A CAVAN RESEARCH WHITE PAPER

The Reluctant Landlord

Why Build-to-Rent Is Becoming the 1031 Exit for Aging Private Real Estate

$290,400

estimated tax cost on every $1,000,000 of recognized gain

Illustrative. Combined federal and state estimate; individual outcomes vary.



8.3M
small multifamily units built before 2000

25–30%
of gross proceeds consumed by a taxable exit

45 days
to identify replacement property after closing

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Organized for institutional advisor review, with standalone exhibits for the core demographic, tax, suitability, and execution-window visuals.

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EXECUTIVE SUMMARY

A lot of private real estate wealth has nowhere good to go.

Millions of high-net-worth investors hold directly owned real estate that they built over decades: small apartment buildings, strip retail, older rentals. These assets appreciated, but they also aged. Deferred maintenance stacked up, insurance costs rose, and the investors themselves moved past the point where active management fits their lives. For many long-held properties, selling outright can represent 25 to 30 percent of gross proceeds in combined federal and state tax — a figure that varies materially based on basis, depreciation recapture, filing status, and state of domicile.

So they hold. Holding has become the default, not because it is the right financial decision, but because every standard exit option carries a significant cost. Selling is expensive. Trading into more of the same keeps the management problem intact. Delaware Statutory Trusts left a portion of this audience burned. UPREIT conversions and operating partnership interests are accessible only through large institutional sponsors and remain out of practical reach for most private holders.

This paper presents the case that Build-to-Rent communities, purpose-built single-family neighborhoods held under professional management, represent a compelling 1031 exchange replacement option worth serious consideration for this investor profile. This is an investment thesis, not a factual conclusion, and individual suitability depends on each investor's specific circumstances, tax situation, and risk tolerance. The opportunity exists not because the tax mechanics changed, but because a qualifying replacement property now exists at scale in a form that did not a decade ago: new construction, no landlord burden, institutional operations, and a demand base that does not depend solely on interest rates staying high. For the investor who has been holding a fourplex they cannot figure out how to exit, this is a conversation worth having before the next maintenance call.

SECTION 1

The Problem with Having Built Well

Call him what he is: a careful investor who made good decisions. In 1998, he paid $340,000 for a twelve-unit apartment building in a mid-size Midwestern city. He financed it conservatively, managed it himself, fixed things when they broke, kept rents reasonable, and held it through two recessions. The building is now worth $1.4 million. By most measures, it worked.

Today it is also costing him something he did not budget for. The roof was replaced four years ago. Two HVAC units need attention. The plumbing in three units dates to original construction. He had a property manager for six years and let her go after the relationship stopped working; he has been managing directly since, which means he takes the calls. His insurance premium increased 22 percent last year. Two of his long-term tenants moved out within four months of each other, and the turnover cost and vacancy period together ran close to $18,000.

He is 62 years old. He would like to stop taking the calls.

Selling is the obvious answer, except that it is not obvious at all. A sale at $1.4 million triggers a federal tax event on roughly $1.06 million in gain, split between appreciation and depreciation recapture. At current rates for a taxpayer in his bracket, a rough illustrative estimate of combined federal and state tax liability falls somewhere between $240,000 and $300,000, depending on basis, holding period, depreciation recapture, and state. Individual outcomes will vary. He walks away with less than three-quarters of what the building is worth. Twenty-six years of discipline, and the exit costs him a quarter-million dollars just for the privilege of stopping.

So he holds. Holding is no longer the neutral choice it was in 2005. It is an active decision to keep absorbing maintenance costs, management friction, and insurance exposure solely to avoid a tax bill.

> **Strategic Insight**
> Absorbing operational risk to defer a tax liability is not an investment strategy. It is a trap. This paper is about the way out.

