1031 OFFRAMPS: INCENTIVES FOR SMALL INVESTORS TO SELL SINGLE-FAMILY RENTAL HOMES

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It has never been so expensive to purchase a single-family home. Multiple interrelated causes contribute to the affordability crisis, such as historically low interest rates that suddenly spiked higher, ongoing net population growth, a decade of historic underbuilding of starter homes in the aftermath of the Great Recession, and Wall Street's unprecedented new business model of purchasing single-family rental homes ("SFRs") in concentrated areas across the country.

Yet, while those contributing causes ebb and flow over time, a more structural and long-lasting factor has remained unexamined in the current crisis: the lock-in effect that arises from Section 1031 of the Internal Revenue Code. The 1031 lock-in powerfully impacts the single-family home market because, on the one hand, Section 1031 incentivizes investors to buy SFRs, and, on the other hand, it strongly disincentivizes investors from selling SFRs before death.

This Article proposes both short-term and long-term solutions to the 1031 lock-in effect in the single-family home market. The proposed solutions, or 1031 offramps, are designed not only to alleviate the immediate price and supply pressures in the starter home market but also to prevent the 1031 lock-in from reoccurring in the single-family home market. Whereas existing proposals seek to disincentivize large corporate buyers from purchasing single-family homes and converting them into SFRs, this Article's proposals are unique in their quest to affirmatively incentivize small "mom and pop" investors to sell SFRs. Because small investors own the large majority of SFRs, incentivizing them to sell is an important strategy to increase the supply of single-family homes available for sale to first-time homebuyers seeking to pursue the American dream of homeownership.

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Introduction

The mortgage rate lock-in effect in the single-family home market is the talk of the town. And understandably so, as property owners who secured fixed interest rates around 3% a few years ago are reluctant to sell their homes and purchase a replacement with mortgage rates now hovering around 7%.[1] Add to this a substantial shortage in the supply of single-family homes after a decade of underbuilding in the wake of the 2008 housing crisis, and the table is set for the current anomalous situation where home prices and interest rates have *both* been rising, instead of moving inversely, as they normally would.[2]

1. Joint Ctr. for Hous. Stud. of Harv. Univ., The State of the Nation's Housing 2024 4–5 (2024), https://www.jchs.harvard.edu/sites/default/files/reports/files/Harvard_JCHS_The_State_of_the_Nations_Housing_2024.pdf [https://perma.cc/BXQ9-RXHQ] (discussing the rate lock-in effect).

2. Matt Egan, *The Housing Market Is 'Stuck' Until At Least 2026, Bank of America Warns*, CNN (June 27, 2024), https://www.cnn.com/2024/06/27/economy/housing-market-prices-inflation/index.html#:~:text=Economists%20at%20Bank%20of%20America,The%20housing%20shortage%20will%20persist [https://perma.cc/K588-JZXW]; Emily Badger & Quoctrung Bui, *Can Home Prices and Interest Rates Soar at the Same Time?*, N.Y. Times (Mar. 30, 2022), https://www.nytimes.com/2022/03/31/upshot/home-prices-mortgage-rates.html [https://perma.cc/AM86-YBJ4].

The thesis of this Article, however, is that a different lock-in effect in the market for single-family homes is significantly more severe, long-lasting, and widespread, and thus more urgently requires solutions: the 1031 death lock-in. The inescapable logic of the 1031 tax-deferred exchange prevents investors from exiting the real estate market. During life, investors may "exchange" one property for another without paying taxes, but they cannot exit real estate investments altogether. They cannot exit either to redirect investments into non-real estate assets or simply to withdraw their funds from real estate and spend the proceeds as they wish. At death, however, the investor's heirs can exit real estate tax-free! We might call it Hotel 1031: you can check out (of property management) anytime you like, but you can never leave (property ownership) . . . at least, until you die. The death lock-in therefore disincentivizes single-family homes from hitting the market at a time when these properties are needed more than ever.

The 1031 death lock-in arises because the tax incentives under Section 1031 of the Internal Revenue Code (the "Tax Code") are critically imbalanced. Section 1031 creates strong incentives (or "onramps") for investors to buy and hold single-family rental properties ("SFRs") but no corresponding incentives for investors to sell SFRs and exit real estate investments during their lifetimes ("offramps"). After an investor's death, however, Section 1014 of the Tax Code authorizes a step-up in basis for an investor's heirs, which allows heirs to exit inherited investments without paying the tax that the deceased owner would have faced had the owner exited real estate investments during life. These imbalanced incentives not only prevent homes from being listed for sale—thereby exacerbating supply shortages—but also, they inefficiently lock capital into real estate that could be deployed elsewhere, thereby artificially inflating real estate prices.

Because the imbalanced 1031 incentives coercively, inefficiently, and artificially lock capital into real estate, reduce supply of homes for sale, and increase the prices of homes that are for sale, capital needs an escape valve to avoid the loud and painful bang of another real estate bubble bursting. And because the imbalanced 1031 incentives are regular and enduring features of U.S. real estate markets, the 1031 death lock-in exercises a longer-lasting impact than the likely-temporary mortgage rate lock-in that resulted from the rapid and rare seesaw between historically low interest rates in 2019–21 and historically average rates in 2022–24.

This Article, therefore, proposes timely and politically feasible solutions to the 1031 death lock-in problem in the form of 1031 offramps. For reasons described below, the solutions advanced in this Article relate solely to SFRs, not to any other types of real estate investment property, such as apartment buildings, shopping centers, or office complexes. These solutions not only directly address the current drastic shortage of single-family homes but also promise to alleviate future 1031 lock-in effects in the single-family home market.

Broadly, this Article proposes the creation of 1031 offramps that incentivize small real estate investors to sell SFRs instead of contributing them to a real estate investment fund or holding them until death. The first proposal is to expand existing incentives for selling owner-occupied homes to small investors who own SFRs. The second proposal is to accelerate the existing morbid 1031 death benefit (which arises in combination with Section 1014) to give SFR owners more humane and efficient options to sell SFRs during their lifetimes. In sum, making 1031 offramps available to investors prior to death would act as a counterweight to existing 1031 onramps that encourage investors to buy homes but not sell them. Pre-death offramps thus offer the potential to create a more balanced real estate market and reduce future impacts of the 1031 death lock-in effect.

One partial 1031 offramp does exist, but it fails to solve the lock-in problem and can even exacerbate it. For SFR investors seeking to divest from direct property ownership during their lifetimes, tax policy incentivizes them to either contribute their property to a large corporate holding company (i.e., a real estate investment trust, or "REIT")[3] or sell their property and "exchange" the proceeds for interests in a REIT.[4] Both approaches, though, only compound the 1031 lock-in problem because they lead to what we might call the REIT lock-*up* problem.

First, in the REIT lock-up, an investor's proceeds from the sale of property remain invested in real estate instead of being invested elsewhere or spent on consumption. This is because the proceeds from the 1031 sale are redirected into the REIT, an entity that, by definition and design, may only invest in real estate. Second, single-family homes either directly contributed to REITs, or purchased by REITs on the open market, are then locked up even further because REITs, again by statutory design, are severely restricted from selling the properties they own. The REIT lock-up may even extend the 1031 lock-in because the restrictions on REIT sales last indefinitely instead of expiring when the 1031 investor passes away. Accordingly, the 1031 death lock-in and the REIT lock-up operate in combination to incentivize

3. Jason S. Oh & Andrew Verstein, *A Theory of the REIT*, 133 Yale L.J. 755, 796 (2024) (discussing the direct contribution model and explaining that, "[i]n an important sense, the story of REIT success starts and ends with tax").

4. *See infra* Part II.C (discussing the 1031 tax-deferred exchange model involving ownership interests in Delaware Statutory Trusts).

the consolidation of property ownership in large investment companies while disincentivizing the sale of properties to ordinary people, such as first-time homebuyers.

This Article's proposals focus on incentivizing small SFR investors instead of large corporate owners of SFRs for primarily two reasons. First, it is a pragmatic, ethical, and political non-starter to give additional tax incentives to large companies (in this case, companies that own many SFRs). Second, targeted benefits to small investors are likely to have the greatest impact on the housing market because these investors, in the aggregate, own many more SFRs than large investors.

Incentivizing small investors to sell SFRs without purchasing replacement properties therefore has the potential both to 1) increase the supply of homes available for families, individuals, and first-time homebuyers to purchase and 2) stabilize the historic increases in home prices over the past few years. And because pent-up demand for single-family homes among non-investor buyers (e.g., first-time buyers and trade-up buyers that seek to purchase a home to occupy themselves) is currently so high, now is the ideal time to combine the "sell-side" proposals described in this Article with existing "buy-side" proposals that purport in various ways to limit the number of SFRs large corporate investors may own. Such a combination could help avoid the unintended consequence of incentivizing small investors to sell SFRs only to end up with large investors purchasing the bulk of these SFRs when they reach the market.

This Article explains and elaborates on the problems and proposals outlined above. Part I sketches the well-documented supply shortages in the current housing market, describes the effects of the mortgage interest-rate lock-in, highlights the impact of Americans' continued preference for homeownership over renting, explains Wall Street's new business model of owning SFRs in bulk, and canvasses existing proposals to address consolidated corporate ownership of SFRs.

Part II then explains the central and multi-layered problem this Article addresses: that tax policy unwisely incentivizes people to buy SFRs and either never sell them, exchange them for a different property, sell them only after they die, or transfer them to a REIT and thereby further lock up ownership of the property. In short, current tax policy inefficiently locks investors into the real estate market.

Part III proposes simple, concrete, and realistic solutions in the form of SFR offramps that are patterned off two existing laws. The first proposal is to allow small SFR owners to sell a limited number of SFRs and receive the same incentives that currently apply only to sales of owner-occupied homes. The second is to allow small SFR owners to sell a limited number of SFRs and accelerate the 1031 sale benefits during their lifetime that currently apply only upon death.

I. Dynamics of the Single-Family Home Market

"You can't buy what's not for sale."[5] This Part considers a confluence of factors that have combined to constrict the supply of single-family homes for sale in the U.S. This supply shortage has resulted in rapidly rising prices for homes that do reach the market, even while the Federal Reserve has raised interest rates to curtail inflation, thereby decreasing demand from purchasers reliant on mortgage financing. Home prices spiked over 50% from 2019–24,[6] even as interest rates on a 30-year fixed mortgage shot up to above 6% (and even above 7% for several months) in 2023–24 from lows of below 3% in 2020–21.[7]

Subpart A explores one significant factor in the current supply shortage: the historic underbuilding of single-family homes during the past decade. Subpart B then examines the growing trend of large corporations purchasing single-family homes to be used as SFRs as another factor that also has characterized the past decade. Subpart C examines Americans' preferences for homeownership over renting, and Subpart D then discusses Wall Street's contrary preferences for a rentership society driven by a business model predicated on bulk corporate purchases of SFRs. Finally, Subpart E summarizes recent policy proposals to improve affordability in and access to the single-family home market in the U.S. but suggests that these proposals alone are insufficient because they fail to address the 1031 lock-in problem that is the focus of this Article.

A. Supply Shortage: Fewer Starter Homes and the Mortgage Lock-In Effect

The foreclosure crisis that began in 2007 as part of the Great Recession was a massive shock to the market for single-family homes. From just over 500,000 foreclosure filings nationwide in 2005, foreclosure filings skyrocketed to nearly 3 million per year in 2009 and 2010 and remained above 1 million per year through 2015.[8] With the

5. Gabriella Cruz-Martinez, *Return to the '70s? Today's Housing Market Has Echoes of Dark Era*, Yahoo Fin. (May 6, 2024), https://finance.yahoo.com/news/return-to-the-70s-todays-housing-market-has-echoes-of-dark-era-122740663.html [https://perma.cc/E77X-2KG3].

6. Kevin Schaul, *Are Home Prices Still Rising? See How Prices Have Changed in Your Area*, Wash. Post (May 14, 2024), https://www.washingtonpost.com/business/interactive/2024/housing-market-price-trends-zip-code-map/ [https://perma.cc/9QW8-AL7N].

7. Erika Giovanetti, *Historical Mortgage Rates: See Averages and Trends by Decade*, U.S. News & World Rep. (June 26, 2024), https://money.usnews.com/loans/mortgages/articles/historical-mortgage-rates [https://perma.cc/S5ZP-CND2].

8. *Number of Properties with Foreclosure Filings in the United States from 2005 to 2023*, Statista (Apr. 15, 2024), https://www.statista.com/statistics/798630/number-of-properties-with-foreclosure-filings-usa/ [https://perma.cc/VK3Z-RX8X].

market awash in foreclosed homes, builders responded predictably by slashing the number of housing construction starts for single-family homes, which declined to only 430,000 in 2011 after hitting a peak of 1.7 million in 2005.[9]

"The 2010s was by far the lowest decade of single-family production in the last 60 years," with 6.8 million units constructed in the 2010s compared to amounts ranging from 9.3 million in the 1960s to 12.3 million in the first decade of the 2000s.[10] Meanwhile, the U.S. population is estimated to have increased by nearly 23 million people between 2010 and 2020, or some 2 million people per year,[11] with an additional 8.5 million net increase from 2021 to 2024, due primarily to international immigration.[12] Even when counting new apartment units alongside single-family homes, household formation in the United States outpaced new home construction by approximately 2.5 million homes in the decade between 2012 and 2023.[13] The data thus reveal a stark reality: it will take four to five years to close the housing gap, *even after* "*tripling* the rate" of housing starts for single-family homes.[14] If multi-family is included along with single-family construction, total housing starts would still need to increase 50% to close the gap within two to three years.[15] In short, housing supply simply has not kept pace with demand.

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9. Diana Olick, *It Suddenly Looks Like There Are Too Many Homes for Sale. Here's Why That's Not Quite Right*, CNBC (July 9, 2024), https://www.cnbc.com/2024/07/09/why-home-prices-are-still-rising-even-as-inventory-recovers.html [https://perma.cc/M2P4-E9AV].

10. Robert Dietz, *A Decade of Home Building: The Long Recovery of the 2010s*, NAT'L ASS'N OF HOME BUILDERS (Jan. 6, 2020), https://www.nahb.org/blog/2020/01/A-Decade-of-Home-Building-The-Long-Recovery-of-the-2010s [https://perma.cc/B55N-WV9P].

11. U.S. CENSUS BUREAU, HISTORICAL POPULATION CHANGE DATA (1910–2020) (Apr. 26, 2021), https://www.census.gov/data/tables/time-series/dec/popchange-data-text.html [https://perma.cc/F3KW-XTR8].

12. Jon Kamp et al., *Immigrants Dominate U.S. Population Growth*, WALL ST. J. (Dec. 19, 2024), https://www.wsj.com/us-news/census-data-immigration-state-population-changes-9f8f4508 [https://perma.cc/SQQ2-JYGN].

13. Mary K. Jacob, *There's a Whopping 7.2 Million Home Shortage in the U.S. Housing Market*, N.Y. POST (Feb. 28, 2024), https://nypost.com/2024/02/28/real-estate/the-us-housing-supply-is-short-7-2-million-homes/ [https://perma.cc/8Y9S-2PGT] (citing a study pegging the missing amount of housing units at 2.5 million and discussing the housing shortage); *see also* Max Zahn, *Home Prices Are Soaring. Is This Another Bubble?*, ABC NEWS (May 11, 2024), https://abcnews.go.com/Business/home-prices-soaring-bubble/story?id=110101842 [https://perma.cc/9583-CVF2] (citing a different study placing the amount at 3.2 million); Hannah Jones, *U.S. Housing Supply Gap Grows in 2023; Growth Outpaces Permits in Fast-Growing Sunbelt Metros*, REALTOR.COM (Feb. 27, 2024), https://www.realtor.com/research/us-housing-supply-gap-feb-2024/ [https://perma.cc/B3KL-KNAC] (discussing housing starts and household formations over time).

