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INTRODUCTION
INTRODUCTION

Real estate constitutes the foundation of economic activity, with real estate transactions providing the connecting pathways between individuals, businesses, and governments. In 2014 the value of real estate in the United States totaled $42.4 trillion. Sales of commercial real estate assets—priced at or above $2.5 million—totaled $438 billion in 2014, while sales of smaller commercial assets—priced below $2.5 million—comprised an additional $60 billion. In addition, sales of residential real estate totaled $1.1 trillion in 2014, with existing properties accounting for 89 percent of the total.

For a significant proportion of real estate market participants, like-kind exchanges (LKE) provide an important vehicle to dispose and acquire property. Internal Revenue Code (IRC) Section 1031 codifies that the tax owed on any gain after an exchange may be deferred as long as the proceeds are reinvested in a similar property through a like-kind exchange. The Internal Revenue Service (IRS) makes note of the fact that while the gain “is tax-deferred [...] it is not tax-free.”

According to the IRS, “like kind property is property of the same nature, character or class. [...] Most real estate will be like-kind to other real estate.” Generally, a parcel of land with a rental house may be exchanged for vacant land. Similarly, an office building may be exchanged for an industrial warehouse or a retail shopping center. The IRS makes exception with real properties located outside the United States, noting that domestic U.S. real estate may not be treated as like-kind to international real estate.

Personal property does not qualify as like-kind with real property for exchange purposes. For personal property, qualifying criteria are more stringent. For example, to be eligible for a like-kind exchange, a tractor may not be exchanged for a truck, and—in the case of livestock—a dairy cow may not be exchanged for a beef cow.

Like-kind exchanges also feature a time factor. Once a property is disposed of, the replacement property has to be identified within 45 days, and the replacement property must be acquired and the exchange completed within 180 days.

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1 Federal Reserve Board, Flow of Funds B.101, B103, B104 tables
2 Real Capital Analytics, US Capital Trends®
3 Smith and Ratiu (2015), "Small Commercial Real Estate Market,” National Association of REALTORS®
4 U.S. Census Bureau, New Residential Sales; National Association of REALTORS® Existing Home Sales
6 Ibid.
The main benefit of like-kind exchanges resides with the opportunity to allocate capital and resources more efficiently. For example, an entrepreneur may develop a business idea leading to better economic use of an existing property. Engaging in a like-kind exchange would allow the repositioning of the property and the realization of economic gains. Therefore, transactions of such properties are of great importance for economic growth and job creation. The benefit is even more so during periods of transition, such as economic recessions and recoveries, when individuals’ and businesses’ needs change significantly.

The National Association of REALTORS® represents more than 1 million members, who are actively engaged in real estate transactions across the full spectrum of property types, from land to residential houses, and from office and industrial buildings to retail properties and apartments. REALTORS® are active participants in like-kind exchanges as investors, brokers and agents, intermediaries and professional advisors. This report provides their perspectives on the like-kind exchange environment from a real estate viewpoint.
HIGHLIGHTS
HIGHLIGHTS

Market Assessment

• **Sixty-three percent** of REALTORS® participated in a like-kind exchange transaction during 2011-14
  - Sixty-eight percent of members reported their role in the exchanges as broker/agent
  - Twenty-four percent of REALTORS® indicated they acted as owner/investor in the transactions

• **Forty-eight percent** of exchanged properties’ fair market value (FMV) was held in individual or sole proprietorships
  - Thirty-three percent of the properties’ FMV was held in a S-Corporation, Partnership, limited liability corporation (LLC), limited liability partnership (LLP) or master limited partnership (MLP)
  - Ten percent of the assets’ FMV was held in a C-Corporation
  - Eight percent of the exchanged properties’ FMV was held in a real estate investment trust (REIT)

• **Eighty-six percent** of respondents indicated that additional capital is allocated for the improvement of acquired properties
  - Seventy-two percent of REALTORS® reported that, on average, an amount equal to **10% – 49%** of an acquired property’s FMV is dedicated to improvements

• The average **holding period** of real estate disposed in like-kind exchanges was medium- to long-term
  - **Seventy-four percent** of REALTORS® reported holding periods of **5 – 14 years**
  - **Thirteen percent** of respondents indicated that property was held for **15 – 24 years** prior to being exchanged

