



Why Like-Kind Exchanges in a Distressed Real Estate Market Make a Difference

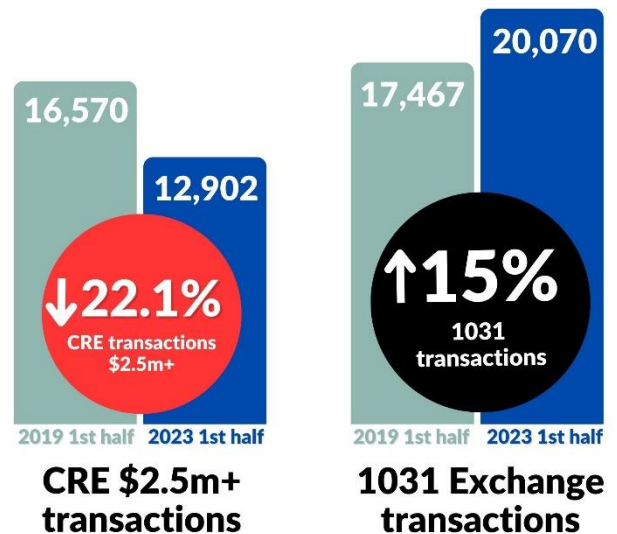
The current commercial real estate market is experiencing significant headwinds. Malls, strip shopping centers, office buildings, and hotels are all distressed. As lenders and capital markets restrict investment activity, 1031 exchanges become particularly important. Investors that have significant gain are able roll over that gain and identify distressed real estate as a replacement property where they can repurpose and improve the property making it viable and productive. In rolling over the gain these investors use less leverage, and often have more equity, than other purchasers, thereby reducing systemic risk in the banking industry.

Looking at the Trends

Commercial real estate activity between 2019 and 2023 was a roller coaster distorted by COVID. To determine current underlying trends, you need to compare 2019 to 2023 and set aside 2020-2022. We compared the first half of 2019 to the first half of 2023.

Marcus and Millichap did an analysis based on Real Capital Analytics data which tracks commercial real estate transactions greater than \$2.5 million.* In the first half of 2023 the transaction count fell 22.1% below the first half of 2019. ** But, according to the Federation of Exchange Accommodators, the number of 1031 exchanges initiated*** increased nearly 15% from 17,467 in the first half of 2019 to 20,070 in the first half of 2023.

The 15% rise in the number of exchanges initiated, when commercial real estate transaction count fell by 22.1%, underscores the importance of like-kind exchanges in periods of reduced commercial real estate market activity.



Examples of The Power of Section 1031

- In Naperville, Illinois, a rundown shopping center where a K-mart had been, was revitalized using a 1031 to bring in new investors. The new owners upgraded the property and brought in Costco which attracted enough tenants to fill all of the remaining retail space, as a result a dilapidated, worn-out property became vibrant again.
- In Chicago, the Chicago Neighborhood Initiatives, developed a national grocery store in a food desert in the Bronzeville neighborhood on the city's South Side. The site was formerly the demolished Ida B. Wells public housing complex, which had remained a vacant lot for more than 15 years. The company developed a Mariano's grocery store in its place, and then a New York investment group purchased the new development through a 1031 like-kind exchange. This outside capital infused a rebirth of jobs, housing and commerce into the Chicago neighborhood.
- "We need to keep the 1031 like-kind exchange (as it is) in our tax code because it is another tool to encourage private capital to flow into commercial real estate projects that will help revitalize our underserved communities," said the president and CEO of DL3 Realty and developer of the Whole Foods, Starbucks and Chipotle in Chicago's South Side Englewood community.

* Based on "Economic Impacts of Commercial Real Estate" published by NAIOP Research Foundation plus "Economic contribution of the like-kind exchange rules to the US economy in 2021: An update" published by EY.

** Omits STORE Capital entity acquisition in 1Q 2023

*** Exchanges initiated includes all 1031 exchanges, not only those involving commercial real estate

*** Exchange open orders includes all 1031 exchanges facilitated, not only commercial real estate