Real Estate Digest

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How Trump's Tax Plan Will Impact Real Estate

With the new administration underway, Donald Trump is already working on a new tax plan. Analysts at Baker Newman Noyes, a leading national accounting and consulting firm, have reviewed President Donald Trump's vision for tax reform and predict that the changes to the tax code will have significant impacts on the real estate and construction industries.

While some details of the plan are already available, analysts are still trying to interpret the meaning of other general provisions that remain vague. Here are a few of the provisions that analysts have interpreted thus far and what they mean for individual taxpayers and businesses.

Capital Gains on Property

When Sold: The tax code prior to the new administration provided favorable federal tax rates on long-term capital gains. Depending on the recipient's "regular" tax bracket, the current capital gains rates are 0, 15 or 20 percent. While tax brackets will change under Trump's tax plan, the overall structure and impact of capital gains tax won't change much for taxpayers.

When Donated: Trump's tax plan would still permit charitable contributions of certain types of property, including appreciated

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real estate held for more than one year. However, analysts say the current language of the plan provides little insight as to whether these charitable contributions will be subject to itemized deduction caps ($100,000 for single filers and $200,000 for joint filers).

When Held Until Death: Beneficiaries who inherit such property will have the gains taxed when the property is received, if previously untaxed gains exist at the time of death and those gains exceed $5,000,000.

Pass-through Income: Trump proposes a flat income tax rate of 15 percent for businesses, which also applies to flow-through income. However, some analysts believe that businesses will be subject to a second layer of tax applicable to distribution in exchange for the tax rate reduction.

AMT: Trump's tax plan calls for an immediate end to the Alternative Minimum Tax (AMT).

Carried Interest: Under Trump's tax plan, favorable interest rates will come to an end. However, how this will occur is still uncertain.

"We are missing enough details that we cannot provide meaningful guidance on how flow-through income will fare generally, so we are even less able to explain how treatment of carried interest will fit into the picture," says Stanley Rose, CPA, MST. "Trump plans for across the board tax decreases, so it is possible that carried interest will no longer qualify for capital gain rates, but will not be beaten as soundly as it would if top rates remain where they are now."

This brief analysis of the new administration's tax changes and the potential impact on the real estate industry are mostly speculative, given that the legislation is still making its way through Congress. Analysts expect more details about the tax changes to become available in the coming months.

Average Real Estate Commissions Decline to Low 5 Percent Range

According to new research, the average real estate commission paid on U.S. home sale transactions continues to decline and may dip below 5 percent within the next few years. Real Trends Consulting Inc., a research and advisory company, made this prediction after reviewing data on the sales and commission rates of 450,000 sales agents across the country. "We are headed for (a) sub-5 percent overall rate within the next few years," said Steve Murray, Real Trends president, in an article in the column "The Nation's Housing."

The move to commission rates below 5 percent marks a sharp decline from the 1980s and early 1990s, when the standard real estate commission rate was 7 percent in some local markets.

Analysts attribute the decline in commission rates to increased competition among agents who work for brokerages (rather than being independent contractors), tech-savvy competing firms, shortages of available listings, and increased negotiations towards lower commission rates between brokers and agents.

According to survey data from the National Association of Realtors, 83 percent of recent buyers and sellers chose full-service brokers for their transactions, while just 17 percent chose brokers who offered limited services.

Traditional brokers argue that skimping on fees and working with discount firms have resulted in negative consequences for sellers, including poor marketing efforts, inadequate photography, inexperienced agents, and the risk of losing more money on the final sale price than a seller saves in fees.

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Consumer Sentiment Declines in January but Remains Near 13-Year High

The University of Michigan said that its preliminary reading of consumer sentiment declined to 98.1 in January, a decline from December 2016's final reading of 98.2. It is up 6.6 percent from a year ago.

Economists surveyed by *The Wall Street Journal* predicted a January reading of 98.6, a difference of 0.4 percent from the officially reported survey results.

In recent years, consumers have increasingly mentioned government policies and administrations during the survey, which indicates the important role that government action plays in how consumers feel about the economy.

"The postelection surge in optimism was accompanied by an unprecedented degree of both positive and negative concerns about the incoming administration spontaneously mentioned when asked about economic news," said Richard Curtin, the University of Michigan survey's chief economist.

Consumer sentiment recently reached its highest level in 13 years, up 7.5 percent in January from a year ago. The numbers are a sign of consumers' confidence in the economy after the election of Donald Trump.

Foreign Real Estate Investors Still Confident About U.S. Real Estate

According to a recent survey from the Association of Foreign Investors in Real Estate (AFIRE), foreign investors continue to view U.S. real estate as a sound investment.