• The **middle thirty percent** of respondents indicated that like-kind exchanges in which they participated created between **10-35 jobs**

• In **2014**, REALTORS®’ average fair market value of all transactions was **$7.0 million**
  - Like-kind exchanges accounted for 39 percent of total FMV, or **$2.7 million** per respondent
HIGHLIGHTS

Estimated Impact of Repeal of IRC Section 1031

• REALTORS® reported that 40 percent of 2011-14 transactions would not have occurred, absent IRC Section 1031

  - An additional 24 percent of NAR members marked that “75% - 99%” of transactions would not have occurred during the period without 1031

  - Eighteen percent of respondents indicated that “50% - 74%” of deals would not have occurred without the tax deferral provision

• According to REALTORS®, the impacts on debt financing levels would generally be negative:

  - Sixty-seven percent of respondents indicated repeal would lead to a large increase in leverage

  - New construction loans would decrease according to 86 percent of members

  - Sixty-three percent of respondents mentioned that purchase money loans would decline

  - Refinance activity would rise according to 59 percent of members and decline per 41 percent of members

• Ninety-six percent of REALTORS® indicated a decrease in real estate values in case of repeal of like-kind exchange provisions

• Ninety-four percent of members stated that repeal would lead to a decrease in demand for core assets, business and services
SURVEY RESULTS
Market Assessment
Like-kind exchanges (LKE) feature prominently in NAR members’ real estate transactions. Slightly over 60 percent of respondents indicated that they participated in at least one like-kind exchange within the 2011-2014 period. Of the total, 40 percent participated in 1—3 transactions, while 14 percent were active in 4—6 exchanges.

REALTORS® were active participants in like-kind exchanges during 2011-2014. The majority of respondents—68 percent—indicated that they acted as a real estate broker/agent in the exchange. An additional 24 percent identified their role as a real estate owner/investor. NAR members acted as professional advisors or qualified intermediaries in six percent and two percent of transactions respectively.

REALTORS® were asked about the composition of business entities which held the properties transferred through a like-kind exchange. The survey results show that 48 percent of total FMV of the exchanged properties was held in an individual or sole proprietorship and 33 percent was held in a S-Corporation, Partnership, LLC, LLP, or MLP. An additional 10 percent of properties were held in C-Corporations (which excluded REITs).

Exhibit 3-1: Number of LKE Transactions for All Members 2011-14

Exhibit 3-2: NAR Member Role in LIKE Transactions

Exhibit 3-3: Total Fair Market Value of LKE by Business Entity
The types of real estate properties exchanged pursuant to IRC Section 1031 are diverse and range across the spectrum of property types. Based on REALTORS® responses, residential properties comprised the largest proportion of recent deals, accounting for 27 percent of disposed properties and 24 percent of acquired properties, respectively. Apartments accounted for about one-in-five sale transactions, and 22 percent of acquisitions. Apartments ranked third in disposals and second in acquisitions, trading ranking spots with land.

Land assets accounted for 19 percent of disposals and 17 percent of acquisitions. Retail properties accounted for 13 percent of acquisitions and 8 percent of disposals. Office buildings comprised 11 percent of properties disposed and 10 percent of properties acquired. Industrial buildings made up 7 percent of both total disposals and acquisitions. Hotel transactions were a minor share of all transactions.

NAR members were asked how long they or their clients held property before disposing of it in a like-kind exchange. Based on the data, 47 percent of respondents reported their holding period was between 5-9 years, followed by 27 percent who indicated a holding period of 10-14 years.
Based on NAR members’ responses, the average total fair market value (FMV) of all real estate sold or transferred in 2014 was $7.0 million per respondent. Of the estimated $7.0 million of total fair market value that the average REALTOR® disposed or transferred in 2014, nearly 40 percent was disposed or transferred pursuant to IRC Section 1031. The deferred gain component accounted for 36 percent of the total fair market value sold or transferred during the year, with the difference likely made up of realized gains.

A like-kind exchange transaction provided a gateway for additional capital into the local market. When asked if they or their clients invested additional capital in order to make improvements after acquiring real property, a majority—86 percent—answered affirmatively.