14. Jones, *supra* note 13 (emphasis added).

15. *Id.*

Furthermore, the building shortage has not affected all market segments equally because the homes constructed over the past decade were disproportionately higher-end properties, not smaller, lower-cost homes. For example, while "more than 400,000 entry-level homes" were constructed annually in the 1970s, this number dropped to approximately 150,000 per year in the 2000s and a mere 65,000 in 2020.[16] This shift away from building starter homes makes economic sense: after the Great Recession, "only rich people could buy . . . [leaving] a dearth of smaller houses where people can get started."[17] The supply shortage thus hits hardest in the lower end of the housing market.

In addition to insufficient construction of new housing—and in particular of starter homes—fluctuating interest rates make owners of existing homes hesitant to sell, creating the "mortgage lock-in effect." It is not that people have suddenly ceased wanting to trade up to larger homes; rather, they are trapped in their existing home due to the low interest rate on their existing mortgage and the significantly higher interest rates for new mortgages. With interest rates having moved from between 2%–3% to above 7%, estimates place the cost of switching to current rates from a low, locked-in rate at approximately $50,000, or $511 per month, for average mortgage holders.[18] In some cases, trading up to a more expensive home, coupled with an interest rate four to five percentage points higher, could mean tripling a household's monthly interest payment, which is a financial non-starter for many homeowners.[19] Pointedly, another calculation concludes that moving to a different home and exchanging a low-rate mortgage for one at current rates would "be like taking $60,000 and lighting it on fire."[20] As a result, "[t]he starter home for many has become a keeper home, unfortunately."[21]

The uniqueness of the mortgage rate lock-in effect is revealed in the fact that rarely (and from 1998 to 2020, never) have more than 40 percent of mortgage holders in the U.S. had "locked-in rates more than

16. Rukmini Callimachi, *Stuck in a Starter Home*, N.Y. Times (June 2, 2024), https://www.nytimes.com/2024/06/02/realestate/housing-market-rates-prices-slow.html [https://perma.cc/F44P-8CQS].

17. Cruz-Martinez, *supra* note 5.

18. Emily Badger & Francesca Paris, *A Huge Number of Homeowners Have Mortgage Rates Too Good to Give Up*, N.Y. Times (Apr. 15, 2024), https://www.nytimes.com/2024/04/15/upshot/mortgage-rates-homes-stuck.html [https://perma.cc/ESN7-DPVJ].

19. Callimachi, *supra* note 16.

20. James Rodriguez, *Denmark's Genius Housing Fix*, Bus. Insider (May 29, 2024), https://www.businessinsider.com/denmark-mortgage-rates-lock-in-effect-home-buying-selling-easier-2024-5 [https://perma.cc/BY7B-HY6T].

21. Callimachi, *supra* note 16.

one percentage point below market conditions."[22] But "[b]y the end of 2023, . . . about 70 percent of all mortgage holders had rates more than *three* percentage points below" market rates for a new home loan.[23] Overall, then, the mortgage rate lock-in effect appears to be largely "responsible for about 1.3 million fewer home sales in America during the run-up in rates from the spring of 2022 through the end of 2023."[24]

Considering the impact of both the mortgage rate lock-in effect and the starter home construction shortage together, the single-family home market is severely skewed compared to historical averages. For example, "[n]ew construction now makes up 30% of total inventory, about twice its historical share," compared to the inventory of existing homes listed for sale.[25] Given that sales of existing homes "fell in 2024 to the lowest level since 1995,"[26] and, as noted above, new construction currently sits near historical lows, the net effect of these trends is that in 2023 "about 900,000 fewer homes changed hands than in a typical year,"[27] a nearly 20% drop from the typical annual total of "about 5 million homes" sold.[28]

In addition to the interest rate lock-in effect, prices for starter homes over the last 20 years have risen faster than prices for single-family homes overall: where the latter have doubled, the former have nearly tripled,[29] in large part due to builders cutting back on building starter homes, as described above. In sum, ordinary starter-home buyers face not only higher interest rates but also significantly higher prices, putting home affordability increasingly out of reach for buyers who rely on mortgage financing to purchase a home to live in. As described below, though, another reason for the disproportionate increase in the price of starter homes is that competition increased dramatically from large investors seeking to purchase starter homes to rent out, rather than to live in, and these investors are not dissuaded by rising mortgage interest rates because they purchase homes in cash.

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22. Badger & Paris, *supra* note 18.
23. *Id.*
24. *Id.*
25. Olick, *supra* note 9; Alexander Hermann, *With Existing Inventories Historically Low, Homebuyers Turn to the New Home Market*, Joint Ctr. for Hous. Studies at Harv. Univ. (Sept. 12, 2023), https://www.jchs.harvard.edu/blog/existing-inventories-historically-low-homebuyers-turn-new-home-market [https://perma.cc/VA6D-85BZ].
26. Nicole Friedman, *U.S. Homes Sales in 2024 Fell to Lowest Level in Nearly 30 Years*, Wall St. J. (Jan. 24, 2025), https://www.wsj.com/economy/housing/u-s-homes-sales-in-2024-fell-to-lowest-level-in-nearly-30-years-3ce94fd9 [https://perma.cc/5QKK-X6Z9].
27. Callimachi, *supra* note 16.
28. Rodriguez, *supra* note 20.
29. Callimachi, *supra* note 16.

B. More Buy-Side Pressure: Institutional SFR Buyers

Just as the Great Recession and accompanying mortgage crisis caused builders to build fewer starter homes, it also opened the door to institutional investors to begin buying SFRs in bulk. Investors viewed the foreclosure crisis as "a potentially massive opportunity . . . to convert the glut of repossessed homes into rental properties."[30] A 2011 Morgan Stanley report titled "The Rentership Society" suggested a fundamental shift was afoot and likely to continue in the U.S. housing market in which the ranks of home renters would swell while those of homeowners decline.[31] Emblematic of the Wall Street sentiment was the idea that "the next fortunes could be minted scooping up repossessed homes and renting them out."[32] A new business model was thus born out of the ashes of the crisis, and, "on a size and scale previously not seen," large investment firms began pouring billions of dollars into SFRs.[33]

Adding fuel to the fire, the federal government also incentivized this institutional buying spree. For example, one incentive was through a billion-dollar loan on favorable terms to a large institutional investor.[34] The government also "packaged thousands of homes together and sold them to investors in bulk at a discounted price."[35] At the extreme, fully "95% of [foreclosed] homes sold by Fannie Mae and Freddie Mac . . .

30. Ryan Dezember, *After the 2008 Housing Crisis, a Lot of People Made Big Money Buying Up Foreclosed Homes and Renting Them Out—and it Shows One Response to a Financial Crash*, Bus. Insider (Aug. 4, 2020), https://www.businessinsider.com/after-2008-housing-crisis-people-bought-and-rented-foreclosed-homes-2020-8 [https://perma.cc/CLE4-PSVL] (noting that institutional investors sensed more than just a market opportunity and embraced the idea of a potential societal transformation, which they dubbed "Housing 2.0," or a world in which Wall Street conquers "the final frontier for institutional real-estate investors: suburban single-family homes").

31. *Id.*; Stan Alcorn, *How Investors Are Profiting Off a 'Rentership Society'*, Marketplace (Oct. 10, 2014), https://www.marketplace.org/2014/10/10/how-investors-are-profiting-rentership-society/ [https://perma.cc/U2ZR-XZDE] (quoting the Morgan Stanley report as saying, "The combination of falling home prices, limited mortgage credit, continued liquidations, and better rental options is fundamentally changing the way Americans live. We believe this change is only beginning, and is moving the country towards becoming a Rentership Society."); Les Christie, *Home Ownership Hits Lowest Level Since 1965*, CNN Money (Aug. 5, 2011), https://money.cnn.com/2011/08/05/real_estate/home_ownership/index.htm [https://perma.cc/8439-GJN3].

32. Dezember, *supra* note 30.

33. Mary Jo Wiggins, *Supremacy Lost?: Zoning, Covenants, and the Evolution of Single-Family Ownership*, 128 Penn St. L. Rev. 139, 152 (2023).

34. Sarah K. Lynch-Chaput, *When Wall Street Becomes America's Landlord: How Wall Street Single-Family Rental Investment Firms Are Infiltrating American Neighborhoods and Disrupting the Housing Market*, 63 Washburn L.J. 449, 455 (2024).

35. Wiggins, *supra* note 33, at 151.

were purchased by institutional investors for pennies on the dollar."[36] And in the internet age, far from needing to appear in person on the courthouse steps to outbid individuals and local investors in property auctions across the country, private equity and other institutional buyers used proprietary software to bid electronically on thousands of properties simultaneously.[37]

The institutional dollars invested today in SFRs are staggering, in the hundreds of billions of dollars.[38] Investment firms view the opportunity in SFRs as "nearly boundless, measured in trillions of dollars."[39] Exact figures on the extent of institutional SFR ownership do not exist. Furthermore, in such a fragmented and unregulated market, estimates are likely "appreciably underinclusive," for multiple reasons.[40] But even potentially underinclusive data shows that the share of total investor SFR purchases made by institutional investors more than doubled from 10% in 2011 to 22% in 2022.[41] This shift has led to significantly larger scale in the SFR industry, which has historically been dominated by small and disaggregated investors. By contrast, the five largest SFR owners (including public and private companies) each own and operate upwards of 50,000 SFRs each, and in some cases 80,000 to 85,000 homes each.[42]

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36. Andrew Watkins, Note, *Redistributive Takings Under a Modern Midkiff*, 2024 U. Ill. L. Rev. 317, 323 (2024).

37. Faisal Chaudhry, *Property as Rent*, 94 St. John's L. Rev. 363, 430 (2020).

38. *Id.* at 427 (describing institutional commitments to SFRs of more than $600 billion).

39. Dezember, *supra* note 30.

40. Watkins, *supra* note 36, at 324 (describing that the level of institutional ownership of SFRs is difficult to ascertain with precision because "studies tend to exclude homes bought by institutional investors which are then sold to third parties to rent out . . . [,] studies generally exclude homes built as condominiums, even though most condominiums are rented out like traditional apartments . . .[,] institutional investors tend to be 'deliberately opaque' in reporting acquisitions and transactions . . . . [S]ome estimates exclude certain private institutions that traditionally participate in the rental market from their definition of institutional investor.").

41. Alex Pettee, *Single-Family Rental REITs: Renting the American Dream*, Seeking Alpha (Apr. 4, 2023), https://seekingalpha.com/article/4592114-single-family-rental-reits-renting-american-dream [https://perma.cc/JRV3-YFPT] (defining institutional investors as those owning 100 or more homes, and showing ownership percentages over time in a table under the header, "Deeper Dive: Broader SFR Industry Trends").

42. Wolf Richter, *The Biggest Landlords of Single-Family Rental Houses and Multi-Family Apartments: Who Owns the U.S. Housing Stock?*, Wolf Street (Apr. 9, 2024), https://wolfstreet.com/2024/04/09/the-biggest-landlords-of-single-family-rental-houses-and-multifamily-apartments-in-the-us/ [https://perma.cc/4ATC-XVR9]. Another lens through which to analyze Wall Street ownership of SFRs is "economic othering," in which wealthy, non-local investors (the "in-group") own the homes of "others" (or, the "out-group") in poor neighborhoods. *See* Edward W. De Barbieri, *Lawmakers and Economic Othering*, 76 Okla. L. Rev. 575, 575–88 (2024) (discussing "economic othering" in the context of Opportunity Tax credits).

Despite the rapid growth of institutional investors in the SFR space, proponents of the industry emphasize that these figures overstate the overall role these investors play in the SFR market.[43] For example, although relying on likely underinclusive data, one nationwide study of public records and census data concluded that landlords owning more than 1,000 homes operate only approximately 3% of all SFRs in the U.S.[44] The next tier down (i.e., owners of 100 to 999 SFRs) owns an additional 3%, with 14% owned by landlords with 10 to 99 units.[45] On these numbers, then, "mom-and-pop" landlords who own between one and nine SFRs represent approximately 80% of all SFRs, while corporate owners of more than 10 SFRs own approximately 20% of SFRs.[46] Projecting into the future, however, if current trends continue, some estimate that institutional SFR owners could control 40% to 60% of SFRs by 2030, when "the institutionalization of [SFRs] . . . may near full maturity as an asset class."[47]

For purposes of this Article's thesis, such aggregate estimates of SFR ownership—however imprecise the estimates may be—are important for two reasons. First, the estimates indicate that "mom-and-pop" landlords currently own a substantial majority of SFRs; therefore, by focusing on small SFR owners, this Article's proposals target the largest segment of the SFR market and thus purport to offer the largest potential impact. Second, the increased presence of large corporate owners in the SFR market forces to the surface the fundamental issue that lies at the heart of policy-making decisions related to single-family homes: is individual homeownership a public good to be preserved and defended, or is a rentership society equally—or even more—desirable?

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43. Sarah Borchersen-Keto, *Single-Family Rental REITs Playing Key Role in Boosting Supply and Allowing Families to Live in Neighborhoods Otherwise Not Accessible*, NAREIT.COM (July 11, 2023), https://www.reit.com/news/articles/single-family-rental-reits-playing-key-role-in-boosting-housing-supply-and-allowing-families-to-live-in-neighborhoods-otherwise-not-accessible [https://perma.cc/FM4S-8X7E] (noting, for example, that large SFR investors own "about 3% of the 15.1 million total" SFRs and "the traditional mom-and-pop ownership structure . . . still dominates the industry today").

44. Richter, *supra* note 42; *see also* Laurie Goodman et al., *A Profile of Institutional Investor-Owned Single-Family Rental Properties*, URB. INST. (Apr. 25, 2023), https://www.urban.org/sites/default/files/2023-04/A%20Profile%20of%20Institutional%20Investor%E2%80%93Owned%20Single-Family%20Rental%20Properties_0.pdf [https://perma.cc/8DRG-L4DY] (providing statistics on the SFR market and acknowledging the difficulty in measuring SFR ownership).

45. Richter, *supra* note 42.

46. *Id.*

47. Cameron Abrams, *Abbott Takes Aim at Corporate Investors Purchasing Single-Family Houses*, THE TEXAN (Mar. 20, 2024), https://thetexan.news/issues/texas-taxes-spending/abbott-takes-aim-at-corporate-investors-purchasing-single-family-houses/article_914c6b2a-e638-11ee-916d-17c5e69a56fd.html [https://perma.cc/VM3C-XZRK].

C. Valuing Homeownership over Rentership

In the U.S., private ownership of land and home has traditionally been thought of as "a bedrock principle of the United States."[48] For John Locke, the Founding Fathers, and countless early American leaders, ownership of private property—and specifically of one's personal home, or "estate," in Locke's words—has the deepest of roots in American history and lore.[49] And modern-day presidents from both political parties continue to extol the "American Dream" of homeownership.[50]

Yet individual homeownership in the U.S. is not inevitable. Critics today increasingly attack the "supremacy" of single-family homeownership and the zoning laws that create single-family neighborhoods.[51] Single-family zoning laws are said to have, albeit "unintentionally, la[id] the roots for the severe housing shortage today"[52] because they "restrict every other type of housing, including senior housing, duplexes, apartment buildings, low-income housing and student housing" which typically provide more housing per square

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48. Stephen George, *Not for Sale: Why Congress Should Act to Counter the Trend of Massive Corporate Acquisitions of Real Estate*, 6 BUS. ENTREPRENEURSHIP & TAX. L. REV. 97, 97–98 (2022).

49. Stuart Bruchey, *The Impact of Concern for the Security of Property Rights on the Legal System of the Early American Republic*, 1980 WIS. L. REV. 1135, 1136–37 (1980); Paul J. Larkin, Jr., *The Original Understanding of "Property" in the Constitution*, 100 MARQ. L. REV. 1, 27–46 (2016) (discussing the priority and preeminence of property rights at the founding of the United States).