SECTION 2

How Much Capital Is in This Position

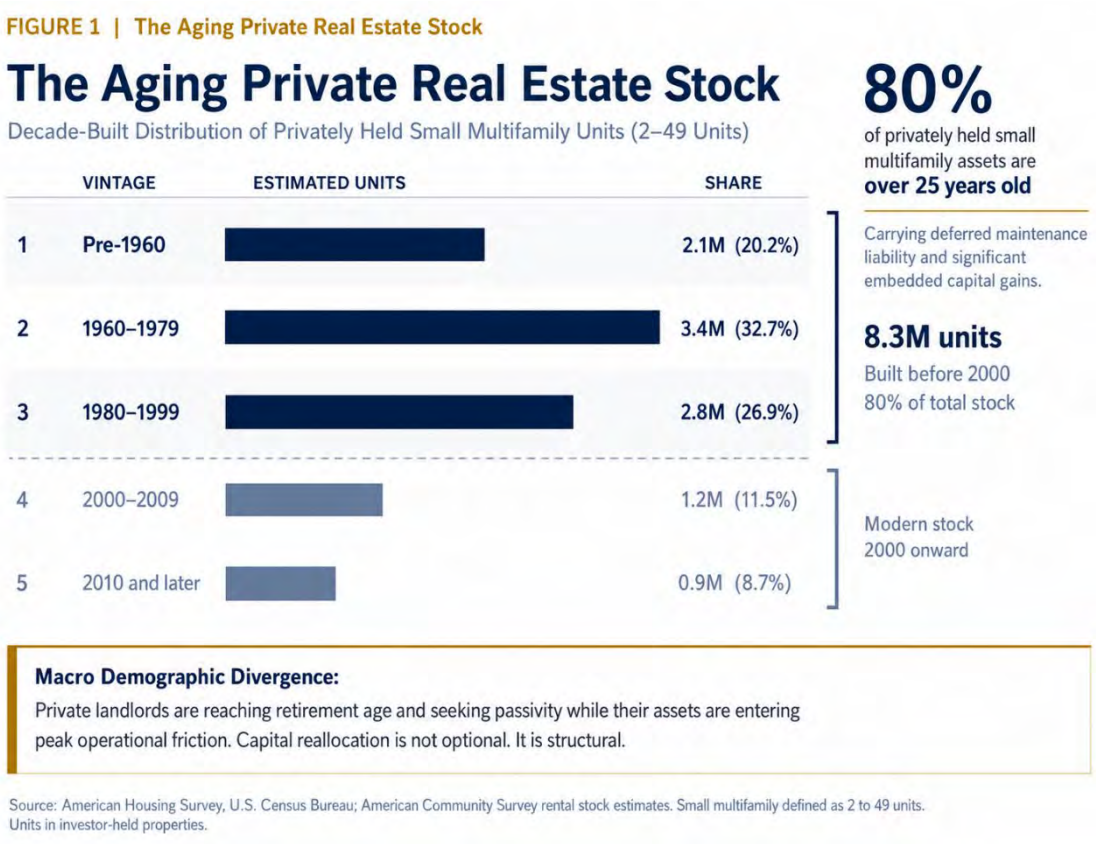
The investor described above is not unusual. He is representative of a large, underserved group of private real estate holders whose wealth is concentrated in assets that are simultaneously appreciating and increasingly burdensome.

According to the Federal Reserve's Survey of Consumer Finances, privately held real estate outside of a primary residence accounts for a significant share of net worth among households in the top two wealth quintiles. The majority of that real estate is not institutional. It is small residential and commercial property: buildings with two to forty-nine units, strip retail, older mixed-use, and single-tenant net-lease properties bought decades ago and held.

The American Housing Survey and Census Bureau data tell the same story from the asset side. Of the approximately 10.4 million small multifamily units (2 to 49 units) currently in private investor hands, a substantial majority were built before 2000. That means most of this stock is now more than twenty years old, carrying deferred maintenance liability, facing insurance repricing driven by national catastrophe exposure, and owned by investors who are themselves aging into the same transition question. The pre-2000 vintage units represent an estimated 80 percent of this privately held inventory based on the decade-built distribution shown in Figure 1; readers should consult the underlying Census Bureau tables for precise breakdowns.

The scale of this aging stock is not a footnote. It is the central macroeconomic fact of private real estate wealth in this country.

FIGURE 1 | The Aging Private Real Estate Stock



Source: American Housing Survey, U.S. Census Bureau; American Community Survey rental stock estimates. Small multifamily defined as 2 to 49 units. Units in investor-held properties.

