Life Advanced Markets

TARGET MARKETING:

Commercial Real Estate Industry

2021: 3Q - 4Q

COMMERCIAL REAL ESTATE

Industry	The commercial real estate industry is composed of those primarily engaged in acquiring real estate properties; managing those properties; renting, leasing, or generating income off of the properties in other ways; and eventually selling the properties for gain. At the end of 1Q 2021, the Bureau of Labor Statistics reported over 2.2 million are employed in this sector, with a 4.5% industry unemployment rate.
Trends	The pandemic has had a significant impact on the commercial real estate sector. 33% within the industry have seen at least a 25% revenue decline since the pandemic began, with another 27% anticipating a similar decline in the future. 65% of commercial office decision-makers continue to see significant value in on-site operations, though 61% also plan to reassess their future space needs.[1] The 2017 Tax Act provided the commercial real estate sector with a substantial tax break (20% Qualified Business Income Deduction), particularly through an exception that provides a safe harbor for "rental real estate enterprises." This act automatically expires in 2026, though it could be repealed sooner.
Concerns	The 2017 Tax Act **narrowed the use of a like-kind exchange** – for deferring recognition of capital gains under IRC § 1031 – to only real estate. These exchanges are a likely target in future tax legislation which will attempt to roll back these advantages. Opportunity Zones are a common tool for deferring the recognition of capital gains, if gains are reinvested in qualifying opportunities (typically low-income communities). These designations also expire, this time in 2026, and they may also be a target of future legislation to raise revenue. Deferred Sales Trusts (IRC § 453) are a tool regularly presented to business owners in this industry. These trusts are promoted as a means of deferring capital gains by selling an asset to a third-party trust in exchange for a promissory note. Though they are commonly presented to clients, Deferred Sales Trusts are **not approved as a recommended strategy by Allianz** and they may not own an Allianz life insurance policy. Do not confuse Delaware Statutory Trusts with Deferred Sales Trusts (same acronym, DST). A Deferred Sales Trust is a more aggressive tax strategy for deferring gains on the sale of assets such as real estate, while a Delaware Statutory Trust accomplishes similar tax goals and is, as the name suggests, based on statutory law in Delaware.

[1] BOMA International COVID-19 Commercial Real Estate Impact Study, Building Owners and Managers Association International, 2020, https://www.boma.org/BOMA/Research-Resources/3-BOMA-Spaces/Newsroom/Press_Room/2020/PRCOVID19IMPACT.aspx.

AMK-556 (7/2021)

ISSUE	OPPORTUNITY
Many commercial real estate investors owned other businesses first and used the proceeds from the sale of those businesses to invest in real estate. Their "business" is more of an investment, and there is less interest in passing the business to family members intact.	**Irrevocable Life Insurance Trust (ILIT):** Heirs will likely wish to sell the real estate, but those transactions take time. An ILIT (or SLAT) funded with a fixed index universal life insurance policy (FIUL) may provide a death benefit, which is generally passed on income-tax-free to beneficiaries, and thereby liquidity to pay estate taxes, property management fees, property taxes, insurance, and other costs until the property may be sold at the best available price.
The potential for substantial limitations on IRC § 1031 as a means for deferring capital gains tax on the sale of property.	**Charitable Remainder Trust (CRT):** If taxes cannot be deferred as easily, look for opportunities to create other tax deductions in the year of sale. A CRT combined with an ILIT may be appealing.
The pandemic may cause commercial real estate investors to reconsider their investment properties – office space may lose its appeal in comparison to other property types. But with increases in online retail, the demand for warehouse capacity has increased.	**Key employee compensation:** Strategies to recruit and retain employees with specific experience and knowledge in managing and developing particular property types. **Business continuation bonus plan:** Heirs may not have the expertise or know-how to successfully transact real estate. A plan should exist to incentivize key employees to remain with the business until the property is sold.
Tax rates for high-income earners may potentially increase.	**Tax-advantaged financial vehicles:** e.g., FIUL. (For more information on the features and potential benefits of FIUL, refer to the carrier's product marketing materials.)

ADDITIONAL TALKING POINTS:

- Real estate developers typically own multiple properties and may routinely buy and sell new properties triggering capital gains. This creates years in which their taxable income is substantial compared to other years, which may create a desire to find income tax deductions in those years. **Those with an interest in passing on a portion of their wealth to charity may find a charitable trust strategy appealing.**
- Financial professionals working with real estate developers should be familiar with Real Estate Investment Trusts (REITs) and Delaware Statutory Trusts (DSTs). Both provide a means to participate in the commercial real estate market without owning specific properties. They also have the advantage of diversifying the client's real estate portfolio. **REITs and DSTs may be appealing to real estate investors/developers looking to transition away from active management/ownership.**
- Financial professionals working in states with high state and local income taxes may also want to become familiar with Delaware or Nevada Incomplete Nongrantor Trusts (DING/NING). These are trusts established in states with low, or no, state-level taxes that are marketed as a means of selling highly appreciated assets, like a business entity or real estate, while avoiding state-level taxes. **Since real estate developers may be involved in multiple sales of highly appreciated properties, those in high-taxed states may be approached with this strategy.**

RESOURCES: Click these links to learn more.

- Building Owners and Managers Association International, BOMA International
- CCIM Institute (Their CIRE Magazine, under the "Industry Resources" tab, provides an excellent window into current issues and opportunities for those involved in commercial real estate.)
- IRS Opportunity Zones Frequently Asked Questions

To learn more, contact the Advanced Sales and Practice Platform team at 800.800.3220 or AdvancedStrategies@allianzlife.com

Fixed index universal life insurance requires qualification through health and financial underwriting.