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2018 … THE YEAR OF PROMISE FOR LANDLORDS

Employment & Wages Are Up … Taxes Are Down

Plus a Brand New, Major Tax Break for Residential Rental Investors

All good news for Virginia residential rental investors!

At the beginning of each of the last three years, with the help of my crystal ball, I clearly and accurately predicted that …

"*There is nearly a perfect storm climate for rental property investors … one which may not prove repeatable for decades."* Two of the elements that make up this unique mix, particularly in the Greater Richmond and Tidewater regions, are low mortgage interest rates and the upward trending of rents. **Click Here to Read More** **INSERT PDFs OF 1/15, 1/16 & 1/17 ARTICLES**

As we enter 2018, I'm gazing into that same crystal ball and once again urge investing in residential real estate. I now predict that this year the *perfect storm* is driven by added *fair winds* … increased wages and employment, individual tax cuts plus a new tax deduction for owners of pass-through businesses *(read, **most residential landlords**)*.

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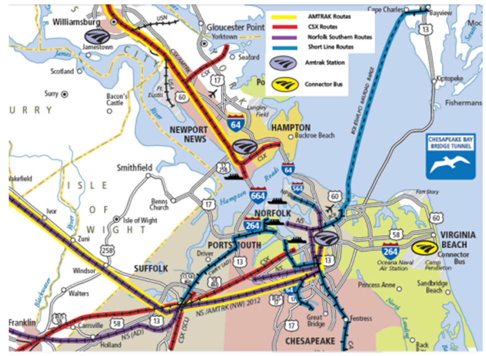

Faster National Growth = Benefits for Richmond Metro and Tidewater Regions

Expansion in gross domestic product (GDP) is the broadest indicator of economic activity. Expectations are that it will expand to enter the record books.

The Richmond area should continue to grow faster than both the state and nation. Health care is anticipated to add nearly 3,000 jobs coupled with an additional 2,000 jobs in firms that provide temporary help and professional employer organizations.

Both the Richmond and Tidewater areas maintain their attraction as a magnet to Millennials and Seniors … both prime candidates as residential renters. Additionally, household formation continues to be brisk in both markets which drives demand for rentals.

Prices continue to rise in Virginia, particularly for apartments and single family rentals. Real *Capital Analytics*, a New York-based real estate research firm expects this trend to continue into 2018 as more investors seek exposure in real estate.

Investors recognize that pricing of residential rental investment properties in many larger cities has become prohibitive. That means smaller cities such as Richmond/Tidewater become attractive alternatives and may anticipate a significant uptick in investment dollars flowing in from other states.

One example is the recent acquisition of a 366 unit apartment community in Henrico County for $54.2 million by *StoneBridge Investments*. While that is a more significant purchase than most residential rental investors can afford, the rationale that drove the buying decision is valuable.

Kees Bruggen, managing director, *StoneBridge Investments* said *"Led by a strong white-collar employment base, in combination with reasonable living costs, short commuting times, and extensive cultural amenities, Richmond continues to be an attractive live-work-play destination. We are very bullish on Richmond's fundamentals, and think its long-term prospects are strong, and intend to remain active in the Richmond market for the foreseeable future."*

Meanwhile, on somewhat of a smaller scale, we are seeing midrise apartments going up in Scott's Addition, Reynolds South in Manchester along with similar construction in Midlothian and western Henrico County.

Real Data reports *that "Demand for apartments in Norfolk-Virginia Beach-Newport News continues to outpace new supply. In the last year, there were more than 2,400 units absorbed and just over 1,800 new units completed. As a result, the average vacancy rate has improved to 5.2%. Rent growth has strengthened with same-unit rent change at nearly 3.0% for the year.*

The average rental rate is now $1,050 per month. One-bedroom units rent for $960, two-bedroom units rent for $1,052 and three-bedroom units rent for $1,243 per month.

There are more than 3,200 new apartments proposed or currently under construction throughout the area. Most of the new development is occurring in Southside, where the average vacancy rate is just 4.1% currently."

How the Tax Cuts and Jobs Act (TCJA) Affects Landlords

First off, let me be clear. I am not a professional when it comes to interpreting tax law. That said, you are urged to meet with your tax advisor and seek professional guidance for the specifics of TCJA as it may apply to your unique circumstances. Here, I only present my understanding of the provisions of the revised Act and how I think it may present unique advantages to residential rental investors.

Pass-Through Tax Deduction

The vast majority of residential rental landlords own their properties as sole proprietors, partnerships or S corporations … all deemed pass-through businesses. That means profits earned from rental activity is passed through to the owner(s) to pay tax at their individual tax rates.

The TCJA permits a tax deduction of up to 20 percent of business related income with some limits and exceptions. That means landlords may deduct 20% of net rental income over and above all other rental-related deductions. *Net result … only 80% of rental income will be taxed.* This could be HUGE!

Section 179 Deductions

This section of the tax code has never applied to rental property owners. Now, under the TCJA, residential rental owners are permitted to deduct *in one year* the cost of depreciable personal property used in the rental business. Personal property includes furniture and appliances and perhaps carpeting and flooring. Beginning in 2018, the maximum annual deduction is $1 million that may now be deducted in one year rather than amortizing over several years.

This is a major victory for landlords!

Self Employment Taxes

As business owners, landlords are required to pay Social Security and Medicare taxes on their net business income in addition to income taxes. These taxes are called self-employment taxes. Under the TCJA landlords who *do not provide* substantial personal services to their tenants (e.g.

a bed & breakfast or hotel) are now exempt from having to pay self employment taxes. That means savings of 12.4 percent on your Social Security tax and 2.9 percent on Medicare taxes.

There are additional provisions, but the above is my understanding of the significant, positive affects the new tax law will have for residential rental investors.

The National Association of Realtors (NAR) has an interesting take on tax reform. NAR said it would be much more advantageous to rent a house than to buy one based on the new rules. While savings with the new tax bill will vary based on earnings, the NAR believes just about everyone will save more money in taxes by renting.

Strategies for 2018

Given the above analysis of the Richmond/Tidewater residential rental landscape with the TCJA as the added backdrop, here are some strategies to be considered by residential rental investors in the upcoming year.

- Mortgage rates are likely to rise. Consider refinancing now.
- Problem property, i.e.one you're "not in love with" … consider seeking a 1031 exchange for a property that will deliver less hassle and more peace of mind.
- Neighborhood issues … e.g. rougher area. The good news is rental margins are often better, but the property is more labor intensive. Consider upgrading to a better area with less maintenance and fewer tenant problems.
- The new tax laws may free up investment dollars. Richmond/Tidewater present opportunities even in a somewhat "frothy" real estate market.

Summary

Lots going on in the Richmond /Tidewater residential rental markets … most of it positive and upbeat. That coupled with the benefits to landlords under the *Tax Cuts and Jobs Act* points to robust opportunities for investors in 2018.