This year, 95 percent of survey respondents said that they plan to "maintain or increase" their investments. U.S. real estate was also ranked first by survey respondents for security, stability and opportunity for capital appreciation.

In addition, investment opportunities in U.S. real estate have increased, with investors preferring industrial properties as the top investment type, over multifamily properties.

Foreign investors are also becoming increasingly confident in emerging U.S. real estate markets, such as Charlotte, N.C. and Nashville, Tenn. Fifty percent of respondents also reported that they believe Brexit will have a positive impact on U.S. real estate. However, some investors are uncertain about political and economic changes in the U.S. as a result of the new presidential administration.

"As uncertainty rises with a new government in Washington and interest rates that have risen dramatically, it is no surprise that investors have signaled a note of caution," says James A. Fetgatter, CEO of AFIRE. "Previous, comfortable spreads between cap rates and interest rates have narrowed, making the investment criteria more selective and difficult. Increased market research and discipline will be required."

Mortgage Applications Decline 12 Percent to End 2016

Mortgage application volume plunged 12 percent on a seasonally adjusted basis from two weeks earlier for the last week of December, according to a report from the Mortgage Bankers Association (MBA). On an unadjusted basis, the Index decreased by 48 percent.

"Mortgage application volume typically drops sharply over the

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holidays. However, this year, as mortgage rates continued their upward climb reaching the highest levels in more than two years, overall application volume fell even more than the holiday slowdown would suggest," said Michael Fratantoni, chief economist for the MBA.

The Refinance Index decreased by 22 percent from two weeks prior, while the refinance share of mortgage activity increased to 52.2 percent of total applications from the week prior. The FHA share of total applications increased to 11.6 percent from 10.7 percent the week prior. The VA share of total applications decreased to 12.3 percent from the week prior. The USDA share of total applications increased to 1.1 percent from the week prior.

The seasonally adjusted Purchase Index declined by 2 percent from two weeks prior, while the unadjusted Purchase Index decreased by 41 percent, a 1 percent year-over-year decline.

The MBA survey includes more than 75 percent of all U.S. retail and consumer direct residential mortgage applications. Survey respondents include mortgage bankers, commercial banks and thrifts.

New Report Names CEO of Zillow as Most Powerful Person in Residential Real Estate

A new list of the most powerful people in residential real estate in North America demonstrates technology's impact on the business of buying and selling homes.

The Swanepoel Power 200 list, released by real estate consulting company T3 Sixty, named Spencer Rascoff, CEO of Seattle-based Zillow Group, as the most powerful person in residential real estate in North America. T3 Sixty is the consulting arm of San Juan Capistrano, Calif.-based Swanepoel T3 Group, a real estate information company.

Five other Zillow executives were named on the list, along with Glenn Kelman, CEO of Redfin, another Seattle-based real estate/tech company. Renwick Congdon, CEO of Bellevue-based Imprev, a tech company that provides automated marketing for real estate brokers, was also named on the list. This is the first time since the rankings have been published that a technology leader has achieved the top slot.

"Seven years into his tenure as CEO, Rascoff, 41, has Zillow Group humming on all cylinders," states the ranking. "It operates the world's most popular real estate site in Zillow, is building a comprehensive data management platform epitomized by the acquisition of Bridge Interactive Group, and saw the company's market cap climb to $6.5 billion."

Rising Home Values Haven't Shaken Consumers' Memories of the Financial Crisis

In a keynote speech at the National Retail Federation's annual conference in New York, William Dudley, president of the Federal Reserve Bank of New York, said that consumers' memories of the recession are one reason why retail sales have remained sluggish. Although home prices and values have increased on average nationally, these recent gains aren't enough to persuade homeowners to spend against the growing value of their homes.

According to the National Retail Federation, retail sales rose 4 percent in November and December. However, retail spending continued to remain choppy during the 2016 holiday season as traditional retailers struggled to meet sales goals due to consumers' reluctance to spend money backed by the future value of their homes.

Since 2012, home values have increased an average of 40 percent. In addition, Dudley is predicting that it is unlikely that there will

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be another financial crisis within the next five to ten years, given that the financial system is safer and 2008 housing crisis.

"As time passes, people will forget the financial crisis," said Dudley.

Consumer confidence hit a 15-year high in December 2016. In the future, Dudley predicts that housing equity will once again become a consumer spending source.

U.S. Real Estate Sales Could Be Affected by China's Capital Controls

Chinese buyers have become a formidable force in the U.S. residential and commercial real estate markets. However, stricter capital controls from China may threaten or change the marketplace.

In November 2016, China's State Council, the country's most powerful government body, notified all government departments that they must sign off on all foreign acquisitions over $10 billion or $1 billion if it is outside of the acquirer's "core" business.

