

Reflections on Real Estate

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Leasing Options Provide Many Benefits

by Mike Souza

Leasing and sales are two of the most common ways real estate is transacted. However, sometimes a lease and a sale are combined in the form of a single transaction. A lease with an option to purchase and a sale-leaseback are two such examples.

A lease with an option to purchase can be used on most any type of real estate, and is commonly used in home sales, sales of single tenant office or commercial buildings, and can be used for ag ground also. It is a convenient tool to use when a buyer does not have enough money for the down payment or has difficulty obtaining financing.

As the name implies, a lease with an option to purchase is the lease of property for a set period of time, at the



end of which the lessee (renter) has the option to purchase the property, usually

at a predetermined price. Most times the lease payment (rent) does not apply to the purchase price, other times a percentage of the lease payment may apply.

Leases with option to purchase are commonly seen in tight real estate markets with slow sales. They can benefit a seller in that the property may not be able to sell under a conventional sale, but the lease with option to purchase provides income from the property until the property can sell. One potential disadvantage is that as a purchase price is locked in,

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Shades of Gray in 1031 Flips

by James Callejas

Forget cooking shows, America's newest reality show obsession is watching real estate shows such as Flip This House, Flip or Flop, and Rehab Addict. Seeing how a house is bought at a bargain price, quickly transformed and sold for large profits can be scintillating. In fact, it can entice many to try their hand at flipping properties. A big question often encountered is whether profits earned from a flipped property can be used, tax deferred, to purchase the next fixer-upper by structuring the purchase as a 1031 Exchange?

To qualify for tax deferral under section 1031, the property must be "held for" investment or to own the property for the taxpayer's trade or business ("a qualifying purpose"). This "held for" requirement is not purely black and white.

Rather it contains shades of gray.

To help understand the "held for" requirement, the two words "principal intent" are crucial. If the property was acquired with the principal intent to sell, like most flipped properties are, then the property is considered to be inventory and will not be eligible for tax-deferral under section 1031. The goal for most people acquiring property to rehab and thus intent, is for a quick sale and profit, not for an investment or business purpose. Therefore, instead of being able to use all of their profits, tax-deferred to purchase the next property, profits will be taxed as ordinary income.

However if somebody buys a property to fix up to rent, then the principal intent is to own the property for trade or business - the business of renting.

This qualifies as a proper use for section 1031 purposes. Likewise, if they acquire vacant land with the intent to hold the property for future appreciation, this qualifies as an investment use for 1031 purposes.

There are other important factors considered by the courts. These can include length of time before selling, why the property was purchased, how the property was used, what improvements were made to the property, the taxpayer's ordinary business and number of prior sales (are their actions consistent with investing or selling inventory), and how the property was being used when sold. There is no one single factor that will prevail. Rather, courts tend

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the market value goes up during the lease term. Another disadvantage is that the lessee always has the option not to purchase, leaving the seller with the property and having to search for another buyer.

It is advantageous to the buyer in that it is a way to get into a property sooner than he might otherwise be able to, and he does not have to obtain financing.

A sale-leaseback can involve almost any type of property, however it generally involves property that is used in the seller's (lessee's) trade or business. This is a transaction in which the seller sells the property to a buyer and the buyer becomes the lessor and leases the property back to the seller who becomes the lessee.

There are both business and tax advantages which make the sale-leaseback of real estate a valuable alternative to the more traditional method of raising funds by obtaining a mortgage. As in most real estate transactions, a knowledgeable broker and tax advisor are imperative.

A sale-leaseback can afford many business advantages by raising funds when conventional financing cannot be obtained or is not desired. Among these advantages

is that a sale-leaseback provides for 100% financing of the property, it provides a means of financing a property in tight money markets, and the buyer-lessor may secure better financing terms than the seller-lessee. A sale-leaseback may improve the sellers borrowing position, it avoids loan restrictions, and avoids usury limits.

There also are some disadvantages to a sale-leaseback. The residual value of the property is lost, the flexibility of ownership is given up, and there could be a higher cost of financing.

Depending on a seller's situation, there could be some major tax advantages in this type of transaction. Deductions for rent paid by the seller-lessee might exceed the cost of the interest and depreciation if the property were not sold. Being a sale-leaseback is normally used on property which is used in the seller-lessee's trade or business, it qualifies as 1231 property. The gain or loss on the sale of 1231 property qualifies for capital gain - ordinary loss treatment. This means that a gain can be treated as a capital gain, and the loss can be treated as an ordinary loss. Of course, you must consult your CPA to discuss possible pitfalls which may be attributable to your particular situation.