50. Nadav Shoked, *The Reinvention of Ownership: The Embrace of Residential Zoning and the Modern Populist Reading of Property*, 28 YALE J. ON REG. 91, 93–94 (2011).

51. *See, e.g.*, Wiggins, *supra* note 33, at 132 (describing how "institutional capitalization has the potential to significantly mitigate patterns of single-family favoritism" and observing "that the United States could be witnessing an unprecedented decoupling of single-family homes from their traditional roots because of institutional capitalization"); *see also* John Infranca, *Singling Out Single-Family Zoning*, 111 GEO. L.J. 659, 661, 666–716 (2023) (noting that "[i]n the court of public opinion, single-family zoning faces the fiercest test in its century-long existence" and chronicling the development of single-family zoning laws); Sarah Schindler & Kellen Zale, *Anti-Tenancy Doctrine*, 171 U. PA. L. REV. 267, 272, 358 (2023) (arguing that historic and current "law and policy choices . . . treat tenants as less than homeowners" and suggesting "ways to elevate the status of tenants through legislation and litigation, rather than solely pursuing methods to help existing tenants become homeowners"); Kristen David Adams, *Homeownership: American Dream or Illusion of Empowerment*, 60 S.C. L. REV. 573, 595 (2009) (noting that "American society has come to deem homeownership a virtue in its own right" and has "stigmatized renting and renters"); Stephanie M. Stern, *Reassessing the Citizen Virtues of Homeownership*, 111 COLUM. L. REV. 890, 928, 936 (2011) (seeking "to unseat assumptions about the breadth and intensity of homeownership effects" and considering "alternatives to ownership and nontraditional ownership forms").

52. Nathaniel Meyersohn, *The Invisible Laws that Led to America's Housing Crisis*, CNN (Aug. 5, 2023), https://www.cnn.com/2023/08/05/business/single-family-zoning-laws [https://perma.cc/6Z3Z-YB3T].

foot.[53] Opposition to single-family zoning often also arises from a desire for "corrective justice" for housing practices seen as discriminatory or exclusionary.[54] On the leading edge of the movement against single-family zoning, one city, Minneapolis, ended single-family zoning designations in 2018, and Oregon followed in 2019.[55] The trend has continued elsewhere, although not without controversy and opposition from those who, for example, "worry it will change the character of their neighborhoods . . . and . . . prefer that apartment buildings stay in dense commercial corridors."[56]

Even though "many observers have viewed [single-family living] as doing more harm than good,"[57] numerous studies make clear that "Americans overwhelmingly prefer owning a home to renting one."[58] When renters are asked if they intend to own a home someday, approximately 70 to 80 percent answer affirmatively.[59] One study of both owners and renters "found that fully 94 to 95 percent of people between the ages of 18 and 44 expected to" own a home in the future.[60]

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53. *Revisiting Single-Family Zoning: Creating Options for a More Affordable Housing Supply*, CivicWell (Aug. 30, 2019), https://civicwell.org/civic-news/single-family-zoning-for-affordable-housing-supply [https://perma.cc/RJ76-TEZT].

54. Rachel D. Gosil & Sarah E. Waldeck, *Home Equity: Rethinking Race and Federal Housing Policy*, 98 Denv. L. Rev. 523, 526–27 (2021) (advancing proposals that are "massive in size and scope," such as "a $100 billion federal fund to offer down payment assistance" as part of a broad effort to "correct past injustices in housing policy"); *see also* Jared Bernstein et al., *Alleviating Supply Constraints in the Housing Market*, White House Council of Econ. Advisors (Sept. 1, 2021), https://www.whitehouse.gov/cea/written-materials/2021/09/01/alleviating-supply-constraints-in-the-housing-market/ [https://perma.cc/7KBN-6FSZ] (describing the Biden administration's housing policies, including the goal to "[i]ncentivize the removal of exclusionary zoning and harmful land use policies").

55. *Id.*

56. *Ending Single-Family Zoning Increases Affordable Housing Availability*, Found. for Affordable Hous., https://www.ffah.org/blog/post/ending-single-family-zoning-increases-affordable-housing-availability/ [https://perma.cc/J7XE-YXTxM]; *see also* Alexander Von Hoffman, *Single-Family Zoning: Can History Be Reversed*, Harv. Joint Ctr. for Hous. Studies (Oct. 5, 2021), https://www.jchs.harvard.edu/blog/single-family-zoning-can-history-be-reversed [https://perma.cc/E4UR-6UZP] (providing a brief history of single-family zoning laws, their problems, and reform efforts).

57. Wiggins, *supra* note 33, at 139.

58. *See, e.g.*, Watkins, *supra* note 36, at 321.

59. Eric S. Belsky, *The Dream Lives On: The Future of Homeownership in America*, Harv. Joint Ctr. for Hous. Studies 5 (Jan. 2013), https://www.jchs.harvard.edu/sites/default/files/w13-1_belsky_0.pdf [https://perma.cc/B89K-2XXZ]; *see also* Anna Kodé, *The American Dream Without a House? Believe It*, N.Y. Times (Sept. 7, 2024), https://www.nytimes.com/2024/09/07/realestate/american-dream-homeowner-young-people.html [https://perma.cc/VNY9-Q422] (chronicling generational perspectives on homeownership and noting that "homeownership is becoming increasingly inaccessible for young Americans").

60. Belsky, *supra* note 59, at 5.

And not only are people "enamored with homeownership," but there are also financial reasons for preferring owning over renting, such as a home often being "the one leveraged investment available to households," the "forced savings" of paying down a home mortgage instead of paying rent, the tax benefits of ownership, and the home serving as "a hedge against inflation," among other reasons.[61] Accordingly, despite critics' opposition to single-family zoning and the traditional value of owning one's own home that single-family zoning represents, the ideal of homeownership remains a clear preference for the great majority of Americans and should remain a top priority for policymakers.

D. Potential Problems with Institutional SFR Ownership

The institutionalization of the SFR industry, however, threatens not only a value many Americans hold dear, as discussed above, but also the wider housing market, as discussed below. At the same time, advocacy groups for institutional SFR owners are keen to highlight the potential benefits of corporate SFR ownership, such as more efficient and professional property management services.[62] For instance, these advocates assert that institutional SFR ownership will lead to increases in property taxes and jobs in the building trades and allow for investments in energy efficiency and neighborhood improvement, all while making rental homes available in neighborhoods that were previously dominated by owner-occupied housing, thereby increasing access to desirable neighborhoods for people who could not otherwise afford to live there.[63]

Yet it is important to highlight several potential problems with consolidated corporate ownership of SFRs. First, consolidated SFR ownership at such a large scale means that opportunities for anti-competitive collaboration among market participants become more feasible than what is realistically possible in an otherwise uncoordinated and localized market. For example, the FBI is conducting an "investigation into an alleged rental price-fixing conspiracy" among large corporate landlords that use the same property management software to coordinate rent increases nationwide and in local markets.[64]

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61. *Id.* at 13–14.

62. Borchersen-Keto, *supra* note 43.

63. *Id.*; *see also* Oliver Chang, *Rentership Revisited*, SYLVAN ROAD (Sept. 22, 2015), https://sylvanroad.com/wp-content/uploads/Rentership-Revisited.pdf [https://perma.cc/4AC9-49EK] (describing, as the author of the original 2011 Morgan Stanley report, "The Rentership Society," the ongoing development of Housing 2.0).

64. Sherin Shibu, *Is One Company to Blame for Soaring Rental Prices in the U.S.?*, ENTREPRENEUR (June 4, 2024), https://www.entrepreneur.com/business-news/realpage-rent-price-fixing-probe-escalates-with-fbi-raid/475109 [https://perma.cc/LD4H-JS28].

Although the current FBI investigation centers on apartment rentals, a similar risk of anti-competitive behavior exists for companies that rent SFRs at scale.

The opportunity for anti-competitive collaboration is especially evident in local markets where institutional SFR owners control a large percentage of rental housing. Moreover, institutional ownership is indeed much more pronounced in certain markets, making nationwide SFR statistics unrepresentative of the potential impact of institutional SFR ownership in local markets. Significant SFR ownership concentration exists, for example, in the Sun Belt (such as Arizona and California), the Southeast (such as Florida and Georgia), and the Midwest (such as Missouri and Indiana).[65] In cities like Memphis and Atlanta, institutional investors purchased approximately one-third of single-family homes on the market in 2021, and approximately one-quarter in Charlotte and Miami.[66] In Kansas City, a study found that large investors (i.e., investors with more than 10 SFRs) own "nearly 20 percent" of all SFRs in the city, and "[t]hirty-three companies own nearly 14,000 homes in the Kansas City region, five of which own nearly 8,000 homes."[67] Relatedly, companies also concentrate their ownership of properties within a particular neighborhood, or even along a particular block. For example, one large investor purchased over 100 homes in just one Cincinnati neighborhood and converted them into SFRs as it sought "to buy 25 houses a month" in the city.[68] As a result, in local markets where institutional owners control a large number of rental units, the incentive to collude at the expense of consumers is high and can have dramatically detrimental effects.

Furthermore, institutional ownership is not only concentrated in specific locations, but also corporate SFR owners gravitate to specific types of properties. Large investors "tend to buy the most affordable properties and convert them into rentals," thus removing starter homes that would-be first-time homebuyers might otherwise purchase.[69] High demand due to large investors' appetite for starter homes, coupled

65. Sam Wasson & Lora Novak, *Are Big Companies Really Buying Up Single-Family Homes*, TODAY'S HOMEOWNER (Sept. 15, 2023), https://todayshomeowner.com/blog/guides/are-big-companies-buying-up-single-family-homes/ [https://perma.cc/NNH3-HYDB]; Rachel Bowman, *Inside the Midwestern State where Real Estate Investors Are Snapping Up a Record Share of Homes*, DAILY MAIL (July 14, 2024), https://www.dailymail.co.uk/news/article-13633127/Missouri-real-estate-investor-purchases.html [https://perma.cc/298C-98TZ].

66. Watkins, *supra* note 36, at 325.

67. Bowman, *supra* note 65.

68. Alcorn, *supra* note 31.

69. Watkins, *supra* note 36, at 323.

with low supply due to builders' neglect of constructing lower-cost homes, as described in Subpart A above, combine to make the recent disproportionate price increases for starter homes all but inevitable. Not only do institutional buyers with all-cash offers easily out-compete individual buyers who may struggle to scrape together a down payment while also qualifying for a bank loan,[70] but institutional investors can also afford higher prices because of their lower cost of capital versus individual borrowers.[71]

In addition to out-competing individual buyers in the market for existing properties, institutional SFR owners also have now entered the construction business. In a classic move toward vertical integration, institutional investors have kickstarted the industry of build-to-rent homes that are never offered for sale.[72] In this way, institutional SFR investors potentially create "a two-fronted chokehold on the homeownership market, controlling both the existing home market and the newly-constructed home market."[73] In some ways, building more single-family homes of any kind is a benefit to all because it creates more supply and thus potentially reduces home purchase prices. But in other ways, building SFRs—instead of starter homes meant for first-time homebuyers—only furthers the corporate dream of a rentership society while making the American Dream of homeownership ever more distant and uncertain.

Finally, in echoes of the sub-prime mortgages that were packaged and sold as securities before the Great Recession, institutional SFR

70. Al Yoon, *All-Cash Homebuyers Are Becoming 'Disruptive' to the Housing Market*, BUS. INSIDER (June 8, 2023), https://www.businessinsider.com/all-cash-homebuyers-disrupting-housing-market-2023-6 [https://perma.cc/TQD7-69A8].

71. Cameron LeBlanc, *The Real Reason It Matters that Investment Firms Are Buying Up Houses*, FATHERLY (June 21, 2021), https://www.fatherly.com/news/investors-single-family-home-market-rentals-wealth [https://perma.cc/QNU8-ZTXA] (describing below-market-rate loans available from the federal government that allow large investment companies to "agree to a purchase price that's $5,000 to $20,000 more, according to *Slate*'s math, while paying the exact same actual cost as the individual homeowner would.").

72. Borchersen-Keto, *supra* note 43 (quoting the CEO of Invitation Homes, one of the largest corporate owners of SFRs, as saying, "We're building more homes than we're buying right now"); Kristi Waterworth, *The Rise of Built-for-Rent*, U.S. NEWS & WORLD REP. (Feb. 10, 2023), https://realestate.usnews.com/real-estate/articles/the-rise-of-built-for-rent [https://perma.cc/KV8W-6X3U] (noting that build-to-rent homes "are growing dramatically," with "an increase of 42% [between September 2021 and September 2022] over the same period the year before"); JOINT CTR. FOR HOUS. STUDIES OF HARV. UNIV., *supra* note 1 (observing that the amount of built-to-rent SFRs in 2023 was "the highest annual number on record dating back to the mid-1970s . . . [and comprised] 9 percent of new single-family construction, up from the historic rate of roughly 3 percent and the 5 percent averaged since 2013").

73. Watkins, *supra* note 36, at 324.

owners are now securitizing streams of rental payments from SFRs in a way that "is strikingly similar to the business model used by financial institutions before the 2007–2009 financial crisis."[74] Securitization creates liquidity (in the form of publicly tradable stock) out of a typically illiquid asset (SFRs). With this ease of liquidity, institutional SFR investors can attract hundreds of millions of dollars in IPOs,[75] which provides capital for future purchases and an exit for investors. Wall Street has thus come full circle, from the pooling and securitizing of sub-prime mortgages before the Great Recession, to "a new class of real estate derivatives" built on SFRs purchased during and after the Great Recession.[76] In structure, the new class sounds just like the old class: SFR derivatives involve "the pooling of rental payments . . . and slicing them into different tranches with varying levels of potential risk and reward."[77]

E. Existing Proposals Directed at the Single-Family Home Market

In the aftermath of the mortgage and foreclosure crisis of 2008, the current crisis of decreasing housing supply and increasing home prices has spawned numerous proposals for fixing the single-family home market. This subpart summarizes several such policy proposals. First, it provides a constitutional analysis of the government's eminent domain power in the context of the housing crisis. Then, it focuses on statutory proposals involving direct government interventions in the housing market, at both the federal and state levels. Next, it describes local measures that city governments, and even neighborhood homeowners' associations, have taken, as well as complementary state-level proposals. Finally, approaching the housing crisis from a different direction, the subpart ends by highlighting an ambitious and transformative proposal from abroad that would restructure the underlying home mortgage system in the U.S. to reduce the mortgage rate lock-in effect. But whatever the virtues or deficiencies of these proposals, they ignore the powerful lock-in effect that prevents SFRs from being sold to ordinary homebuyers and thus leave a significant policy hole that this Article seeks to explain and fill in Parts III and IV.

74. Ken Chilton et al., *The Impact of Single-Family Rental REITs on Regional Housing Markets: A Case Study of Nashville, TN*, 8 SOCIETIES 93, 96 (2018); Chaudhry, *supra* note 37, at 425–31 (discussing the securitization of SFRs).

75. Chaudhry, *supra* note 37, at 427–30 (describing two SFR investment company IPOs that raised $300 million and $1.54 billion, respectively).

76. *Id.* at 425.