Government departments must also halt foreign real estate purchases by state-owned enterprises if they exceed $1 billion. Although these rules are not new, analysts expect that the Chinese State Council will enforce these rules more strictly. The increased oversight results from China's effort to clamp down on the outflow of capital from the country, which hit an all-time high in October 2016.

"The Chinese government may crack down on some types of deals, but not all. Submitting paperwork to Beijing for special clearance before proceeding is not new to Chinese enterprises doing massive investment overseas. The new policy is aimed to regulate rather than to stop international investment," said Xinyi McKinny, senior managing director of China direct investment at Cushman & Wakefield.

Analysts are expecting that large commercial buyers will be mostly unaffected by the changes because the majority of these transactions are under $1 billion. However, privately held companies, smaller companies and wealthy buyers are likely to see the impacts.

Trump Administration Suspends Mortgage Premium Rate Cut

The Department of Housing and Urban Development suspended a reduction to the annual mortgage insurance premiums borrowers pay when taking out government-backed home loans. The cut was announced during the final days of President Obama's term and has since been "suspended indefinitely" by President Trump.

The cut reversal was a part of a memorandum from White House Chief of Staff Reince Priebus to all executive departments and agencies to freeze new and pending regulations from the previous administration.

According to the Federal Housing Administration, the cut, at a quarter of a percentage point, would have saved homeowners an average of $500 this year. Borrowers with larger home loans would have seen an even larger reduction in their premium rate.

"The capital ratio that is the statutory requirement minimum is 2%, it's only at 2.32[%]—this strikes me as very little buffer above the minimum. And after all, as recently as 2013 the FHA needed a bailout," said Republican Senator Pat Toomey from Pennsylvania, during his questioning at the confirmation hearing for HUD secretary, Ben Carson.

Borrowers with lower credit scores or those who cannot afford

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the traditional 20 percent down payment prefer FHA loans. However, recent increases in home prices, along with mortgage insurance premiums, can make monthly payments high.

Keep an Eye Out for At-Risk Senior Clients

As America's population ages, more of your real estate clients are likely to be seniors. As a result, you may run into cases where your senior clients have become targets of financial fraud.

Financial fraud is rapidly becoming the top form of abuse against seniors. According to True Link Financial, an estimated 40 percent of seniors fall victim to fraud in any given five-year period. In addition, the Federal Trade Commission found that roughly 1.8 percent of fraud cases against seniors resulted in the loss of a home or other major asset.

Every state has laws that criminalize financial abuse against seniors. Despite the consequences for criminals, unscrupulous individuals continue to take advantage of seniors. You should be aware of potentially high-risk schemes, given that these cases often involve real estate.

Foreclosure-rescue, reverse mortgage, and property investment deals are the main areas in which companies and individuals target older people to exploit. In some cases, a close family member or friend can exert undue influence over an elderly homeowner, convincing him or her to sell a property with consequences that are often disastrous for the victim.

As a Realtor, it is your job to watch out for these scenarios to ensure that your elderly clients are not acting against their own wishes.

"If you remain vigilant for the signs of financial abuse, you'll avoid becoming embroiled in real estate transactions—and possible legal actions—involving criminal or unethical exploitation of the elderly," says Jessica Edgerton, NAR associate counsel.

To protect yourself and your clients against financial abuse, here are a few steps to follow on every real estate transaction.

- **Document all conversations and follow up at every stage of the transaction.** You should provide both oral advice and a transcript of every important conversation.
- **Know your client.** Don't allow yourself to be distracted by family members who attempt to make decisions on behalf of an elderly homeowner.
- **Understand powers of attorney.** If a family member or friend claims to represent a senior homeowner pursuant to a power of attorney, demand a copy and ask an independent lawyer for verification of its legitimacy and applicability to the real estate transaction at hand. You should be especially wary if the so-called representative stands to gain financially from the transaction.
- **Familiarize yourself with the signs of elder abuse.** The Federal Administration on Aging has provided a wealth of information on the signs of elder abuse.
- **Educate your team and clients.** Brokers should be certain that their agents are educated about real estate–related exploitation of the elderly. If your firm works with senior clients regularly, you and your agents may also want to consider taking continuing education courses in order to receive Senior Real Estate Specialist designation.
- **Report suspected abuse.** Report abuse to a local Adult Protective Services agency in your area, or visit aoa.gov for further information.

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2015 ENTREPRENEURS of the YEAR

UPPER MIDWEST: MINNESOTA, IOWA, NEBRASKA, NORTH DAKOTA AND SOUTH DAKOTA

"There is always room to improve for the customer. At TitleSmart we're obsessed with all of the little things that make up a great customer experience."

Co-Founder and President Cindy Koebele