Reflections on Real Estate is a publication by Souza Realty & Development. SR&D is a family-run real estate firm specializing in development, development consulting, land and commercial brokerage, and land valuation.

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Recent Land & Ranch Sales

ALAMEDA CO.			CONTRA COSTA CO.		
AC.	PRICE		AC.	PRICE	
Hansen Rd., Livermore	3.23	560,000	4901 Briones Vly Rd., Brentwood	14.30	600,000
4 Little Valley Rd., Sunol	4.00	550,000	Byron Hwy, Byron	20.00	265,000
25180 Palomares Rd., Castro Vly	5.15	525,000	3725 Kellogg Creek Rd., Byron	25.04	860,000
9875 Dublin Cyn Rd., Castro Vly	5.70	1,780,000	Sellers Ave., Brentwood	38.12	2,287,500
Happy Valley Rd., Pleasanton	10.00	1,375,000	Bradford Island, Oakley	50.00	130,000
611 E. Vineyard Ave., Livermore	19.79	4,600,000	1190 Bear Creek Rd., Martinez	69.13	490,000
818 Kalthoff Common, Livermore	20.36	2,662,000	5700 Alhambra Vly Rd., Martinez	73.92	520,000
109 Castlewood Dr., Pleasanton	27.09	3,650,000	Rheem Blvd., Moraga	178.89	7,400,000
Oakville Ln., Livermore	27.73	1,295,000	Orwood Rd., Knightsen	411.56	3,500,000
17667 Mines Rd., Livermore	33.05	680,000	SANTA CLARA CO.		
5800 Eagles Run Rd., Livermore	100.03	1,218,750	San Antonio Rd., San Jose	160.00	160,000
29551 Palomares Rd., Castro Vly	117.00	2,375,000	54230 Mines Rd., San Jose	431.20	705,000
Greenville Rd., Livermore	141.71	2,700,000	STANISLAUS CO.		
34400 Palomares Rd., Castro Vly	159.68	1,335,000	Kern Canyon Rd., Patterson	1278.67	1,253,500
20850 Mines Rd., Livermore	239.30	500,000	TRACY AREA		
CONTRA COSTA CO.			20575 Naglee Rd.	6.96	530,000
9375 Deer Vly Rd., Brentwood	5.00	225,000	21356 Naglee Rd.	8.49	830,000
5600 Bruce Dr., Danville	5.38	875,000	27380 Hansen Rd.	17.81	460,000
4145 Morgan Terr. Rd., Clayton	9.49	725,000	6001 W. Grant Line Rd.	21.08	2,166,500
Gateway Rd., Bethel Island	10.12	100,000	19306 S. Tom Paine Ave.	32.98	450,000
7171 Johnston Dr., Danville	10.31	2,100,000	6351 W. Delta Ave.	40.00	190,000
280 Balfour Rd., Brentwood	10.82	775,000	7060 W. Durham Ferry Rd.	41.20	1,700,000
2470 Tule Ln., Oakley	10.98	605,000	19953 Laurel Rd.	43.42	434,500
Hampton Rd., Martinez	11.08	500,000	221 E. Wright Rd.	66.37	830,000
Camino Diablo, Byron	12.70	575,000	W. Byron Rd.	139.89	2,300,000
1631 Arabian Ln., Brentwood	14.13	820,000	16666 W. Corral Hollow Rd.	160.00	400,000

November 2014 marked the new high for planned store openings in the U.S., according to the "National Retailer Demand Monthly" report from RBC Capital Markets. Retailers in the firm's database indicated they will open 77,547 new locations over the following 24 months—an increase of 0.7 percent compared to the figures projected at year-end 2013.

RBC Capital Markets

Available Properties



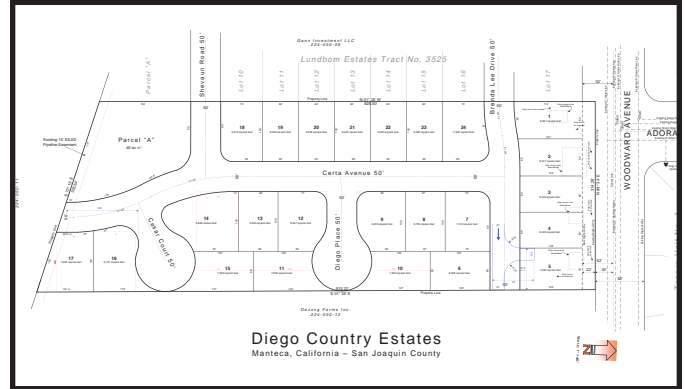
±158 ACRES OF RANCH LAND FOR SALE
16980 TESLA ROAD, LIVERMORE
\$495,000
ACROSS THE STREET FROM CARNEGIE SVRA; IN WILLIAMSON ACT



