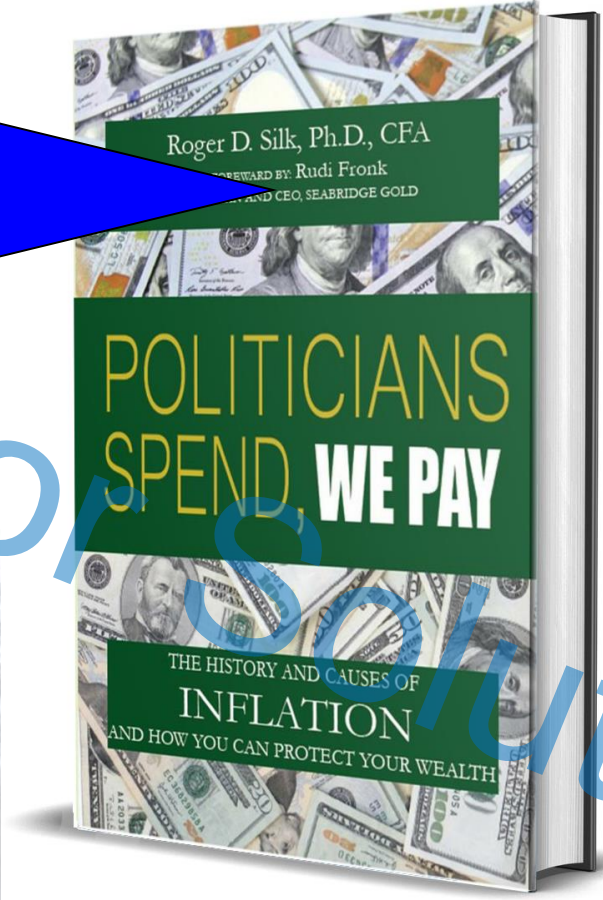
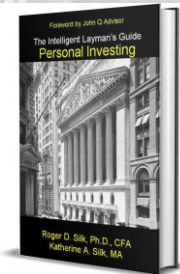
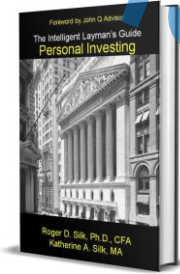
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The Intelligent Layman's Guide to Personal Investing

The Intelligent Layman's Guide to Personal Finance



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Strategic Growth Partnership Program

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