SECTION 3

Why the Standard Exits Are Closing

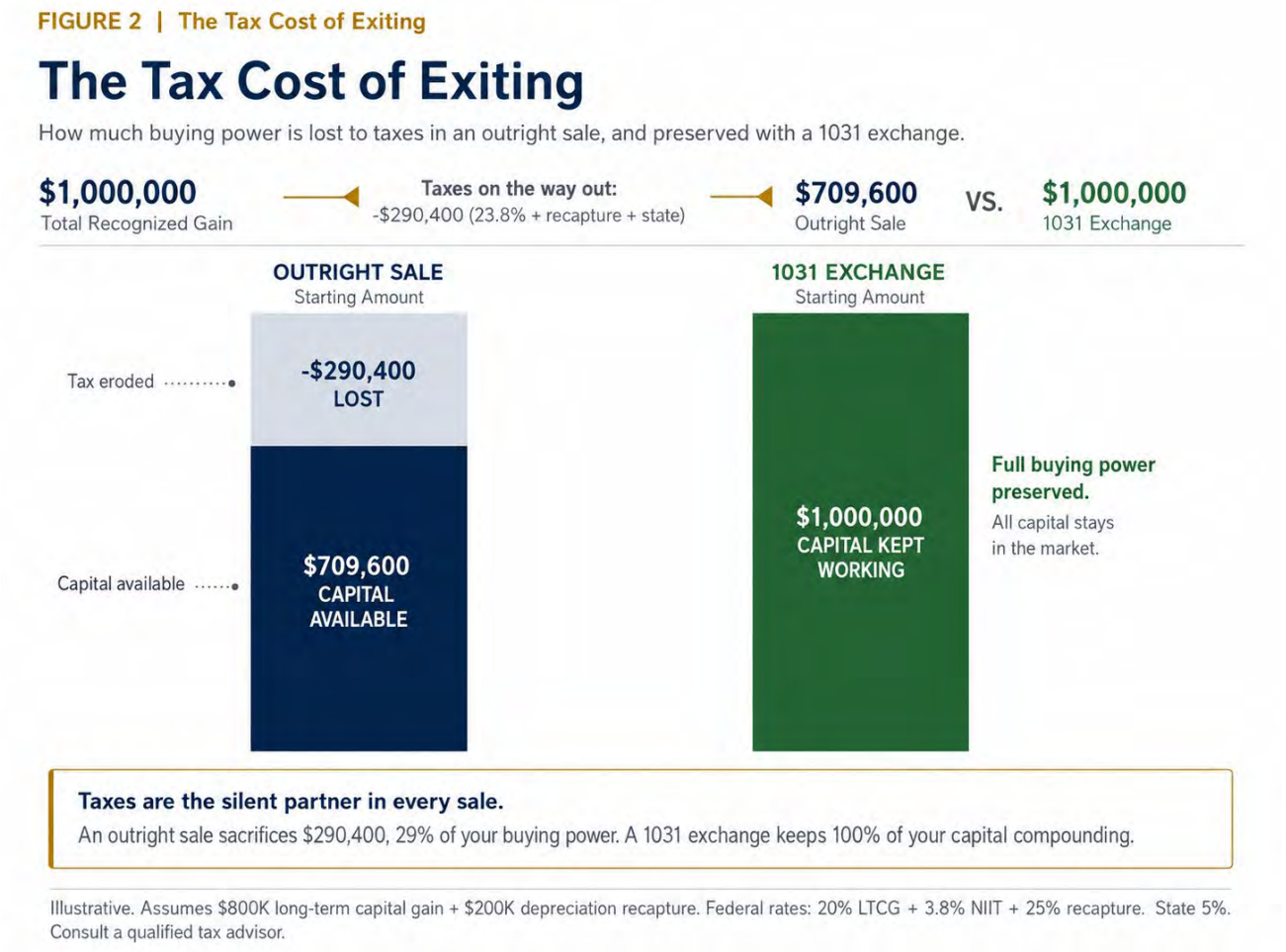
An investor in this position has historically had four ways out. Each of them has gotten harder for different reasons, and understanding why matters before considering what has changed.

1. Outright Sale

At combined federal long-term capital gains rates, the 3.8 percent net investment income tax, and unrecaptured Section 1250 depreciation taxed at rates up to 25 percent for residential real property, a taxpayer in the upper brackets can face a combined effective rate of 23.8 percent on the appreciated gain plus up to 25 percent on the recaptured depreciation, depending on asset type and individual circumstances. State taxes add another 3 to 13 percent

depending on location. For a long-held property with substantial embedded gain, the tax event on an outright sale can consume 25 to 30 percent of gross proceeds before the investor sees a dollar, depending on individual tax circumstances. The longer the hold, the worse the math.

FIGURE 2 | The Tax Cost of Exiting



2. Trading Into More of the Same

A 1031 exchange into a comparable, directly held property solves the immediate tax problem but keeps the management problem intact. An investor who exchanges a twelve-unit building for a fifteen-unit building has

deferred the gain but retained the operational friction. For an investor who is sixty-two and wants to stop taking midnight maintenance calls, this is not a solution. It is a postponement.