Moreover, 56 percent of respondents indicated that they or their clients made property improvements in the 10 – 24 percent range of the acquired property’s fair market value. An additional 16 percent reported that the volume of new capital for improvements accounted for 25 – 49 percent of the property’s fair market value. REALTORS® pointed to the fact that these additional investments are generally responsible for the creation of new jobs, such as construction and property management.

Exhibit 3-7: Like-Kind Exchanges

Exhibit 3-8: Is Additional Capital Invested for LKE Property Improvements?

Exhibit 3-9: Average Capital Investment in Property Improvements (% of Property’s Fair Market Value)
When looking at the incidence and characteristics of like-kind exchanges of real property, the results of NAR’s 2015 survey pointed to a few differences between commercial and residential members. The responses mirrored the differing product and market characteristics of NAR’s members, and also comported results from other surveys.

A larger percentage of commercial members reported engaging in like-kind exchange transactions compared with residential members. While 76 percent of commercial members were involved with a like-kind exchange in the past four years, 45 percent of residential members did. On balance 63 percent of commercial members who engaged in like-kind exchanges participated in an average of 1 – 6 transactions during 2011-14. In comparison, 41 percent of residential members reported being involved in 1 – 6 like-kind exchanges over the same period.

NAR members’ role in the exchange was similar across specialties, with the majority acting as real estate broker or agent. The difference in roles between commercial and residential members was negligible. About one-in-four members engaged in like-kind exchanges as real estate owners/investors.
Properties disposed and acquired through like-kind exchanges mirrored NAR members’ practice specialty areas. Residential members handled a significantly larger share of residential properties, which comprised 54 percent of dispositions and 48 percent of acquisitions. Residential members also participated in a noticeable share of apartment transactions, accounting for 15 percent of dispositions and 25 percent of acquisitions. Conversely, commercial members were more active across the commercial property types—office, land, retail, apartment and industrial.

In line with the markets which REALTORS® represent across the country, like-kind exchange transactions featured the major business entities, with only slight differences by member specialty. Properties held by individuals or sole proprietorships were responsible for over half of residential members’ transactions. The same business entity featured in 46 percent of commercial members’ activity. The second most favored ownership structure comprised of S-corporations, partnerships, LLC, LLP or MLP. It accounted for 36 percent of commercial members’ transactions and 28 percent of residential members’ transactions.
The holding period for property involved in a like-kind exchange tends to be longer term, with the majority of REALTORS® indicating 5 – 14 years. Based on the category breakdowns, there were two slight differences in holding periods between commercial and residential members. About 8 percent of commercial members reported that they or their clients hold property for a short term, 0 – 4 years. Close to double that proportion—15 percent—of residential members reported a similar holding period. For the holding period choice of 5 – 9 years, 48 percent of commercial members responded affirmatively compared with 43 percent of residential members.

When asked about the total fair market value of their transactions during 2014, members indicated different volume, consistent with NAR's other surveys of member activity. Commercial members reported an average annual transaction volume of $7.7 million. Residential members indicated an average sales volume of $5.0 million for 2014. When asked about the proportion of fair market value which was tied to like-kind exchanges and deferred gain, commercial members pointed to a slightly higher percentage compared with residential members. Based on the $7.7 million in total transactional value, commercial members responded that 41 percent of it was exchanged pursuant to IRC Section 1031, and 37 percent elicited deferred gain for participants. In comparison, residential members had a slightly lower incidence of like-kind exchanges—33 percent, with an equal proportion benefiting from deferred gain.

**Exhibit 3-15: Holding Period for LKE Real Estate and Personal Property**

- **Commercial**
  - 35 or more years: 10%
  - 30 – 34 years: 20%
  - 25 – 29 years: 20%
  - 20 – 24 years: 15%
  - 15 – 19 years: 10%
  - 10 – 14 years: 10%
  - 5 – 9 years: 7%
  - 0 – 4 years: 7%

- **Residential**
  - 35 or more years: 5%
  - 30 – 34 years: 10%
  - 25 – 29 years: 10%
  - 20 – 24 years: 10%
  - 15 – 19 years: 10%
  - 10 – 14 years: 10%
  - 5 – 9 years: 10%
  - 0 – 4 years: 10%