77. *Id.*

Proposals for addressing affordability and supply issues in the single-family home market can be divided, as below, between carrots and sticks, or incentives and prohibitions. However, the Takings Clause of the Fifth Amendment may limit the extent to which the government may act against private property ownership. Nonetheless, one commentator's analysis of Supreme Court precedent may suggest viable ways in which the government can act vis-à-vis the consolidation of private ownership of SFRs in the hands of a small number of corporations without presenting a takings problem.[78]

In the Supreme Court's 1984 *Midkiff* decision, the Court affirmed the Hawaiian state government's use of eminent domain in a 1967 law to "compel [large] . . . landowners to transfer fee simple ownership of their property to . . . individual Hawaiians" because the takings were for a valid public use:[79] that of "diluting the residential property market" where "nearly half of all property in the state was owned by a mere seventy-two individuals."[80] Because of this concentration, the Hawaiian legislature found, "owners' refusals to sell their land caused not only a shortage of fee simple ownership opportunities for citizens but also an artificial inflation of price."[81] As a result, the Hawaiian law "set up a step-by-step process of forced condemnation that ultimately resulted in the transfer of fee simple ownership from the landlord to the former tenant."[82] In upholding the Hawaiian law, "the *Midkiff* Court found a rational relationship between forced transfer of ownership and the legislature's goals of diluting the highly concentrated property market."[83]

To analogize to the context of the current consolidation of SFR ownership in the U.S., then, the public use argument from *Midkiff* may prove most effective in local markets where SFR ownership is highly concentrated and harmful to individuals' prospects of purchasing a home.[84] Even so, a different commentator succinctly notes the dilemma policymakers face when contemplating solutions as extreme[85] as the redistributive taking in *Midkiff*: "I get that people aren't a fan of restricting who can buy what. We normally wouldn't tell investors that

78. Watkins, *supra* note 36, at 329–34.
79. *Id.* at 320.
80. *Id*. at 320, 332.
81. *Id.* at 329.
82. *Id.*
83. *Id.* at 331.
84. *Id.* at 335–47.
85. *Id.* at 344, 350 (concluding that schemes patterned off *Midkiff*, if structured properly, "would likely merit the stamp of constitutional approval," yet also recognizing that such "potential solution[s] may rightfully be labeled extreme").

they can't go buy shares of Apple stock, but we don't live in stock. These are homes, and for a lot of people, residential real estate is one of the few ways they can build generational wealth."[86] Accordingly, given the vital role that residential real estate plays in Americans' personal lives, and in the nation's broader economic and political life, such extreme solutions as redistributive takings—or less extreme variations thereof—may indeed be worth considering and, if structured properly, could pass constitutional muster.

One example of a proposal seeking to prohibit corporate ownership of SFRs entirely is the "End Hedge Fund Control of American Homes Act," introduced in the U.S. Senate at the end of 2023.[87] This proposal would ban any entity with more than $50 million under management from owning SFRs.[88] The ban would be phased in over a 10-year period, and each year, current corporate owners of SFRs would be required to sell at least 10% of their SFRs or pay a $50,000 annual tax on each SFR still owned above the 10% annual reduction threshold.[89] Also, hedge funds that purchase additional SFRs would be required to pay a 50% tax on the fair market value of the acquired SFR.[90] The combined effect and explicit goal is that "[a]fter a 10-year full phase-out, all hedge funds will be completely banned from owning any single-family homes."[91]

Alternative prohibitive approaches abound. A different federal proposal would cap corporate SFR ownership at 50 homes; one in Minnesota would cap ownership at 20 SFRs.[92] In Nebraska, proposed legislation would prohibit out-of-state companies from buying SFRs entirely.[93] In California, a proposal would ban any company that already

86. Kevin V. Nguyen, *California Lawmaker Wants to Ban Companies from Owning More than 1,000 Homes in State*, S.F. STANDARD (Feb. 20, 2024), https://sfstandard.com/2024/02/20/alex-lee-proposes-corporate-landlord-ban-single-family/ [https://perma.cc/5JKC-65V5] (quoting "Ryan Lundquist, a certified residential appraiser in Sacramento who used tax billing data to map out how one firm ended up owning more than 10,000 homes in California").

87. End Hedge Fund Control of American Homes Act, S. 3402, 118th Cong. (2023).

88. Sen. Jeff Merkley, *Summary of End Hedge Fund Control of American Homes Act*, SENATE.GOV, https://www.merkley.senate.gov/wp-content/uploads/imo/media/doc/end_hedge_fund_control_of_american_homes_act_bill_summary.pdf [https://perma.cc/F8LH-KZXA].

89. *Id.*

90. *Id.*

91. *Id.*

92. Will Parker, *Wall Street Has Spent Billions Buying Homes. A Crackdown Is Looming.*, WALL ST. J. (Apr. 29, 2024), https://www.wsj.com/real-estate/wall-street-has-spent-billions-buying-homes-a-crackdown-is-looming-f85ae5f6 [https://perma.cc/K9EN-RSXT].

93. Daryl Fairweather, *Ban Corporate Landlords: A Housing Crisis Solution or a Distraction?*, FORBES (Mar. 5, 2023, 9:55 AM), https://www.forbes.com/sites/

owns over 1,000 SFRs from acquiring any additional single-family homes to convert into rentals.[94] Violators would pay a $100,000 penalty, per property, and be forced to sell the property to a third party.[95] Another proposal using financial penalties was the Biden administration's proposed elimination of accelerated depreciation tax deductions for landlords that own more than 50 SFRs if they raise rent by more than five percent per year.[96]

Another prohibitive approach has been to address the developer-to-investor pipeline. For instance, a proposal in California "would ban developers from selling homes in bulk to big investors" in an effort to stop build-to-rent developments in which homes are never offered for sale to individuals.[97] A similar result can also be accomplished on a local basis. For example, officials in College Park, an Atlanta suburb, "turned away one developer who requested permits for a build-to-rent subdivision of new single-family homes that would never be offered for sale."[98] The town mayor explained, "We were not interested in that . . . . We're interested in building pathways to wealth through homeownership for members of our community."[99] Other localized approaches include neighborhood homeowner association bylaws that restrict bulk purchases, cap the number of rentals in the neighborhood, require new homeowners to occupy the home for at least one or two years before renting out the property, or other similar measures.[100]

Against the prohibitive proposals outlined above, other incentive-based approaches seek to affirmatively encourage or assist people to

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darylfairweather/2024/03/05/ban-corporate-landlords-a-housing-crisis-solution-or-a-distraction/ [https://perma.cc/KG8E-T8BT].

94. Nguyen, *supra* note 86.

95. *Id.*

96. Julia Shapero, *Biden Proposes Eliminating Tax Breaks for Landlords Who Raise Rent More than Five Percent*, THE HILL (July 16, 2024, 5:00 AM), https://thehill.com/business/4774248-biden-proposes-eliminating-tax-breaks-landlords-more-than-5-percent/mlite/?nxs-test=mlite [https://perma.cc/H6DC-PULN].

97. Ben Christopher, *What You Need to Know About California Housing and Corporate Landlords*, CAL MATTERS (Mar. 7, 2024), https://calmatters.org/housing/2024/03/institutional-investors-corporate-landlords/ [https://perma.cc/2EZN-E8A8].

98. Sharon O'Malley, *Governments Begin Pushing Back on Investors Snatching Up Homes*, ROUTE FIFTY (July 4, 2022), https://www.route-fifty.com/infrastructure/2022/07/while-investors-are-snatching-homes-governments-fight-save-properties-residents/368927/ [https://perma.cc/NJE9-RM5Y].

99. *Id.*

100. *Id.*; *see also* Ben Horowitz & Libby Starling, *Rise in Investor-Owned Single-Family Rentals Prompts Policy Response*, FED. RESERVE BANK OF MINNEAPOLIS (Mar. 27, 2024), https://www.minneapolisfed.org/article/2024/rise-in-investor-owned-single-family-rentals-prompts-policy-responses [https://perma.cc/45JL-GVPQ] (noting that a city ordinance in a suburb of Minneapolis restricts the number of SFR licenses on a block-by-block basis).

buy and occupy single-family homes. For example, an Ohio proposal would introduce a 45-day waiting period anytime a corporate investor submits the winning bid on a foreclosed property.[101] During the waiting period, the tenant in the property could purchase the home for an amount equal to the investor's bid.[102] Failing that, any other individual buyer who commits to living in the property for at least one year, or any non-profit affordable housing group, could buy the property by offering more than the investor's bid.[103] In Texas, a similar approach would restrict corporate buyers from purchasing single-family homes until after a home has been on the market for 30 days, thereby giving individual buyers an opportunity to purchase the home first.[104] State and local governments have also financially incentivized individual homeownership in the face of corporate rental consolidation—for instance, the Cincinnati Redevelopment Authority raised $14.5 million through government bonds "to buy 194 single-family rental homes in a bidding war with 12 institutional investors," with the goal of creating pathways for tenants to acquire the property in which they live.[105] In California, an even more direct government incentive was announced: up to $150,000 in downpayment assistance for first-generation homebuyers.[106]

A different approach to the single-family housing crisis would target the mortgage market instead of the housing market directly. This approach, as suggested by *The Economist*, among others,[107] would borrow from Denmark's mortgage market, which is designed to reduce the mortgage-rate lock-in effect.[108] In Denmark, homeowners are paid a cash profit when they pay off a mortgage with below market interest rates after selling their home.[109] This occurs because, like in the U.S., Danish mortgage issuers sell "matching

101. O'Malley, *supra* note 98.
102. *Id.*
103. *Id.*
104. Abrams, *supra* note 47.
105. O'Malley, *supra* note 98.
106. McKenzie Diaz, *Gov. Newsom Announces First-Generation Homebuyers Have Been Approved for a Home Loan Program*, KSBY (June 29, 2024, 12:10 AM), https://www.ksby.com/news/local-news/gov-gavin-newsom-announces-first-generation-homebuyers-approved-for-the-dream-for-all-shared-appreciation-loan-program [https://perma.cc/Z5E4-G9X6].
107. *To Fix Broken Mortgage Markets, Look to Denmark*, THE ECONOMIST (Aug. 21, 2023), https://www.economist.com/leaders/2023/08/31/to-fix-broken-mortgage-markets-look-to-denmark [https://perma.cc/TPY3-MD44]; *see also* Rodriguez, *supra* note 20.
108. *See* Jesper Berg et al., *Peas in a Pod? Comparing the U.S. and Danish Mortgage Finance Systems*, 24 FED. RSRV. BANK N.Y. ECON. POL'Y REV. 63, 63–64, 70–71 (2018).
109. Rodriguez, *supra* note 20.

bonds" to investors to cover each mortgage.[110] Then, if "borrowing rates for new mortgages go up, the value of bonds tied to older, cheaper mortgages goes *down*," as "a loan that pays 7% interest is worth more than one that pays only 3%."[111] But, unlike in the U.S., "when Danish homeowners pay off their mortgages, they have two choices: pay back the balance of their home loan, same as Americans, or pay the *market value*, which is the amount their covered bonds would trade for on the open market."[112] Accordingly, if interest rates go up, Danes can earn a cash profit from paying off their mortgage! Alternately, because Danish home loans are assumable, sellers can instead choose to transfer the existing mortgage to a home buyer and obtain a better price for the sale.[113]

Adopting such a system in the U.S. would entail "an overhaul of our mortgage market,"[114] and would thus not be a quick fix. Nor would it alleviate the current mortgage rate lock-in dilemma because it would not be retroactive. Regardless, the Danish example shows that the mortgage rate lock-in effect is not inevitable but is rather a creature of policy and design choices. If the Danish model were to take root in the U.S., it could not only reduce the mortgage rate lock-in effect going forward, but it would also allow entrepreneurial finance companies to offer a range of innovative mortgage solutions that could be more beneficial to consumers.

Having summarized several existing proposals to alleviate the current housing crisis and having reviewed arguments for and against single-family zoning and homeownership, the next section proceeds to this Article's core argument. Existing housing proposals tend to focus on curtailing the actions of large corporate investors or aiding individual homebuyers. Both approaches are worthwhile and forward-looking goals, but such solutions are incomplete. Small mom-and-pop landlords (those who own less than 10 SFRs) own, in the aggregate, significantly more SFRs than large corporations and therefore play an outsized role in the SFR market. Accordingly, interventions into this sector of the industry are essential for addressing the current housing crisis. The remainder of this Article focuses on these small-scale SFR owners.

110. *Id.*
111. *Id.*
112. *Id.*
113. *To Fix Broken Mortgage Markets*, *supra* note 107.
114. Rodriguez, *supra* note 20.

II. The 1031 Lock-In Problem

Common advice in real estate investment is to buy as much real estate as possible and never sell.[115] Tax incentives make such a strategy extremely effective for building generational wealth in real estate. Yet, if tax policy incentivizes buy-and-hold strategies and discourages real estate sales, then is it not plausible that tax incentives may be at least partially responsible for the current shortage of single-family homes for sale in the U.S.? Further, beyond present-day supply shortages, might the current panoply of tax incentives in the U.S. housing market systemically and artificially create a chronically imbalanced market for single-family homes?

Part II explains how 1031 tax incentives create significantly imbalanced pressures to buy but not sell single-family homes. Subpart A first shows how one set of incentives (Section 121 of the Tax Code) motivates both the buying and selling of single-family homes, so long as those homes are owner-occupied. In contrast, Subpart B shows how a different mix of incentives (Section 1031 of the Tax Code) motivates investors to buy SFRs while simultaneously discouraging them from ever exiting real estate investments during their lifetimes. This discrepancy then exerts imbalanced pressure on U.S. real estate markets and limits supply in the market for homes listed for sale. Finally, Subpart C explains that where a partial 1031 offramp does exist for small real estate investors to transfer a property into a REIT, the logical effect of this partial offramp is further consolidation of the long-term ownership of SFRs in large corporate entities, which are further disincentivized from ever selling these properties on the open market.

A. *Incentives to Buy and Sell Owner-Occupied Homes*

When homeowners sell the home in which they live, Section 121 of the Tax Code allows them to pay no tax on up to $250,000 in gains in the home's value since purchase, or $500,000 if filing jointly with a spouse, provided they have lived in the house for at least two of the last

115. *See, e.g.*, Chris Mayer, *Buy a House… Then Buy Another*, Bus. Insider (Jan. 10, 2011, 2:00 PM), https://www.businessinsider.com/buy-a-house-then-buy-another-2011-1 [https://perma.cc/E3QE-97RZ]; *Never Sell Your House (Or Any Real Estate) – Here's Why*, Diamond Realty & Loan (Feb. 24, 2022), https://www.diamondrealtyandloan.com/blog/why-never-sell-house-real-estate [https://perma.cc/7PD9-NV3P]; *c.f.,* Debbie Carlson, *Eight Reasons to Sell Investment Properties*, U.S. News & World Rep. (May 2, 2019), https://money.usnews.com/investing/real-estate-investments/slideshows/8-reasons-why-owners-should-sell-their-property-investments?onepage [https://perma.cc/7LE7-S35Y] (listing personal reasons to sell real estate but nonetheless highlighting the benefits of a 1031 exchange for like-kind property instead of cashing out of real estate entirely).

five years.[116] From a purely financial perspective, then, as a homeowner's property appreciates in value, the homeowner has an incentive to sell the home and harvest tax-free gains any time after living in the home for two years and prior to home price appreciation exceeding the $250,000 or $500,000 threshold, as applicable. Importantly, upon selling a home under Section 121, homeowners are not restricted in what they do with their tax-free gain.[117] For example, a homeowner may choose to pocket the entirety of the gain. A homeowner may alternatively use the gain to purchase a new home or reinvest it in other investments like stocks. It is a tax-free gain, free and clear, and homeowners may do with it what they please.[118]

If they choose to purchase a new home, homeowners may then repeat the process and harvest additional gains—again up to the amount of the exclusion threshold—so long as they owned and used the home as a residence for two of the five years preceding each sale.[119] Of course, it typically would take significantly more than two years for home price appreciation to reach the exclusion level of $250,000 or $500,000; thus, the tax exclusion does not normally push homeowners to sell in such a short timeframe. But the threshold could incentivize homeowners to sell sooner than they would otherwise once their home price appreciation nears the exclusion threshold. A related way of thinking of the exclusion threshold—again, solely from a tax perspective—is that the homeowner is penalized by staying in a home too long and not selling it once the home appreciates beyond the applicable threshold of $250,000 or $500,000.