±344 ACRES OF RANCH LAND FOR SALE
MORGAN TERRITORY ROAD, LIVERMORE
\$2,400,000
SUITABLE FOR AG, MITIGATION OR PRESERVATION; IN WILLIAMSON ACT



2,520 & 5,040 Sq. Ft. LIGHT INDUSTRIAL SUITES
MACARTHUR DRIVE, TRACY
\$0.60/SQ. FT. NNN
SUITABLE FOR AUTOMOTIVE, DISTRIBUTION, RECREATION & MORE



±6.34 ACRES OF RESIDENTIAL LAND FOR SALE
9308 E. WOODWARD AVENUE, MANTECA
\$1,780,000
APPROVED TENTATIVE MAP FOR 24 SINGLE FAMILY LOTS; R-1 ZONING



±1,425 Sq. Ft. TURNKEY MEDICAL SUITE FOR LEASE
1530 BESSIE AVENUE SUITE 105, TRACY
\$3,000/MONTH GROSS
INCLUDES FOUR EXAM ROOMS WITH SINKS; NEAR TRACY HOSPITAL



±1,480 Sq. Ft. OFFICE/RESTAURANT FOR LEASE
95 W. 11TH STREET, TRACY
CALL FOR RENTAL RATES
RESTAURANT SPACE INCLUDES HOOD; IN DOWNTOWN TRACY

1031 continued

to look at all of the facts to determine whether the taxpayer held the property for a qualifying purpose.

Flips can be lucrative and create a reward of a quick profit. However with

most flips, you will be paying taxes at ordinary income tax rates. If your intent is for business or investment and you meet certain criteria, then your property may qualify for 1031 treatment. In areas of gray, consider the benefits of a

1031 compared to the potential costs of an IRS audit, interest and penalties compared to paying taxes due. Talk to your tax or legal advisor to review your individual circumstances.

SPECIALIZING IN

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We are converting our newsletter to an electronic-only format. Please send an email to mglazzy@souzard.com or call (209) 835-8330 to receive it by email. Thank you!

Interest Rates

By Rich Davidson

Treasuries have traded within a narrow range during the last eight months, and as you can see, long term rates have even trended down a little bit more. I have been doing this newsletter article for a number of years and I can't remember a time where the 10 year treasury rate has been below 2% as it is right now. As low as our 10 year treasury rate is today, it still offers a higher rate than the 10 year German government bond at 0.20%. This means that our long term bonds are still more attractive to global buyers compared with European and Japanese bonds with their lower rates. Since inflation remains low, this has not threatened the bond's value.

All of our lenders continue to show active interest in making new loans and there remains a lot of liquidity in the lending market. Our correspondent life insurance companies remain quite active

and are best suited to fixed rate deals for 10 years and longer. Our correspondent CMBS lenders remain very active and banks are also very aggressive.

Please call if I can be of any assistance or answer any questions.

RECENT CLOSINGS

- \$8,755,000 Retail (Sacramento)
- \$4,300,000 Office (Santa Rosa)

- \$1,100,000 Multifamily (San Francisco)
- \$9,050,000 Housing Construction (Santa Barbara)

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KEY INTEREST RATES & INDICES March 19, 2015

INDEX	CURRENT RATE	4 MONTH CHANGE	NOTES
Bank Prime	3.25%	None	
1 Yr. Treasury	0.27%	+0.13%	
5 Yr. Treasury	1.48%	-0.15%	
10 Yr. Treasury	1.98%	-0.33%	
30 Yr. Treasury	2.54%	-0.48%	
LIBOR (1 Mo.)	0.17%	+0.01%	
LIBOR (6 Mo.)	0.38%	+0.05%	
LIBOR (1 Yr.)	0.68%	+0.13%	
Mortgage WSJ	3.93%	-0.10%	30 year fixed rate
12 Month Treasury Average	0.14%	+0.03%	T average
11th District Cost of Funds	0.70%	+0.04%	Fund Cost
Consumer Price Index	237.43(Oct)	+3.51 YTD	
Federal Funds Rate	0.25%	None	
Dow Jones Industrial Avg.	17,849	+0.15% YTD	
Gold \$/oz	1,148	-3.01% YTD	
Euro	\$1.07	\$ up 14% YTD	