**Exhibit 3-16: Total Fair Market Value of All Real Estate Transactions - 2014**

- **Commercial**
  - $7.7 Million

- **Residential**
  - $5.0 Million

**Exhibit 3-17: Percentage Allocation of Total Fair Market Value of All Real Estate Transactions - 2014**

- **Section 1031 Exchange**
  - Commercial: 41%
  - Residential: 33%

- **Deferred Gain**
  - Commercial: 37%
  - Residential: 33%
Commercial properties acquired through a like-kind exchange benefit from an infusion of new capital allocated to improvements. Both commercial and residential members indicated in equal measure—86 percent—that they or their clients invested additional capital to improve the property. Only a small fraction of members replied that capital for improvements was not invested in the acquired property.

On average, the majority of members—71 percent of commercial and 74 percent of residential—reported that they or their clients allocated up to 24 percent of a property’s fair market value for improvements. Of those, most of them indicated that investment in building improvements range from 10 – 24 percent. Approximately one-in-five commercial members responded that capital destined for upgrades represented 25 – 49 percent of the property’s fair market value. Residential members who indicated a 25 – 49 percent allocation to improvements comprised 12 percent of total respondents.
SURVEY RESULTS
Estimated Impact of Repeal of IRC Section 1031
SURVEY RESULTS: Estimated Impact of Repeal of IRC Section 1031
All Members

The 2015 survey asked REALTORS® about the potential impacts upon their transactions due to the absence of the tax deferral provision of IRC Section 1031. Based on responses, 40 percent indicated that transactions would not have happened at all during 2011-14 without the availability of like-kind exchanges. Another 24 percent reported that about 75 – 99 percent of their transactions would not have occurred, and 18 percent of members marked that 50 – 74 percent of transactions over a four-year period would not have occurred absent the tax-deferral option.

The effect remained significant when respondents were asked about the likely impact upon those transactions which would have occurred even assuming the absence of IRC Section 1031. NAR members’ answers showed that a significant proportion—56 percent—considered the project would have been smaller than it was. Only 12 percent of answers indicated that the absence of like-kind exchanges would have had no effect on their 2011-14 transactions. The question offered respondents the option of selecting “Other” as a choice, with the availability of an open-ended comment response.

The “Other” option garnered 32 percent of answers, with a majority of comments stating that no transaction would have occurred without a like-kind exchange available.
The importance of like-kind exchanges for real estate was further underscored by member responses related to the holding period for existing properties. Repeal of the IRC Section 1031 provision would likely increase holding periods. Five times as many respondents (49%) said that the holding period would be greater than 50% of useful life compared to those that said there would be no change (9%). An additional 34 percent of members pointed to an increase in holding periods by 20 – 50 percent of a property’s useful life. The responses highlighted that repealing section 1031 would likely decrease the frequency of dispositions in the market.

Repeal of like-kind exchanges or tax-deferral provisions would have a much larger ripple effect through real estate markets. A majority of NAR members—95 percent—indicated that they would expect a decrease in real estate values if IRC Section 1031 were repealed. Additionally, 94 percent expected a decrease in demand for core assets/business/service as a result of a potential repeal.

In addition, repeal of like-kind exchanges would impact debt financing of real estate transactions. According to 86 percent of members, there would be a decrease in new constructions loans.

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**Exhibit 4-3: Impact of Potential Repeal of IRC Section 1031 on LKE Holding Period**

- **No change**: 9%
- **Increase holding period by greater than 50% of useful life**: 49%
- **Increase holding period by 20% - 50% of useful life**: 34%
- **Increase holding period by less than 20% of useful life**: 8%

**Exhibit 4-4: Other Impacts of Potential Repeal of IRC Section 1031**

- **Decrease in real estate values**: 95%
- **Increase in real estate values**: 5%
- **Decrease in demand for core assets/business/service**: 94%
- **Increase in demand for core assets/business/service**: 6%
Purchase money loans would experience a decline, as well, based on 63 percent of responses. Moreover, 66 percent of NAR members indicated that real estate would experience large increases in leverage. In terms of refinance activity, the responses were somewhat more balanced, with 58 percent considering there would be an increase in activity and 42 percent projecting a decrease in activity.