This is precisely what has been occurring with increasing frequency during the recent run-up in single-family home prices, especially in high-priced real estate markets.[120] The exclusion threshold is not indexed to inflation, which has become especially significant in recent years.[121] The current threshold was set in 1997 and has not

116. *Topic No. 701: Sale of Your Home*, INTERNAL REVENUE SERV., https://www.irs.gov/taxtopics/tc701 [https://perma.cc/7SL7-GTZT] (last visited July 19, 2024).

117. *See* Lily Kahng, *Path Dependence in Tax Subsidies for Home Sales*, 65 ALA. L. REV. 187, 216 (2013).

118. Of course, a home's value may also decline, as occurred for many homeowners in the Great Recession, in which case there are no gains to tax anyway. Such is the risky nature of equity ownership.

119. *Publication 523, Selling Your Home*, INTERNAL REVENUE SERV., https://www.irs.gov/publications/p523 [https://perma.cc/NZQ2-XXJB] (last visited July 19, 2024).

120. Yanling Mayer, *An Unexpected Surprise: More Homeowners Paying Capital Gains Taxes Due to Strong Price Growth*, CORELOGIC (Apr. 19, 2024), https://www.corelogic.com/intelligence/unexpected-surprise-more-homeowners-paying-capital-gains-taxes-strong-price-growth/ [https://perma.cc/7U5C-RVXT].

121. Veronica Dagher, *Capital-Gains Tax Hits More Home Sellers*, WALL ST. J. (May 4, 2024, 5:30 AM), https://www.wsj.com/personal-finance/home-sellers-capital-gains-tax-e00bade3 [https://perma.cc/Q9UB-33KV].

been revised since, despite proposals to do so and to tie the exclusion threshold to inflation.[122] Updating the 1997 threshold of $500,000 into today's dollars would equate to a new threshold of over $950,000 for married couples filing jointly.[123] Nor does the exclusion vary from inexpensive locations to more costly locations, meaning that the tax incentive for a homeowner to sell and move to a new home arises more quickly in higher-priced areas.[124] Hence the classic (potentially biased!) realtor advice: "buy and sell to your heart's content. Just don't plan on staying forever!"[125]

For purposes of this Article, the primary takeaway is that Section 121 incentivizes homeowners to both buy and sell owner-occupied homes in a market-balancing manner. Buying the home is like getting on an elevator, selling is like getting off, and tax incentives at both the entrance and the exit encourage people to both buy and sell. The incentive to get on the elevator by buying a home is that while they remain on the elevator, homeowners reap annual tax benefits in the form of income tax deductions.[126] Homeowners are also incentivized to get off the elevator because they pay no tax if they exit with gains of up to $250,000 or $500,000, as applicable. For owner-occupied homes, then, tax incentives to both purchase and sell together stimulate both supply and demand in the housing market.

Historically, the Section 121 exclusion has endured over time because it aligns with the government's long-standing efforts to

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122. *Id.*; *see also* Mark R. Siegel, *The Need to Look Back for Sales of a Principal Residence*, 41 S. Ill. U. L.J. 67, 87–88 (2016) (discussing an alternative policy framework for rollover reinstatement).

123. Dagher, *supra* note 121.

124. *Id.* (noting, for example, that almost 30 percent of sales in California exceed the exclusion threshold compared to less than one percent in West Virginia).

125. Kahng, *supra* note 117, at 217.

126. For example, homeowners who itemize their deductions can reduce their taxable income by the amount they paid in mortgage interest and property taxes during the tax year, among other deductions and tax benefits (like imputed rent). Amy Fontinelle, *Eleven Tax Benefits of Owning a Home*, Forbes (June 20, 2023, 3:26 PM), https://www.forbes.com/advisor/mortgages/tax-benefits-of-owning-a-home/ [https://perma.cc/WHM4-XAZV]; *see also* Dan Bobkoff, *US Homeowners Get a Huge Tax Break Almost Nobody Knows About, and It's Even Part of GDP*, Bus. Insider (Oct. 1, 2016, 7:00 AM), https://www.businessinsider.com/imputed-rent-hidden-tax-break-homeowners-2016-9 [https://perma.cc/PC5D-7UST] (explaining that, if the amount of rent homeowners would be paying to a landlord were imputed to homeowners' income, then, in addition to the mortgage interest and property tax deductions, homeowners "could depreciate the value of the home and everything in it over time[, and deduct] . . . maintenance costs" for maintaining the home. In sum, "[y]ou'd have a higher income, but you'd have greater deductions").

incentivize homeownership.[127] The current version of Section 121 was enacted in 1997.[128] The exclusion has remained largely the same since that time, other than two amendments that were passed in 2004 and 2008.[129] The amendments were designed to close perceived loopholes related to converting a rental property or a second home into a taxpayer's primary residence before sale to qualify for the exclusion.[130] However, neither of these amendments updated the exclusion to reflect current market conditions nor indexed it to inflation.[131]

Unlike the multiplicity of approaches used in the pre-1997 versions of Section 121,[132] the current iteration remains simple and straightforward: exclude gains of up to $250,000 or $500,000, as applicable, upon the sale of an owner-occupied home provided the seller has lived in the home for at least two of the last five years. As the next subpart describes, however, a homeowner who converts an owner-occupied home into a rental property faces a dramatically different tax outlook with a significantly different incentive structure.

B. Incentives to Buy and Not Sell Single-Family Rental Homes until Death

In contrast to homeowners who sell their home and buy a different home to live in, homeowners who buy a new home while keeping and renting out their existing home face starkly different incentives. By choosing to hold the existing home, convert it into an SFR, and become a landlord (albeit sometimes a reluctant one), homeowners cross over into the world of investor-owned properties where the incentives to buy and hold properties—and the disincentives to sell them—become stronger with each passing day. The imbalanced nature of these

127. Andrew Gahan, *The Home-Sale Exclusion: A Proposal Targeted at Eliminating Speculation*, 18 CHAP. L. REV. 267, 267–68 (2014).
128. Kahng, *supra* note 117, at 208.
129. *Id.* at 200–01.
130. *Id.*
131. *See id.*; American Jobs Creation Act of 2004, Pub. L. No. 108-357, § 840(a), 188 Stat. 1418, 1597 (2004) (current version at 26 U.S.C. § 121(d)(10)); Housing and Economic Recovery Act of 2008, Pub. L. No. 110-289, § 3092, 122 Stat. 2654, 2911–2912 (2008) (current version at 26 U.S.C. § 121(b)(5)).
132. For example, at certain times prior to 1997 the exclusion was only available once during a homeowner's lifetime, or only after reaching a certain age, such as 55 or 65. *Id.* at 191–96; Gahan, *supra* note 127, at 271–73. At other times, the exclusion functioned as a roll-over, meaning profits from the sale of a home needed to be reinvested into another primary residence. Kahng, *supra* note 117, at 191–96. Similarly, the exclusion has also previously required the homeowner to trade-up to a more expensive home to avoid capital gains tax. *Id.*

incentives results in a critically unbalanced housing market by creating strong demand for single-family homes that can be converted into SFRs while also reducing supply of such homes on the market.

After converting an owner-occupied home into an SFR, the Section 121 incentives to sell disappear quickly: homeowners have three years remaining during which Section 121 could still apply to the sale of the home.[133] During the first three years of renting out their former primary residence, then, homeowners could still sell the property and exclude their capital gains under Section 121, although with certain limitations attributable to the time during which the property was rented out.[134] But after three years of not personally occupying the property, the Section 121 incentives to sell disappear entirely. Also, Section 121 does not apply at all to a home initially purchased as an SFR and in which the homeowner did not previously live. However, an SFR owner could convert an SFR into an owner-occupied residence and subsequently rely on Section 121 upon the sale of the property, subject to certain limitations.[135]

In addition to capital gains tax, SFR owners are also disincentivized to sell property without reinvesting in real estate due to depreciation

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133. This timeline results because Section 121 covers homes in which owners lived during any two of the previous five years, as described above.

134. Christine Manolakas, *The Mixed Use of a Personal Residence: Integration of Conflicting Holding Purposes Under I.R.C. Sections 121, 280A, and 1031*, 14 Wake Forest J. Bus. & Intell. Prop. L. 2, 37–38 (2013) (explaining that the Section 121 "exclusion does not apply to gain attributable to depreciation deductions taken" while the property was used as an SFR). Alternatively, during the first three years of renting out their former residence, homeowners could also choose to rely on Sections 121 and 1031 simultaneously. Doing so would mean excluding some gains under Section 121 and rolling over the remaining gains into a replacement property through a tax-deferred exchange under Section 1031. For discussion of this hybrid strategy, see *id.* at 36–44; Rev. Proc. 2005-14, 2005-1 C.B. 528, https://www.irs.gov/pub/irs-drop/rp-05-14.pdf [https://perma.cc/299J-YTMQ].

135. Rae Hartley Beck & Jim Probasco, *Capital Gains Tax on Real Estate and Selling Your Home*, Bankrate (Dec. 20, 2024), https://www.bankrate.com/real-estate/capital-gains-tax-on-real-estate/ [https://perma.cc/6GBB-PCPZ] (describing the requirement to live in the former SFR for at least two years and the inability to exclude under Section 121 the depreciation deductions claimed when the property was a rental). In addition, if an SFR is obtained through a 1031 exchange and then converted into an owner-occupied residence, the property must be held for at least five years, to satisfy 1031 holding requirements, and the owner must live in the property for at least two years, before using the Section 121 exclusion. *FAQs About 1031 Exchanges: Is It Possible to Convert an Investment Property into a Primary Residence and Eventually Sell the Property Applying Section 121?*, 1031Exchange.com, https://www.1031exchange.com/faq/ [https://perma.cc/XE5F-MDK5] (last visited Feb. 10, 2025); *see also* Manolakas, *supra* note 134, at 36–43 (providing further insights and examples on how Sections 121 and 1031 can be integrated).

recapture tax. Depreciation recapture tax arises because homeowners may claim an annual depreciation tax deduction on properties used as SFRs, but that deduction is not available when the property is owner-occupied.[136] The depreciation deduction is available for SFRs even when the SFR's market value is appreciating, not depreciating, because the annual deduction is a predetermined accounting figure, not a market-based determination.[137] The mismatch between accumulated depreciation deductions and property appreciation, therefore, typically grows larger the longer the SFR is owned because depreciation deductions continue to accumulate each year even though the market value of the SFR continues to appreciate over time (not depreciate, as the deduction would imply). This mismatch is then reconciled upon sale of the SFR, resulting in a tax to recapture the depreciation deductions that were previously taken but which, at the time of the sale of the SFR, were found to have exceeded the market-based appreciation.

The takeaway point is this: whereas owner-occupiers can sell their home and completely avoid capital gains tax, an SFR owner who sold the exact same home would pay both capital gains tax *and* depreciation recapture tax. Capital gains tax is currently set at the rate of 15%, or 20% for high-income earners.[138] And because taxable income includes the gain from the sale of an SFR, homeowners who normally earn less than the high-income earner threshold could nevertheless be catapulted into the higher tax bracket solely during the year in which they sold the SFR. The second tax, depreciation recapture, is assessed at ordinary income tax rates, which are often higher than capital gains tax rates (although ordinary income rates for low-income taxpayers are lower,

136. Depreciation deductions are only available when the property is held for a business purpose (i.e., as a rental property), not when a home is owner-occupied. *Publication 946 (2023), How to Depreciate Property*, Internal Revenue Serv., https://www.irs.gov/publications/p946 [https://perma.cc/DS5E-GQAH] (last visited July 24, 2024). The incentives to hold an SFR include not only depreciation but also deduction of all other property expenses. More specifically, in addition to the deductions that are available for owner-occupied properties (such as mortgage interest and property tax), an SFR owner can also generally deduct expenses incurred in operating the property as a rental home, such as maintenance, cleaning, upkeep, repairs, management, advertising, and utilities paid by the SFR owner. *Publication 527, Residential Rental Property (Including Rental of Vacation Homes)*, Internal Revenue Serv., https://www.irs.gov/publications/p527 [https://perma.cc/6957-FE3U] (last visited July 24, 2024).

137. Alicia Tuovila, *Depreciation Recapture: Definition, Calculation, and Examples*, Investopedia (Nov. 05, 2024), https://www.investopedia.com/terms/d/depreciationrecapture.asp. [https://perma.cc/2FK4-Q2A4].

138. Jason Fernando, *Capital Gains Tax: What It Is, How It Works, and Current Rates*, Investopedia (Jan. 21, 2025), https://www.investopedia.com/terms/c/capital_gains_tax.asp [https://perma.cc/Y65H-TQR2].

of course).[139] In any case, depreciation recapture rates are capped at a maximum of 25%.[140] Adverse tax consequences thus strongly disincentivize SFR owners from selling—exactly the opposite situation facing owner-occupiers, who are affirmatively incentivized to sell. To make matters worse, once a homeowner decides to become a real estate investor by converting an owner-occupied home into an SFR, an additional tax incentive—Section 1031 of the Tax Code essentially locks the owner into real estate investment for life.

Section 1031's lock-in effect is caused by the widely celebrated[141] yet also widely bemoaned[142] tax-deferred exchange transactions that Section 1031 enables.[143] In simple terms, a 1031 exchange encourages investors to sell one real estate investment property and buy another of equal or greater value—known as "trading" or "exchanging" one rental property for another.[144] Such an exchange allows investors to avoid paying capital gains or depreciation recapture tax because payment of those taxes is deferred to a later date.[145] Meanwhile, selling the same property and investing the proceeds in a non-real estate asset, or simply saving or spending the proceeds, triggers potentially enormous tax consequences, as discussed above. Hence, the 1031 lock-in incentivizes real estate investors to either endlessly trade one property for another

139. Tuovila, *supra* note 137.
140. *Id.*
141. *E.g.*, Brandon M. Weiss, *Opportunity Zones, 1031 Exchanges, and Universal Housing Vouchers*, 110 CALIF. L. REV. 179, 206–08 (2022) (explaining arguments by "real estate industry advocacy groups . . . advancing the basic economic rationale" for 1031 exchanges, such as the contention that "elimination of § 1031 for residential and non-residential real estate would lead to a total reduction in annual GDP of $9.3 billion"); Bradley T. Borden, *The Like-Kind Exchange Equity Conundrum*, 60 FLA. L. REV. 643, 661–71 (2008) (discussing equitable arguments in favor and against 1031 like-kind exchanges).
142. *E.g.*, Marjorie E. Kornhauser, *Section 1031: We Don't Need Another Hero*, 60 S. CAL. L. REV. 397, 407–12, 441 (1987) (reviewing arguments in favor of 1031 exchanges, flaws in these arguments, and concluding Section 1031 "should be abolished because it creates inefficiencies and inequalities which far outweigh any benefits it might provide").
143. 26 U.S.C. § 1031; Kornhauser, *supra* note 142, at 442–47 (explaining the historical evolution of theoretical and practical debates surrounding the benefits and drawbacks of Section 1031); Sarah Klim, *Potential Changes to I.R.C. § 1031, "Like-Kind Exchanges"*, 40 REV. BANKING & FIN. L. 743, 744–47 (2021) (explaining that prior to 2018, personal and intangible property were eligible for like-kind exchange under § 1031, but after the Tax Cuts and Jobs Act, 1031 exchanges are restricted to real property).
144. Robert W. Wood, *What Is a 1031 Exchange? Know the Rules*, INVESTOPEDIA, https://www.investopedia.com/financial-edge/0110/10-things-to-know-about-1031-exchanges.aspx [https://perma.cc/N9AT-SPQB] (last updated Dec. 14, 2024).
145. *Id.*

or to not sell at all.[146] If single-family homeownership under Section 121 is an elevator with incentives to get on and off, SFR ownership under Section 1031 is a merry-go-round with incentives to get on and stay on.[147]

Furthermore, the 1031 lock-in effect grows more powerful over time because a 1031 exchange does not reset an investor's tax basis.[148] Even if a 1031 investor changes seats on the merry-go-round by selling one property and using the proceeds to purchase another property in a tax-deferred exchange, the investor's depreciated tax basis from the original property carries over to the new property.[149] When trading up into a more expensive property, the carry-over tax basis increases only by the amount of the higher price paid for the replacement property, thus incentivizing investors to continue trading up on the real estate investment merry-go-round.[150] Over time, as depreciation continues to reduce the tax basis in the property, and the market value of the property continues to appreciate, the investor faces an ever-growing potential tax liability and therefore an ever-growing disincentive to sell. Eventually, the tax consequences for cashing out can become so large that the investor may look to death for deliverance.

