IREON Insights: A convergence of calamities — Same old story — Now is the time for planning with real estate - by Neil Axler and Craig Stephanson, part 2 of 3

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(This article is the second in a three-set series. This second article continues the discussion of challenges in valuing real estate properties, continues the discussion of the impact of interest rates on real estate values, and introduces the concept of valuation discount planning. Each of the three-part series articles should be read in conjunction with each other)

This year, there are several financial, legislative, economic, and political undercurrents that are lining up for a perfect storm of opportunity for families with real estate wealth and their estate advisors. Core and non-core office markets are continuing to lose value. Since the pandemic, landlords have struggled to keep tenants due to the genie being let out of the bottle, workers can be very productive at home and WiFi works very well. The labor market is still tight for junior professionals and many companies have to accommodate work-from-home (WFH) for their existing workforce and for optimal recruitment initiatives. The health of the office sector is a tale of two cities — ultra class A properties vs. everything else. The modern class A properties with premier technology and amenity space is doing quite well, while all others are suffering. Keys for many office buildings nationally are going back to the banks and other buildings are suffering with low occupancy and exceptionally low rents and short lease terms. Office buildings that have vacancies are suffering from the exuberant amount of capital needed to attract tenants – significant tenant improvement allowances, extremely competitive leasing commissions and free rent.

The current interest rate environment is also creating opportunities for real estate owners and investors. Interest rates are near their highest levels in decades. With debt rates so high, required equity returns are low, thus driving down the values of most all income-producing real estate properties. While certain market segments and property types are still supported by low cap rates, imagine what is going to happen when interest rates go down? Naturally, as rates go down, real estate values will go up. It is widely anticipated that during 2024, the Federal Reserve will start to lower interest rates. In fact, just this past December the Federal Reserve held its key interest rate steady for the third straight time and set the table for multiple cuts to come in 2024 and beyond. It appears from indications that the Federal Reserve is set to decrease rates potentially three to four times in the coming year.

Accordingly, while real estate valuations are low now and expected to go up as mortgage interest rates begin to gradually drop and landlords and tenants sort through the post pandemic real estate markets, and while the gift and estate exemption levels are high and soon to be reverting back to pre-TCJA levels (discussed in the first article in more detail), now is the perfect opportunity to (i) gift real estate at low values, (ii) pay no gift taxes on the gift, and (iii) permanently remove these assets out of your estate. The future anticipated value increase and appreciation on these real estate assets is then passed on gift tax-free to the next generation of family members.

But wait, there is more. What if you could further supercharge this gifting strategy? Through the leveraging of valuation discounts, you can. By using valuation discounts, these gifts of real estate can be effectively valued even lower, thus using up less of your lifetime exemption, passing on even more future asset appreciation to the next generation, and eliminating the family’s current estate tax burden. Accordingly, it is important to do your planning now and get ahead of the curve and get into the queue sooner, rather than later. These types of opportunities present themselves only so often and now is the time to act.

Part three will appear in the April 30, 2024 NYREJ edition.

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