Aside from the tax-deferral provision, survey respondents were asked to also rank, in order of importance, four other factors driving their like-kind exchange activity. Of these factors, the most important reason respondents chose was access to equity for acquisition of another property, or properties. This was followed by estate planning, portfolio diversification, and completion of a development project (land assembly).
SURVEY RESULTS: Estimated Impact of Repeal of IRC Section 1031
By Member Specialty

The impacts due to the absence or potential repeal of the tax deferral provision of IRC Section 1031 were clearly delineated by survey respondents. When analyzed through the lens of member specialty, residential members point to larger impacts.

Without the tax deferral provision, 45 percent of residential members considered that their transactions over 2011-14 would not have happened at all. For commercial members, 37 percent responded that all their deals would not have occurred. The probability of transactions not having occurred remains fairly high for both groups, as 26 percent of commercial and 20 percent of residential members responded that 75 – 99 percent of transactions would not have happened without IRC Section 1031. Another 20 percent of commercial and 15 percent of residential members indicated that the likelihood of transactions not completing was in the 50 – 74 percent range.

Furthermore, when REALTORS® were asked to consider the likely impact upon transactions which would have occurred, even in the absence of the tax deferral provision of like-kind exchanges, members pointed to a downside outcome. While 11 percent of commercial members and 13 percent of residential members responded that the absence of tax deferral would have had “No effect,” the remainder considered that there would have been an effect.

Of those, 54 percent of commercial and 60 percent of residential members indicated that the project would have been smaller than it was.

Exhibit 4-7: Likelihood of LKE Transactions NOT Occurring Without Tax Deferral Provision

Exhibit 4-8: Likely Effect on LKE Transactions In the Absence of Section 1031 Provision
More importantly, REALTORS® were also asked about potential consequences to real estate valuations, debt financing and property holding periods in the event of repeal of IRC Section 1031. The responses underscored the importance of the tax provision.

REALTORS® were also unequivocal in their responses to the impact on real estate valuations and demand for assets in the event of repeal of IRC Section 1031. Ninety-six percent of commercial members and 94 percent of residential members replied that repeal of the tax provision would result in a decrease in real estate values. Similarly, 95 percent of commercial members and 90 percent of residential members responded that repeal would mean a decrease in demand for core assets, business and service.

Both commercial and residential members considered that a repeal of the provision would increase the holding period for existing property. For 35 percent of commercial members the holding period would increase by 20 – 50 percent of the property’s useful life, while 49 percent of commercial members pointed that the holding period increase would exceed 50 percent of the asset’s useful life. Residential members’ responses were similar, with 31 percent ranking the holding period increase in the 20 – 50 percent range, and 50 percent of members indicating the period increase would exceed 50 percent of useful life.

In the survey results NAR members pointed to the importance of like-kind exchanges for construction lending, with 87 percent of commercial and 85 percent of residential members indicating likely drops in new construction loans. Purchase money loans would also decline in the event of repeal, according to 64 percent of commercial and 62 percent of residential members.
When asked to rank the main drivers of like-kind exchanges, aside from the deferral of capital gains taxes, commercial and residential members’ responses were identical. Both groups ranked “Equity for acquisition of another property/properties” as the number one reason they or their clients employed like-kind exchanges. The second reason in order of importance was “Estate planning,” followed by “Portfolio diversification.” Last, but not least, members ranked “Completion of a development project (land assembly)” as an important factor in employing like-kind exchanges.

<table>
<thead>
<tr>
<th>Exhibit 4-11: Ranking of LKE Transaction Drivers (Other Than Tax Deferral)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Commercial</strong></td>
</tr>
<tr>
<td>Equity for acquisition of another property or properties</td>
</tr>
<tr>
<td>Estate planning</td>
</tr>
<tr>
<td>Portfolio diversification</td>
</tr>
<tr>
<td>Completion of a development project (land assembly)</td>
</tr>
</tbody>
</table>
5

SURVEY METHODOLOGY
SURVEY METHODOLOGY

In January 2015, the National Association of REALTORS® invited members to complete an online survey consisting of 20 questions. The invitation selection was made using random samples of 49,593 commercial practitioners and 55,160 residential practitioners, for a combined total sample size of 104,753. A total of 3,450 responses were received from all 50 states and the District of Columbia. The survey had a response rate of 3.3 percent. The information in this report is generally characteristic of the 12-month period ending December 2014, with the exception of the questions where the period 2011-14 was specified. The frequency distribution and mean are the primary statistical measures used throughout this report. Due to rounding and omissions for space, percentage distributions may not add to 100 percent.
APPENDIX
APPENDIX: Survey Results for Selected States
(Among Respondents with a 1031 Exchange)