3. Delaware Statutory Trusts (DSTs)

DSTs became the dominant 1031 exchange product for this investor profile during the 2010s and into the early 2020s. They addressed the management burden and tax deferral simultaneously. However, they also carried structural limitations that a portion of this audience experienced directly: illiquidity that extended beyond projected hold periods, fee structures that reduced net returns, limited investor control, and, for investors who entered DST products in 2019 and 2020, significant operational disruptions during the COVID-19 period that in some cases affected distributions and hold timelines. Market conditions have since improved broadly, but the experience tempered demand among investors who saw it firsthand.

4. The 721 UPREIT

The 721 UPREIT can be one of the most tax-efficient exit structures available. A 1031 exchange into an operating partnership interest, followed by conversion to REIT shares, may defer the gain indefinitely and convert an illiquid private holding into a liquid public security. It is almost exclusively accessible through large institutional sponsors with existing UPREIT structures. While bespoke private umbrella conversions exist in theory, the steep minimum entry requirements, administrative costs, and rigorous contribution underwriting of established institutional REIT operating partnerships make the 721 path functionally unavailable to the single-property owner this paper addresses.

SECTION 4

What Build-to-Rent Is

Build-to-Rent communities are purpose-built neighborhoods of single-family detached or attached homes held under single ownership, professionally managed, and never sold individually to residents.

Picture a street of one-, two-, and three-bedroom homes featuring private yards, garages (attached or detached), and individual entrances. No shared corridors. No elevator lobbies. No stacked units. A resident living in a build-to-rent community experiences something that looks and feels like a traditional neighborhood, because it is one. The difference from conventional apartment living is physical and immediate, which explains why renter-by-choice and downsizing demographics target it specifically. They are not settling for renting; they are choosing an institutional housing product that did not exist at scale a decade ago.

The investor base this asset class was built to serve originally included high-net-worth individuals and family offices allocating new capital. What is less discussed is that it also serves a critical second investor profile: capital already sitting in private real estate that is looking for a superior operational structure. For that legacy capital, build-to-rent can offer a combination of benefits that alternative exit options have not reliably delivered together: potential tax deferral, a meaningful reduction in day-to-day management burden, and a new-construction asset with institutional-quality operations. Sponsor, occupancy, and illiquidity risks remain; the operational burden shifts rather than disappears. A more detailed treatment of the asset class, including demand drivers, geography thesis, and operating cost profile, appears in The Durable BTR: The Case for Midwest Build-to-Rent (available at cavancompanies.com/research), the preceding paper in this series.

SECTION 5

How the Capital Actually Moves

Section 1031 of the Internal Revenue Code permits an investor to defer recognition of capital gain on the sale of qualifying property by reinvesting the proceeds into a like-kind replacement property within a strict statutory

window. The mechanics are rigid: the investor identifies a replacement property within 45 days of closing the sale, completes the exchange within 180 days of closing (or by the tax return due date for that year, whichever is earlier), reinvests proceeds equal to or greater than the sale price, and routes the funds through a Qualified Intermediary who holds the exchange proceeds and prevents constructive receipt.

These rules have not changed materially since 1984. What has changed fundamentally is the replacement property landscape. In a build-to-rent context, the replacement property is not a scattered single home or a simple purchase. Investors typically access BTR communities through one of three distinct vehicles, depending on timeline, capital depth, and sponsor relationship.

Direct Fractional Interest

For investors with larger exchange amounts and flexibility on timing, a direct fractional interest in a specific community is the most straightforward path. The investor acquires an undivided interest in a single property, receives a pro-rata share of net operating income, and participates directly in any eventual sale. The 1031 qualification is direct and clean. The primary constraint is alignment: the investor's 45-day identification window and capital amount must match what a sponsor has available at that specific moment.

Tenancy-in-Common (TIC) Structure

For investors whose exchange amount is too small to acquire a direct fractional interest on its own, a TIC structure allows multiple exchange investors to co-own a single community, each holding an undivided interest. TIC structures are engineered to accommodate overlapping exchange windows, meaning investors closing on different relinquished properties can land in the same replacement asset. IRS Revenue Procedure 2002-22 governs TIC qualification for like-kind treatment; any structure should be vetted by legal counsel before closing.