At death, an investor's heirs receive a step up in tax basis to then-current market values (under Section 1014 of the Tax Code) and may therefore sell the inherited property tax-free,[151] something the investor could not have done even the day before the investor's death. Inheritance laws currently cap the estate tax exemption at over $13 million per person, meaning a married couple can pass on an estate of approximately $27 million, tax-free.[152] The amount of the estate tax exemption often fluctuates,[153] but wherever the exclusion threshold

146. Fred Hubler, *Get Off The 1031 Merry-Go-Round*, FORBES (Jan. 16, 2024), https://www.forbes.com/sites/fredhubler/2024/01/16/get-off-the-1031-merry-go-round/ [https://perma.cc/GC9Y-HW8A]; Joseph A. Snoe, *Tax Simplification and Fairness: Four Proposals for Fundamental Tax Reform*, 60 ALB. L. REV. 61, 86 (1996) (explaining that the potential tax due upon sale of an SFR may make homeowners "reluctant to dispose of the asset. Thus, depreciation promotes the lock-in effect.").

147. Hubler, *supra* note 146.

148. *Simple Rules for Determining Replacement Property Basis in a 1031 Exchange*, FIRST AM. EXCH. CO., https://www.firstexchange.com/determining-replacement-property-basis-in-a-1031-exchange [https://perma.cc/B59A-FD3B].

149. *Id.*

150. *Id.*

151. Oh & Verstein, *supra* note 4, at 775; 26 U.S.C. § 1014.

152. *Estate Tax*, INTERNAL REVENUE SERV., https://www.irs.gov/businesses/small-businesses-self-employed/estate-tax [https://perma.cc/FLN9-LYPB] (last visited July 24, 2024).

153. During the 2000s, the estate tax exemption generally fluctuated between approximately $1 million and $5 million. Goldburn P. Maynard Jr., *Perpetuating*

is set, investors can pass on SFRs to their heirs, tax-free, up to the threshold amount, because of the step-up in basis that SFRs receive upon the owner's death.

A numerical example helps illustrate the financial and psychological impact of the 1031 lock-in on an SFR owner's decisionmaking. Suppose an investor purchased an SFR 20 years ago for $300,000 and is contemplating selling it today for $800,000. Depending on various factors and assumptions, upon sale of the SFR, the investor would likely pay a tax of between approximately $125,000 and $212,000 (or approximately $100,000 to $140,000 in states with no state capital gains tax).[154] As a rough midpoint, then, the investor could anticipate a sticker price of approximately $150,000 in cash as the cost of selling the SFR during the investor's lifetime, a burden which could be avoided by simply holding onto the property until death.

For small SFR owners whose estates are unlikely to exceed the estate exclusion threshold, then, holding an SFR until death means avoiding all taxes on disposing of the SFR. In contrast, selling the SFR before death means paying potentially significant capital gains and depreciation recapture tax. If the mortgage interest rate lock-in is a slow burn of hundreds of dollars per month in additional interest payments when a homeowner dares to move, as described in Part I.A, the 1031 lock-in is a one-time bonfire of hundreds of thousands of

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Inequality by Taxing Wealth, 84 FORDHAM L. REV. 2429, 2433 (2016). This threshold was essentially more than doubled in 2018 under the Tax Cuts and Jobs Act to $13.61 million for 2024. Arti Batra & Emily Paukert, *Increased Estate Tax Exemption Sunsets in Late 2025, Giving Options and Next Steps*, MOSS ADAMS (Nov. 8, 2023), https://www.mossadams.com/articles/2023/11/increased-estate-tax-exemption-sunset-options# [https://perma.cc/M8QY-ZZNR]. Beginning in 2026, the amount of the exclusion is set to revert to its prior level, adjusted for inflation, at which point the estate exemption amount is expected to be approximately $6.8 million per person (unless Congress acts to change the amount before then). *Id.*

154. A simple 1031 tax calculator is *Capital Gain Estimator*, IPX 1031, https://www.ipx1031.com/capital-gain-estimator/ [https://perma.cc/Q5TD-YGL6]. The assumptions used for the sample calculation in the text are as follows:

1) Of the $300,000 purchase price, 80% was attributed to the building ($240,000) and 20% to the land ($60,000);

2) Using a depreciation schedule of 27.5 years resulted in a 20-year accumulated depreciation expense of $174,545;

3) Selling expenses and capital improvements were assumed to be $50,000 and $75,000, respectively;

4) Varying combinations were used for the federal capital gains tax rate (15% or 20%), the depreciation recapture rate was assumed to be the maximum rate of 25%, and the net investment income (NII) tax (3.8%) was included where applicable;

5) State capital gains tax rates used for comparison were Colorado (4.4%), California (13.3%), and several states with a 0% capital gains tax rate (e.g., Alaska, Florida, Nevada, Texas, etc.).

dollars when an SFR owner dares to sell. Many factors impact the market for single-family homes, of course, but tax incentives and disincentives for buying, holding, and, in the case of SFRs, *not* selling, undoubtedly exert a fundamental influence in the single-family home market in the U.S.[155]

While SFR investors are incentivized to hold onto properties indefinitely, there are both policy and economic reasons that this may not be an efficient system. For instance, many small SFR owners may not want to deal with the responsibilities of managing such properties indefinitely. The distance between ownership and management of SFRs is often negligible, and small SFR owners may directly manage their properties instead of hiring a property management company, but even if a property management company does assume day-to-day management responsibilities, higher-level decisions (like capital improvements) still typically require the owner's involvement. Additionally, homeownership entails risks that other types of investment do not. For instance, owners may need to contribute additional capital to maintain the SFR if rental income is insufficient to cover property expenses, which never occurs when owning publicly traded shares of stock. Thus, SFR investors may prefer to invest their capital elsewhere but are prevented from doing so by our current tax policy.

In addition to the headaches associated with landlords being trapped holding investment property they are unprepared or unwilling to manage, the 1031 death lock-in can also be economically inefficient from a market perspective. An SFR investor who would rather sell but cannot due to the 1031 lock-in is unlikely to be the optimal property owner. A new owner may manage the property better, remodel it, or value its use more than the locked-in investor. First-time homebuyers might purchase the house to live in themselves, removing the SFR from rental inventory but allowing the devoted new homeowner to embark on the American Dream. Instead, the current tax regime threatens the investor-owner with a massive tax bill upon sale of the property, which can be avoided simply if the investor's heirs sell the property after the investor's death. Therefore, as a purely financial decision, it is entirely rational for the investor to simply hold the property until death, perhaps performing only the minimum upkeep necessary to keep the property habitable.[156]

155. Oh & Verstein, *supra* note 4, at 774 (discussing the central problem of "taxes inhibiting the sale and transfer of real estate").

156. Oh & Verstein, *supra* note 4, at 775 (observing that an investor's "built-in gain escapes taxation if the owner of real estate simply holds it until death. Accordingly, taxes discourage owners from selling to buyers that might better manage or utilize the real estate . . . . [T]he tax code regularly locks real estate into the wrong hands.").

Even upon death, the 1031 structure may impede heirs from selling their properties on the open market. Although disagreements will likely always rage over whether heirs should receive a step up in basis upon an investor's death,[157] as well as over the level or propriety of the estate tax itself,[158] as a practical matter, current policy design choices create multiple undesirable outcomes in the inheritance of SFRs. One is messy estate planning scenarios, as heirs who stand to inherit SFRs might nonetheless have no interest or expertise in real estate. And even if heirs do have an interest and expertise in real estate, dividing one or more SFRs into multiple interests is much more complicated than sharing liquid assets, which could easily have been apportioned for inheritance had the investor been able to sell the illiquid SFRs before death without the tax liability. Additionally, when heirs receive real estate assets (such as SFRs) instead of liquid assets, they must confront the associated issues of common ownership because no liquid market exists for their separate interests in the SFRs.[159] Even though heirs are free from the tax consequences that faced the deceased investor and can sell the inherited property tax-free, disagreements about whether or when to sell immediately and inherently create problematic relationships between the various owners.[160] Unable to sell their illiquid SFR interests, heirs are faced with the operational challenge of managing a small, closely-held business they may never have anticipated owning. Compare this situation with stocks or other publicly traded securities, where the problems of different time horizons and priorities for different investors are negligible because individual investors can exit the business relationship independently by selling their shares in the enterprise. Additionally, shareholders of large companies are not typically involved in the management of the business.

In terms of balancing the number of buyers and sellers in the real estate market, in a sense the 1031 exchange model works fine, *if* investors ride the merry-go-round by actively trading up and thereby engaging in both a sale and a purchase. But not all real estate investors aspire to own bigger and bigger properties or amass a real estate empire.

157. Nancy M. Annick, *Plugging the "Gaping Loophole" of the Step-Up in Basis at Death: A Proposal to Apply Carryover Basis to Excess Property*, 8 PITT. TAX REV. 75, 93–101 (2011) (reviewing the historical debate over granting a step-up in basis at death).

158. Richard Schmalbeck, *Does the Death Tax Deserve the Death Penalty? An Overview of the Major Arguments for Repeal of the Federal Wealth-Transfer Taxes*, 48 CLEV. ST. L. REV. 749, 752–68 (2000) (reviewing arguments in favor of and against the estate tax).

159. *See* discussion of fractional interests *infra* Part II.C.2.

160. Oh & Verstein, *supra* note 4, at 780 (explaining that "[t]he defining problem for a collective real estate venture is managing the inherent conflicts among its investors, who do not benefit (or suffer) from decisions equally").

Some investors grow tired of the merry-go-round while others simply buy and hold one or a handful of SFRs.[161] And as time passes, they come to realize that selling the SFR and cashing out of real estate has become a financial cliff with an ever-growing latent tax bill hanging over any potential sale.[162] But they also realize that if they hold the property until death—then voilà—the entire tax liability goes away![163] If possible, then, the rational course of action for SFR owners is often just to hold on a little longer. Maybe refinance the property to pull some cash out—tax-free—and increase the debt on the property,[164] or maybe exchange one property for another, but, by all means possible, stay in the real estate game. The 1031 mantra can thus easily become, "whatever you do, do not cash out!" Real estate becomes like Hotel California—you can check out of day-to-day property management, or even check out of one property and check in to another, but you can never leave real estate investment . . . until death.

None of this is to suggest we should feel sorry for small 1031 investors. But it does highlight a problem of our own making that not only discourages real estate investors from selling but also consequently removes opportunities for first-time homeowners to buy. And if we care about keeping the American Dream available for the next generation of families, we must forge a different path. The only offramp available to small 1031 investors need not be death.

C. Incentives for REITs to Not Sell Single-Family Rental Homes

One potential pre-death 1031 offramp would appear to be the real estate investment trust, or REIT. Indeed, Professors Oh and Verstein identify that REITs emerged as a solution to the fundamental 1031 dynamic discussed above that discourages real estate investors from selling their holdings: "Put simply, investors face large tax incentives to avoid sales of real estate during their lifetimes."[165] As such, the REIT is a specialized vehicle for real estate investment, with unique

161. Agnes A. Gaddis, *How to Buy and Hold Real Estate & Why It's the Best Strategy*, REALWEALTH (July 9, 2024), https://realwealth.com/learn/how-to-buy-and-hold-real-estate/ [https://perma.cc/TA54-MUHJ].
162. Oh & Verstein, *supra* note 4, at 774 (noting that "[t]he longer you own real estate, the more time for built-in gain to accumulate").
163. Weiss, *supra* note 141, at 202 (explaining that "the step-up in basis afforded to taxpayers at death" makes it possible "to avoid paying federal capital gains taxes altogether").
164. Nicho Mauricio, *The Tax Implications of a Cash-Out Refinance on Rental Property*, POPLAR (Jan. 9, 2023), https://www.poplarhomes.com/rental-property-management/the-tax-implications-of-a-cash-out-refinance-on-rental-property/ [https://perma.cc/7GRY-U3D4].
165. Oh & Verstein, *supra* note 4, at 774.

tax and corporate governance characteristics that balance the needs and interests of three competing yet complementary constituencies: real estate owners, cash investors, and corporate managers.[166] Oh and Verstein demonstrate that without the REIT's delicate balance of high dividends, operational restrictions, managerial entrenchment, and managerial immunity from corporate takeover, real estate owners simply would not contribute property to a REIT in the first place.[167] But even though REITs provide an elegant solution to certain unique issues that arise in the common ownership and operation of real estate assets, as Oh and Verstein demonstrate,[168] REITs do not solve the fundamental problem of the 1031 death lock-in effect for small SFR owners—and may instead exacerbate it—because REITs create additional lock-ups that go beyond the 1031 lock-in.

REITs are vehicles for acquiring and operating a diversified portfolio of real estate assets.[169] Real estate owners contribute property to a REIT on a tax-free basis through an ingenious combination of a REIT with a limited partnership (known as an "umbrella partnership").[170] The REIT serves as the general partner of the umbrella partnership, and in combination, the structure is thus referred to as an UPREIT.[171] Real estate owners contribute property to the umbrella partnership in return for partnership interests, which are then exchangeable for publicly tradeable (i.e., liquid) shares in the REIT.[172] These partnership interests are equal in economic value to REIT shares, but to avoid the property contribution being deemed a taxable event for the contributor, the contributor receives partnership interests instead of REIT shares.[173] The UPREIT process has spawned an industry all its own and is so ubiquitous in REIT formation that Oh and Verstein conclude "that it makes more sense to simply think of REITs as UPREITs."[174]

Because REITs are designed as real estate holding or operating companies, they may not engage in any significant amount of real estate development activities.[175] Instead, REITs must devote an outsized portion of cash flows to dividend payments (90% of taxable income!),

166. *Id.* at 786.
167. *Id.* at 786–88, 793 (arguing that "[f]rom an ex-ante and macro perspective, there would be no REITs to merge at all" without the balancing of divergent interests that the REIT structure provides).
168. *Id.* at 785–96.
169. *Id.* at 767.
170. *Id.* at 777.
171. *Id.* at 785–88.
172. *Id.*
173. *Id.* at 779.
174. *Id.* at 788.
175. *Id.* at 767.

which inhibits opportunities for REIT managers to engage in self-dealing or empire building with REIT assets.[176] Furthermore, REITs are pass-through tax entities, making them more efficient vehicles for dividend payments than standard publicly-traded corporations, whose dividends typically are subject to double taxation.[177] Finally, REITs are severely restricted in their ability to sell properties they own so as not to trigger the very tax consequences the property contributor sought to avoid by contributing a property to the REIT in the first place.[178]

These restrictions on selling properties are enumerated in the "prohibited transactions" in which REITs may not engage, the definition of which involves multiple either/or possibilities.[179] Although a full description of the possibilities is beyond the scope of this Article, among the general restrictions are requirements like holding a property for at least two years and prohibitions against selling more than seven properties during the year and not selling property in any year worth more than 10% of the value of the REIT's total assets.[180]A REIT that does engage in a prohibited transaction faces a 100% tax rate on any gains from the transaction—quite an effective deterrent![181] By design, then, REITs own and operate properties: they are not real estate developers but rather large holding companies with strong incentives *not* to sell.