Exhibit 6-1: Number of LKE Transactions 2011-14

Exhibit 6-2: Impacts due to Absence or Repeal of IRC Section 1031

<table>
<thead>
<tr>
<th>State</th>
<th>Small Increase in Leverage</th>
<th>Large Increase in Leverage</th>
<th>Increase in New Construction Loans</th>
<th>Decrease in New Construction Loans</th>
<th>Increase in Purchase Money Loans</th>
<th>Decrease in Purchase Money Loans</th>
<th>Increase in Refinance Activity</th>
<th>Decrease in Refinance Activity</th>
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</thead>
<tbody>
<tr>
<td>Arizona</td>
<td>42%</td>
<td>58%</td>
<td>0%</td>
<td>100%</td>
<td>20%</td>
<td>80%</td>
<td>44%</td>
<td>56%</td>
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<tr>
<td>California</td>
<td>46%</td>
<td>54%</td>
<td>0%</td>
<td>100%</td>
<td>29%</td>
<td>71%</td>
<td>68%</td>
<td>32%</td>
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<tr>
<td>Colorado</td>
<td>26%</td>
<td>74%</td>
<td>31%</td>
<td>69%</td>
<td>48%</td>
<td>52%</td>
<td>74%</td>
<td>26%</td>
</tr>
<tr>
<td>Florida</td>
<td>25%</td>
<td>75%</td>
<td>0%</td>
<td>100%</td>
<td>63%</td>
<td>38%</td>
<td>38%</td>
<td>63%</td>
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<tr>
<td>Illinois</td>
<td>15%</td>
<td>85%</td>
<td>25%</td>
<td>75%</td>
<td>45%</td>
<td>54%</td>
<td>55%</td>
<td>45%</td>
</tr>
<tr>
<td>North Carolina</td>
<td>25%</td>
<td>75%</td>
<td>18%</td>
<td>82%</td>
<td>43%</td>
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<td>27%</td>
<td>73%</td>
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<td>Ohio</td>
<td>18%</td>
<td>82%</td>
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<td>75%</td>
<td>23%</td>
<td>77%</td>
<td>64%</td>
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<tr>
<td>Texas</td>
<td>35%</td>
<td>65%</td>
<td>22%</td>
<td>78%</td>
<td>32%</td>
<td>68%</td>
<td>61%</td>
<td>39%</td>
</tr>
<tr>
<td>Virginia</td>
<td>44%</td>
<td>56%</td>
<td>0%</td>
<td>100%</td>
<td>20%</td>
<td>80%</td>
<td>63%</td>
<td>38%</td>
</tr>
</tbody>
</table>
Exhibit 6-6: Likelihood of LKE Transactions NOT Occurring Without Tax Deferral Provision

Exhibit 6-7: Likely Effect on LKE Transactions In the Absence of IRC Section 1031 Provision

Exhibit 6-8: Impact of Potential Repeal of IRC Section 1031 on LKE Holding Period
The National Association of REALTORS®, “The Voice for Real Estate,” is America’s largest trade association, representing over 1 million members, including NAR’s institutes, societies and councils, involved in all aspects of the real estate industry. NAR membership includes brokers, salespeople, property managers, appraisers, counselors and others engaged in both residential and commercial real estate. The term REALTOR® is a registered collective membership mark that identifies a real estate professional who is a member of the National Association of REALTORS® and subscribes to its strict Code of Ethics. Working for America's property owners, the National Association provides a facility for professional development, research and exchange of information among its members and to the public and government for the purpose of preserving the free enterprise system and the right to own real property.

NATIONAL ASSOCIATION OF REALTORS®
RESEARCH DIVISION

The Mission of the National Association of REALTORS® Research Division is to collect and disseminate timely, accurate and comprehensive real estate data and to conduct economic analysis in order to inform and engage members, consumers, and policy makers and the media in a professional and accessible manner.

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