And when REITs *do* sell properties, they face strong incentives to sell in bulk to other REITs, rather than on the open market where, in the case of SFRs, the properties would be available for ordinary people to purchase. For example, a sale of multiple properties to a single buyer is treated as one sale for purposes of the seven properties per year test.[182] This means that if a REIT owns 100 properties that it has held for at least two years, it may sell many of them (say, 30, 70, or even all 100) to a single buyer in one transaction, and that transaction counts as only one sale.[183] Such a rule makes sense from a tax perspective because the transaction simply passes property from one tax-advantaged REIT to another. But the rule's effect is to consolidate ownership of REIT properties in the hands of other REITs and, in the case of SFRs, prevent

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176. *Id.* at 766.
177. *Id.* at 766–67 (noting additionally that REITs may not be closely held entities, as they must have at least 100 shareholders and may not have concentrated ownership among a group of shareholders).
178. *See* discussion of "prohibited transactions" at notes 179–83.
179. 26 U.S.C. § 857(b)(6).
180. *REIT Prohibited Transactions*, RSM (June 4, 2019), https://rsmus.com/insights/industries/real-estate/reit-prohibited-transactions.html [https://perma.cc/MEQ2-LK2N].
181. *Id.*
182. *Id.*
183. *Id.*

those properties being sold individually on the open market where they are available to ordinary homebuyers.

Perhaps this consolidation is not problematic in the case of large REIT assets—like apartment complexes, shopping centers, or office buildings, which ordinary people and small investors are priced out of anyway. But in the case of SFRs, the rules that prohibit or strongly disincentivize REITs from selling single-family homes to ordinary buyers create a lock-up of single-family homes in the hands of large trusts—homes that otherwise could have been available for sale to the public. Furthermore, the REIT lock-up restrictions continue independent of and after the death of the property contributor, thus perpetuating and potentially extending the 1031 lock-in effect far beyond the SFR owner's lifetime—thereby replacing the 1031 "lock-in" with a REIT "lock-up" of indefinite and potentially unlimited duration. The REIT lock-up thus exacerbates the housing supply constraints individuals and families currently face in pursuing the American Dream of homeownership by keeping single-family homes off the market and in the hands of corporate trusts.

From the small SFR owner's perspective, however, REITs offer two concrete benefits that serve as partial offramps from the 1031 lock-in. First, receiving partnership interests exchangeable for REIT shares (i.e., UPREIT interests) allows real estate investors financial flexibility during their lifetime compared to continuing to own individual properties directly. For example, an owner of UPREIT interests could exchange some but not all of the interests for REIT shares and then sell those shares in the public market to obtain liquidity.[184] If the owner exchanged 20% of the owner's UPREIT interests for REIT shares, for instance, the owner would owe tax on the 20% exchanged but could leave the remaining 80% interests to the owner's heirs, who would then receive a step-up in tax basis on the 80% UPREIT interests upon the owner's death. The heirs could then convert these UPREIT interests into REIT shares and sell them tax-free. The UPREIT structure thus facilitates fractional sales but does not reduce the tax consequences of pre-death fractional sales.

A second benefit of the UPREIT structure is that it allows investors to streamline inheritance of real property interests. After contributing a property to an UPREIT, at death an investor leaves highly liquid UPREIT interests to the investor's heirs instead of a physical property. Additionally, ownership of individual UPREIT interests generally does not entail managerial responsibilities, thereby sidestepping the

184. Oh & Verstein, *supra* note 4, at 779.

corporate governance concerns stemming from common ownership of a physical property. Although investors could theoretically try to sell fractional interests in an SFR without first contributing the property to an UPREIT, the friction to do so is prohibitive. The transaction costs involved in exchanging UPREIT interests for REIT shares and selling them are as low as the clicks it takes to sell publicly traded shares of stock, but selling a fractional interest in real property typically involves much higher transaction costs or may not be possible at all.[185] Plus, selling fractional interests in real property still leaves the thorny corporate governance problem of passing on a physical property to heirs, and even makes the problem worse by introducing additional fractional owners. UPREIT interests, in contrast, are easily divisible among different heirs, each of whom may choose to sell or retain their interests in their own discretion and on their own timeline.

Despite their benefits to investors, though, UPREITs do not change the core 1031 tax situation confronting an SFR owner. This is because, after the owner contributes property to an UPREIT and receives partnership interests exchangeable for publicly tradeable shares in the REIT, the owner cannot exchange into and sell REIT shares without incurring the same tax liability the owner would have faced had the owner sold the property instead of contributing it to the UPREIT.[186] The same tax liability remains because the owner's tax basis in the property carries over into the UPREIT partnership interests that the owner received in exchange for contributing the property to the UPREIT. And just like if the owner had continued to hold the property instead of contributing it to the UPREIT, the owner's tax liability upon exchange of the UPREIT interests for REIT shares disappears at death. This death benefit occurs because the owner's heirs receive a step-up in tax basis on the inherited UPREIT partnership interests in the same way the heirs would have received a step up in basis had they inherited the property itself instead of the UPREIT interests.[187] Therefore, while UPREITs

185. *Id.* at 774 (explaining that "[b]ecause real property is not fungible, locating a buyer and contracting for sale involve greater transaction costs than other assets like securities"); *see also* Amanda Lauren, *Fractional Home Ownership—Smart Investment or Real Estate Scam?*, Forbes (Sept. 23, 2023), https://www.forbes.com/sites/amandalauren/2023/09/23/fractional-home-ownership-smart-investment-or-real-estate-scam/ [https://perma.cc/R2FZ-JLDC] (discussing advantages and disadvantages in fractional ownership of vacation rentals and other SFRs).

186. *You Can 1031 Exchange into a REIT, Here's How*, Realized (Mar. 17, 2024), https://www.realized1031.com/blog/rolling-from-property-to-reit [https://perma.cc/CP49-4VRY] (noting that conversion of UPREIT partnership interests into REIT shares triggers deferred capital gains tax).

187. *Id.* (noting that partnership interests "can be passed down to your heirs on a stepped-up basis, eliminating accumulated capital gains taxes").

allow investors to streamline issues of property management and inheritance, they leave unresolved the core tax liability facing investors if they decide to exit real estate investment during their lifetimes.

Accordingly, the two distinct paths to converting ownership of an SFR into interests in a REIT each appear to offer a solution to the 1031 lock-in problem but instead contribute to REIT lock-ups and exacerbate the housing supply shortage. The first path from SFR ownership into REIT interest ownership is a direct property contribution through the UPREIT process described above.[188] The direct contribution model, however, was developed and is much more common for other real estate asset types, such as office buildings, shopping centers, apartment complexes, or industrial facilities.[189]

More recently though, identifying that small SFR owners have historically lacked even the UPREIT partial offramp enjoyed by large real estate investors for decades, a venture-backed company, Flock Homes, is now bringing the direct contribution model to mom-and-pop SFR owners.[190] In the words of the CEO, "[the UPREIT] mechanism has been used for decades by ultra-high net-worth individuals, their families, and institutional investors at large. It's a great idea, but it's hard to get started . . . . Some people call this an UPREIT. We call it: 'The People's REIT.'"[191] Flock thus provides the same partial exit ramp for small SFR owners that investors in other classes of commercial real

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188. Oh & Verstein, *supra* note 4, at 785–88. The UPREIT process has spawned an industry all its own and is so ubiquitous in REIT formation that Oh and Verstein conclude "that it makes more sense to simply think of REITs as UPREITs." *Id.* at 788.

189. *See* SEC Investor Bulletin: Real Estate Investment Trusts (REITs) (Dec. 2011), https://www.sec.gov/files/reits.pdf [https://perma.cc/RWH4-ZB44] (noting that "Congress established REITs in 1960 to allow individual investors to invest in large-scale, income-producing real estate[,]" which often "may include office buildings, shopping malls, apartments, hotels, resorts, self-storage facilities, warehouses," and the like); Peter Gratton, *REIT: What It Is and How to Invest*, INVESTOPEDIA (July 19, 2024), https://www.investopedia.com/terms/c/capital_gains_tax.asp [https://perma.cc/FB23-S9NT] (explaining that "REITs were designed to make real estate investing more accessible so smaller investors could invest in a portfolio of skyscrapers, shopping malls, or apartment complexes with the same ease as buying stocks"); Oh & Verstein, *supra* note 4, at 765–66 (noting that REITs "were intended to achieve the same result for real estate investments" that mutual funds achieved for stock market investors seeking to "own a small piece" of a diversified portfolio of public companies, as "[m]ost investors do not have enough money to buy an entire shopping center or commercial office building"); Chaudhry, *supra* note 37, at 427–28 (noting that the first SFR REIT did not launch until the end of 2012, and during the two years afterwards, three SFR REITs by themselves had already directly purchased approximately 33,000 SFRs).

190. *See generally* FLOCK HOMES, https://flockhomes.com/ [https://perma.cc/LUL4-5UM2] (describing Flock's business model).

191. A*nnouncing Our $26 Million Series A Led by Andreessen Horowitz*, FLOCK HOMES: THE FLOCK BLOG (July 11, 2022), https://flockhomes.com/blog/announcing-our-26-million-series-a-led-by-andreessen-horowitz [https://perma.cc/ARU8-YFFP].

estate already use to facilitate fractional sales and inheritance of liquid assets, albeit without alleviating the intractable 1031 tax problem small SFR investors face before their death.

Flock's innovation appears to have found fertile ground—as one Flock client, a retired mailman, put it, "[i]t's been amazing to be on this highway [of SFR investment], but I'm now realizing that I'm looking for the exit ramp, and it's just not there."[192] Flock raised $26 million in a 2022 Series A financing round led by Silicon Valley heavyweight Andreessen Horowitz,[193] and in its first three years, Flock grew from owning four SFRs to nearly 600, and as this Article goes to print, over 800.[194] This rapid growth—during some very competitive years in the SFR market no less—suggests the partial offramp that the highly-successful UPREIT business model offers to investors in other classes of commercial real estate may also be viable for small SFR owners.

The second path for SFR owners to convert their SFR ownership into REIT shares is to exchange the SFR for an interest in an entity called a Delaware Statutory Trust, or DST.[195] DSTs are entities that own and operate commercial real estate assets,[196] such as apartment complexes, office buildings, shopping centers, or industrial facilities. In the DST exchange model, the SFR owner sells the property on the open market and uses the proceeds to carry out a 1031 exchange into a replacement property.[197] But instead of purchasing another piece of tangible real estate, as would be the case in a typical 1031 exchange, the replacement

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192. *3 Year Anniversary at Flock*, FLOCK HOMES: THE FLOCK BLOG (Apr. 30, 2024), https://flockhomes.com/blog/3-year-anniversary-at-flock [https://perma.cc/NVU9-XQXZ] (quoting a Flock client who pinpoints the problem facing small SFR investors: "the taxes and costs associated with selling mean you also lose a big chunk of equity"); *see also Announcing Our $26 Million Series A Led by Andreessen Horowitz*, *supra* note 191.

193. Mary Ann Azevedo, *Flock Homes Closes on $26 Million for Landlords to Exchange Rentals for Shares in a Portfolio of Homes*, TECHCRUNCH (Mar. 24, 2022), https://techcrunch.com/2022/03/24/flock-homes-closes-on-an-a16z-led-26m-series-a/ [https://perma.cc/S7HC-YD5M]; *see also* Jason Shuman, *Why We Backed Flock Homes, and How It's Unlocking Value for Single-Family Rental Owners,* MEDIUM (Apr. 12, 2021), https://medium.com/thoughts-from-primary-venture-partners/why-we-backed-flock-homes-and-how-its-unlocking-value-for-single-family-rental-owners-d3580d7ec336 [https://perma.cc/QH2J-C9FH] (explaining the rationale of Primary Venture Partners for investing in Flock).

194. *Three Year Anniversary at Flock*, *supra* note 192; *see also Flock's Portfolio*, FLOCK HOMES, https://flockhomes.com/portfolio [https://perma.cc/7CH4-YZCJ] (listing the current number of SFRs the company owns).

195. *You Can 1031 Exchange into a REIT, Here's How*, *supra* note 186.

196. Daniel Goodwin, *Can You 1031 Exchange Into a REIT?*, KIPLINGER (Apr. 24, 2024), https://www.kiplinger.com/real-estate/can-you-1031-exchange-into-a-reit [https://perma.cc/B23Q-TVS8].

197. *You Can 1031 Exchange into a REIT, Here's How*, *supra* note 186.

property is an interest in a DST.[198] After a two-year holding period and predetermined lockout period, the DST can then exchange DST interests for REIT shares,[199] similar to the UPREIT exchange process described above. As such, DSTs serve as tax-deferred onramps into publicly-traded REITs for real estate investors who no longer want to directly own or operate properties due to the headaches of property management, liability concerns, or ongoing insurance or maintenance costs.[200]

Both the UPREIT direct contribution and DST exchange models provide essentially the same tax and estate planning benefits because investors, while alive, can convert all or a portion of their UPREIT or DST interests into REIT shares, pay capital gains tax on the converted shares, and sell the shares on the public market. At death, investors can pass on any remaining UPREIT or DST interests to heirs, who then receive a step-up in tax basis and may convert the interests into REIT shares and sell them on the public market tax-free, or continue to hold them.[201]

Where the two REIT conversion models differ significantly is how they impact the overall single-family home market. For example, in the direct contribution (or UPREIT) model that Flock is pioneering for SFR investors, the investor's property never hits the open market because it is sold directly to the UPREIT in a private transaction. Indeed, Flock's model makes it easier for more SFRs to be consolidated into REITs specifically because it is geared for small investors wishing to exit their direct SFR ownership, and these small investors in the aggregate make up the bulk of the national SFR market. In the DST exchange model, by contrast, the SFR does reach the open market and may be purchased by any buyer, including prospective homeowners or REITs. If a REIT purchases the SFR on the open market, then, the DST exchange model leads to largely the same practical result as the direct contribution model, at least in terms of aggregate SFR ownership.

But even if under the DST exchange model a non-REIT entity like an individual homebuyer purchases the SFR on the open market,

198. *Id.*

199. *Id.* (explaining that just as in the typical 1031 exchange an investor must hold the physical replacement property for at least two years, so an investor must hold the DST shares for at least two years when DST shares serve as the replacement property).

200. Goodwin, *supra* note 196 (describing the benefits to landlords of a DST conversion as including the fact that "[t]he DST sponsor assumes responsibility for everything . . . [and] [i]nvestors can sit back, collecting distributions generated from assets now partially owned yet otherwise outside their ability to source or manage individually").

201. *Id.*; Austin Bowlin, *Seven Estate Planning Benefits of Delaware Statutory Trusts (DSTs),* Real Est. Transition Sols. (Dec. 19, 2023), https://www.re-transition.com/1031-exchange-articles/estate-planning-benefits-dsts/ [https://perma.cc/XCS4-HLWE].

the model nonetheless continues to add demand pressure to real estate markets in the aggregate. This is because the cash proceeds the investor receives from the sale of the SFR are transferred into a REIT (via the DST exchange process described above) which must, by rule, use its capital to invest in buying and holding more real estate. DSTs therefore continue to trap capital on the buy-side of real estate transactions because there are no reciprocal offramps for small investors to sell real estate during their lifetimes and cash out of real estate investment altogether.

Despite their ingenious structures, then, neither conversion path into a REIT eliminates the 1031 death lock-in effect entirely. In fact, as described above, the REIT's unique structure exists and is necessary in large part *because of* the tax incentives and disincentives that create the 1031 death lock-in effect. That is, the REIT structure offers partial offramps that facilitate fractional sales and alleviate inheritance concerns for investors, but it also doubles as an onramp into the REIT lock-up problem, which comes in three varieties. Either the SFR itself is placed into the REIT lock-up (through the direct contribution, or UPREIT, model), or the proceeds from the sale of the investor's SFR are placed into the REIT lock-up (through the DST exchange model, if someone other than a REIT purchases the SFR on the open market), or both the SFR itself and the investor's proceeds from the sale of the SFR are placed into the REIT lock-up (through the DST exchange model, if a REIT purchases the SFR on the open market). In each case, the small SFR investor's funds remain locked into real estate investment of one kind or another due to the one-sided tax incentives to buy and hold SFRs and not cash out before death.

The current system—when considering the combined effects of Section 1031 and the REIT structure—may thus (intentionally or not) incentivize the lock-up of SFR ownership until investors die while also consolidating ownership of real property into the hands of REITs indefinitely. If the tax system's goal is to lock single family homes up as rental properties and expand corporate ownership of real estate, the 1031 and REIT systems seem to be functioning effectively by providing one-sided onramps into real estate investment without any accompanying offramps. But if the goal is to support single-family homebuyers and small real estate investors by distributing ownership of SFRs more broadly, then direct 1031 offramps must be made available during an SFR investor's lifetime.

III. Proposed Solutions: 1031 Offramps for Small Investors

Having identified and described the need for pre-death offramps for small SFR investors, this Part outlines potential solutions to the

1031 lock-in effect in the single-family home market by providing several possible options for how such offramps could be constructed. First, Subpart A suggests expanding the tax incentive that already exists for sales of owner-occupied homes to provide similar incentives to small SFR owners, subject to certain limitations. Second, Subpart B suggests accelerating the tax incentive that already exists upon death for small SFR holders to grant similar incentives to them during life, again subject to certain limitations. Subpart C then considers the government revenue implications of these approaches to creating 1031 offramps, identifying that because the 1031 lock-in currently allows small SFR owners to avoid all tax upon death, proposals that incentivize SFR sales before death may be revenue-neutral or even positive.

The 1031 offramps proposed below are designed to apply only to small SFR investors. As studies cited herein tend to define small SFR investors as those who own less than 10 SFRs, this Article proposes using the same limit, although a different limit could be appropriate. Also, the offramps are not designed to apply to owners of apartment buildings or other types of commercial real estate, such as office buildings or shopping centers. The 1031 lock-in also exists for those types of properties, of course, but a well-developed REIT system already caters to those types of properties. And, as described in Section I.C, the 1031 lock-in for single-family homes deserves special attention to the degree it deprives families and individuals of the emotional and financial value of buying a home for personal occupancy and participating in the American Dream.

A. Incentives to Sell SFRs like Owner-Occupied Homes

Perhaps the most straightforward solution to the 1031 lock-in problem is to allow small SFR owners to sell an SFR as if it were their owner-occupied, primary residence. This would give small SFR investors an incentive to cash out of real estate without having to use the proceeds to buy a replacement SFR. Exiting the 1031 merry-go-round in this way would both increase supply and decrease demand pressure in the single-family home market and potentially open more opportunities for first-time homebuyers to purchase homes.

An SFR sale allowance of this type could be limited in a variety of ways even beyond the dollar caps already contained in Section 121. For example, it could be made available only to small SFR investors who sell an SFR and do not buy another over a certain period, such as no SFR purchases for two or three years after the sale of an SFR. It could also be made available only over the next few years (say, three to five years) to help alleviate current supply shortages and give time for additional construction to be completed without creating longer-term market imbalances. There would be no need to cap the number of SFRs that could be sold per year because the existing dollar caps applicable under Section 121 would already limit the number of SFRs an owner could sell before exceeding the caps. For example, under the current Section 121 caps, an SFR owner who sold a primary residence and exhausted the Section 121 exclusion (i.e., $250,000 or $500,000, as applicable) might be prohibited from using an additional Section 121 exclusion until the following year. But in that following year, the SFR owner could sell another SFR and use the Section 121 exclusion again. And if the sale of one SFR did not result in gains up to the Section 121 threshold, then the SFR owner could sell more than one SFR in that year and exclude the cumulative gains from all SFRs sold, up to the Section 121 threshold. Alternatively, the sale of an owner-occupied home might be treated separately from SFR sales, thereby allowing different dollar caps to apply to each type of sale. Variations of this approach are innumerable. The overarching idea, though, is to reasonably incentivize SFR sales before death without opening the Section 121 exclusion so wide as to create a sudden glut of SFRs on the market.

In combination with allowing small SFR owners to benefit from the Section 121 exclusion, it would also be appropriate to raise the amounts of the Section 121 exclusion threshold because, as noted in Part II.A, the current dollar caps have been in place since 1997 and have not been tied to inflation. Accordingly, individual homeowners have been losing ground on the Section 121 exclusion every year for over 25 years. In particular, the high inflation of the last few years puts a spotlight on this issue because the cap of $500,000 established in 1997 would be over $950,000 today if adjusted for inflation. And increasing the potential use of Section 121 by allowing small SFR owners to use the exclusion highlights even further the need to update the dollar caps to account for today's market prices. Alternately, the Section 121 threshold might be tied to a particular area's average real estate prices. This could be done on a state-by-state basis or even a zip-code-by-zip-code basis. Real estate prices are local; it could make sense for the Section 121 exclusion threshold to track local prices, too. Increasing the Section 121 cap is appropriate for its own sake, but coupling the increase with the inclusion of SFR sales under Section 121 would also be a powerful way to alleviate the 1031 lock-in problem.

Other approaches might adjust other Section 121 requirements. One alternative would be to loosen the current Section 121 requirement that a homeowner live in the home for at least two of the last five years, such as by allowing for two of the last 20 years, or one of the last 10.

Such an approach would make more SFRs immediately eligible for the exclusion, and more likely to be sold. In the longer term, the exclusion threshold could be more restrictive, depending on market conditions. For example, over the next three to five years, small SFR owners could be allowed to use the Section 121 exclusion once per year. But at the end of that period, the Section 121 exclusion could be made available to SFR owners only once every two or three years. Going forward, it would be important to continue to make the Section 121 exclusion available to small SFR owners with some meaningful frequency to maintain an offramp from the 1031 lock-in and not recreate the same problem that exists today. But after the current supply shortage of single-family homes abates, it could be appropriate for 1031 offramps to be available less frequently.

The 1031-to-Section 121 offramp should also be tailored to small SFR investors. Doing so avoids transforming an offramp meant to help small investors into a tax giveaway to massive corporate investors. In addition, as described in Part I.B, large corporate SFR investors already received tremendous government incentives to buy SFRs during the foreclosure crisis through billion-dollar lines of credit and streamlined processes for purchasing SFRs in bulk, opportunities ordinary people and small investors did not have access to.

Because one of the goals of 1031 offramps is to make more SFRs available for purchase by individuals or families looking for a starter home, another option would be to limit the new SFR Section 121 exclusion to only those properties sold to individuals or families who commit to occupying the home themselves. Such owner-occupancy commitments are common for home mortgages, which typically include the contractual obligation that the mortgagor live in the home for at least one year.[202]

B. Incentives to Sell SFRs During Life

A second type of 1031 offramp for small SFR owners would be to accelerate the existing tax incentive that leads investors to hold an SFR until death and instead incentivize sales during an investor's lifetime. Currently, the 1031 lock-in for small SFR investors is released at death, but not a moment before. Moving up this morbid death benefit would help alleviate the current supply shortage of single-family homes for sale. For example, a simple approach would be to allow small SFR

202. Sarah Sharkey, *Understanding Owner-Occupied Properties: What Investors Should Know*, ROCKET MORTG. (Oct. 31, 2023), https://www.rocketmortgage.com/learn/owner-occupied [https://perma.cc/5ZQU-U6MV].

investors to use part of their allotted estate tax exemption before death. A 1031 offramp could be structured to allow small investors to sell an SFR and place the tax-free proceeds into a trust up to the amount of the estate tax exemption (or some portion thereof). This would allow a small investor to sell an SFR and exit real estate investment by moving the proceeds into a more liquid investment tax-free. The investor could then easily pass on these liquid assets to heirs while avoiding the corporate governance headaches of collective ownership of SFRs. Significantly, such an offramp from the 1031 lock-in would not only potentially incentivize sales of single-family homes but also be tax revenue neutral. This is because the estate tax exemption already allows SFR heirs a step-up in tax basis; therefore, allowing an SFR owner to sell an SFR and move the proceeds, tax-free, into a liquid trust account before death simply accomplishes the same goal earlier.[203]

A more direct incentive would be to allow SFR owners to claim part of the estate tax exemption during life with no requirement to place the assets in trust or gift the assets to heirs. For example, a 1031 offramp could permit small investors to sell an SFR and pay no capital gains or depreciation recapture tax, just like the heirs can do at the investors' death. The investors could then use the tax-free proceeds at their discretion during life, whether to spend the money, reinvest it outside of real estate, put it in trust for heirs—anything other than purchasing a replacement SFR, as investors would have been forced to do in a 1031 exchange while riding the 1031 merry-go-round. The amount of the proceeds from this type of 1031 offramp would then count against the investors' estate tax exclusion at death, meaning this type of 1031 offramp would also not reduce government tax revenue. And if the offramp were capped at some percentage of the estate tax exclusion (say, 50%), then SFR investors would still have an incentive to save for their heirs because the offramp would not allow them to exhaust the full estate tax exclusion during life.

Like the offramps described in the preceding subpart, an offramp of this type could be made available only for a limited time, such as

203. A trust account offramp, however, would still leave the capital locked-in until death and therefore may not significantly incentivize SFR owners to sell. One solution would be to allow SFR owners to gift the tax-free proceeds to an heir before death instead of holding the tax-free proceeds in trust until death. But, of course, SFR owners, and especially younger SFR owners, may not be ready to give assets to heirs, and so, again, this type of 1031 offramp may not incentivize all SFR owners to sell SFRs. In any event, a 1031 offramp that incorporates trust accounts or allows gifting arrangements could be attractive to some SFR owners, especially older ones preparing their estates for inheritance. A menu of 1031 offramps could be made available, thereby allowing small SFR investors of different varieties to choose the offramp that best fits their situation.

the next few years. This limitation would be a way both to increase the supply of single-family homes for sale in the short term and give builders time to make up for the last decade's underbuilding of starter homes. Longer term, the dollar amount (or percentage of the estate tax) that a small SFR investor could claim under this type of 1031 offramp could decline over time as the supply of single-family homes stabilized. But leaving the offramp in place at some level over the long term would make sense to avoid causing the same 1031 lock-in that now exists.

A final type of 1031 offramp could borrow its structure from existing incentives for retirement. For example, certain tax-deferred retirement accounts, like traditional individual retirement accounts (Traditional IRAs), allow savers to reduce taxable income each year by the amount they save for retirement.[204] Then, investors are required to withdraw from their IRA each year (a "required minimum distribution," or "RMD"), and pay taxes on the RMD, as they reach retirement age (currently, beginning at age 73).[205] The IRS calculates the amount of each year's RMD based on the investor's age—in short, the older the investor, the higher the annual RMD.[206]

A similar phased approach could function as a 1031 offramp for small SFR investors. For example, SFR investors could be allowed to sell an SFR tax-free (i.e., no capital gains or depreciation recapture tax) and place the proceeds in an investment account, such as a savings account for investing in stocks and bonds. That event would initiate a required distribution schedule, such as 10% of proceeds being required to be distributed each year for 10 years. During the distribution period, the investor could trade stocks in the account and pay no tax on any capital gains. However, the investor would pay tax on the required annual distributions in an amount at or below the capital gains tax rate applicable to the investor. For example, the first- and second-year required distributions could be taxed at 50% of the investor's capital gains tax rate, increasing by 10% every two years, such that the last two years of required distributions would be taxed at 90% of the investor's capital gains rate. Alternatively, like RMDs for Traditional IRAs, the incentive schedule for this 1031 offramp could also be based on the

204. Hayden Adams, *Four Tax-Smart Moves You Can Still Make for 2024*, CHARLES SCHWAB (Nov. 15, 2024), https://www.schwab.com/learn/story/4-tax-smart-moves-you-can-still-make [https://perma.cc/2FYT-BKUT].

205. *Retirement Plan and IRA Required Minimum Distributions FAQs*, INTERNAL REVENUE SERV., https://www.irs.gov/retirement-plans/retirement-plan-and-ira-required-minimum-distributions-faqs [https://perma.cc/Q7L3-5YQ4] (last visited July 29, 2024).

206. *Id.*

investor's age, where older SFR investors take required distributions in larger amounts than younger investors.

Beyond the particulars, such a phased offramp is a win-win-win for investors, the IRS, and single-family home buyers. Investors benefit by being allowed (but not required) to sell SFRs tax-free and reinvest the proceeds outside of real estate in more liquid assets. Investors may also spread out their tax liability over an extended period, such as 10 years, and pay an aggregate tax rate lower than their applicable capital gains rate. A tax incentive of this sort is appropriate because the current regime allows investors to hold SFRs until death, pay no tax whatsoever, and lock up the SFR from the sales market until death, or even indefinitely beyond death. The IRS benefits because this would make the policy revenue-positive because SFR owners who could have paid no capital gains tax at all would instead pay an incremental amount over a 10-year (or other) period. And potential homebuyers benefit because the 1031 lock-in would be broken, as investors would no longer be disincentivized from selling SFRs, and more single-family homes could be made available for sale.

Finally, as with the other offramps described above, this offramp could be structured to provide greater incentives in the short term to stimulate the sales market for single-family homes during the current supply shortage. Then, in the longer term, the incentive could decline while nevertheless remaining a sufficient incentive for SFR owners to sell. In whatever form, 1031 offramps should remain in place to avoid perpetuating the existing situation in which onramps beckon buyers into entering the single-family home market, but no offramps exist to alleviate the 1031 lock-in and encourage small SFR owners to sell single-family homes.

Conclusion

The Tax Code provides significant incentives to buy and hold single-family homes. These buy-side incentives apply to both owner-occupied homes and SFRs. For owner-occupied homes, though, the Tax Code also provides significant incentives to sell. But for SFRs, the Tax Code provides no equivalent incentives to sell: no offramps from the 1031 lock-in currently exist for small SFR owners. To the contrary, existing incentives push SFR owners either to hold SFRs until death or transfer them to large corporate owners (REITs), which are in turn structured to hold SFRs indefinitely, even beyond an SFR owner's lifetime. The end result of this imbalance is an ever-increasing accumulation of single-family homes in the hands of investors who will never live in them, at the expense of individuals and families seeking to purchase, occupy, and build equity in their own homes.

Now is an ideal time to remedy the imbalanced 1031 incentives for small SFR owners, given the acute housing shortage that is driven primarily by three unique and complementary forces. One is the historic underbuilding of single-family homes throughout the prior decade, alongside continued net population growth. Another is the mortgage interest rate lock-in effect that has trapped homeowners in place after record-low interest rates rose sharply. A third is the unprecedented influx of corporate SFR buyers that began with the foreclosure crisis during the Great Recession when SFRs first became an institutional asset class carved out of what had previously been a largely decentralized, small-scale market. The predictable result of decreased supply and increased demand, coupled with imbalanced tax incentives to buy but not sell, significantly inflate prices for single-family homes, especially starter homes, making it ever more challenging for homebuyers to purchase a home.

Markets are always in flux. Interest rates rise and fall. SFR investors buy fewer homes when prices are high and more when they fall. Builders seek to build more homes in response to rising demand. But the 1031 lock-in remains. The 1031 lock-in is a structural, long-term deficiency in the single-family home market. Offramps to the lock-in are necessary, both immediately and over the long term. Such offramps would balance existing one-sided incentives to buy single-family homes and create (the missing) corresponding incentives to encourage small SFR owners to sell. Doing so can help create opportunities for individuals and families to purchase their own home and reinvigorate the American dream for future generations.