Fund Structures

For investors who prioritize diversification across multiple communities, some BTR operators have structured dedicated fund vehicles designed to accept 1031 exchange capital. These offer broader geographic exposure and, in rare and structurally specific cases, potential Qualified Opportunity Zone benefits alongside exchange deferral, though the two mechanisms involve separate statutory requirements and are not routinely combinable. Investors should obtain qualified tax counsel before relying on this combination. Standard partnership interests do not qualify for like-kind exchange treatment under Section 1031, so compliant BTR fund vehicles must be structured as programmatic tenancy-in-common arrangements or equivalent qualifying co-ownership structures. Fund structures vary significantly in how they achieve this qualification, and that status is not automatic. This path is best suited to investors working with dedicated wealth managers or tax counsel familiar with the specific sponsor and fund.

What changes for the investor on the other side of a completed exchange is material. There are no maintenance calls and no tenant negotiation. The unrecovered basis from the relinquished property carries over on its original depreciation timeline, but any excess basis in the replacement property above that amount receives a fresh

27.5-year depreciation schedule. For a new-construction community acquired at a significant premium to the old property's remaining basis, that incremental depreciation benefit may provide a meaningful economic shield. The capital stays working.

What does not change is equally important: the gain is deferred, not eliminated. A step-up in basis at death may ultimately resolve the deferred liability, but that is an estate planning outcome, not a guarantee, and tax law remains subject to change. The asset remains illiquid in the near term, and real estate market risks do not disappear because the property type changes. Any investor completing a 1031 exchange into a BTR structure must review the offering thoroughly with a qualified intermediary, a tax advisor, and legal counsel before closing.

SECTION 6

Why Build-to-Rent and Not Something Else

An investor completing a 1031 exchange has a broad range of qualifying replacement properties available. The question is not whether build-to-rent qualifies. The question is whether it represents a superior choice for this specific investor profile. The case is built on four pillars.

1. Management Burden

The legacy investor is not looking for a new landlord responsibility; he is looking to exit one. Professional management at the community level, handled by an institutional operator whose business depends on occupancy and resident experience, is structurally different from a standard third-party property management

FIGURE 3 | Strategic Suitability Matrix

Strategic Suitability Matrix

Evaluating 1031 Replacement Asset Classes Across Core Risk-Return Dimensions

Build-to-Rent is the Optimal Capital Preservation Structure for Retiring Private Landlords.
Best-in-Class Risk Profile | New Construction | True Passive Ownership | High Tenant Diversification
Across six key dimensions, BTR addresses what legacy alternatives cannot simultaneously deliver.

DIMENSION	BUILD-TO-RENT COMMUNITY	NNN COMMERCIAL	DST MULTIFAMILY
Day-to-Day Management	**Passive** Sponsor-managed	**Tenant Lease** Dependent on tenant	**Passive** Sponsor-managed
Construction Vintage	**New (2020+)** Zero deferred maintenance	**Varies** Often aging stock	**Varies** Often value-add
Depreciation Reset	**Full Reset** Fresh 27.5-yr schedule	**Acquired Only** On acquired basis	**Acquired Only** On acquired basis
Liquidity Profile	**Illiquid** Long hold orientation	**Illiquid** NNN lease term	**Illiquid** 5-10 year hold
Tenant Concentration	**Highly Diversified** Many residents	**Single-Tenant Risk** High vacancy exposure	**Diversified** By unit count
Operating Cost Risk	**Mitigated** Midwest geography	**Shifted** Lease-driven structure	**Market-Exposed** Weather + cost exposure

Strategic Advisor Insight:
While alternative vehicles defer the immediate tax liability, they force investors to swap operational friction for concentration or illiquidity risk. Build-to-Rent is the only structure that simultaneously addresses all three.

agreement on a small building. Institutional management is not a service layered on top of ownership; it is the core operating model. The investor still bears sponsor, occupancy, and illiquidity risk, but day-to-day maintenance decisions and tenant management are handled by the operator.

2. Construction Vintage and Depreciation

New construction means no deferred maintenance on day one. Under standard 1031 rules, the unrecovered basis carries forward on its original timeline, but any excess basis in the higher-value replacement property starts a new 27.5-year schedule. For an investor exchanging out of a twenty-year-old building with a substantially depreciated basis, this incremental step-up depreciation may offer a meaningful economic benefit that value-add or existing-stock alternatives cannot replicate in the same way.

3. Demand Durability

Two distinct demand groups anchor build-to-rent occupancy in a rate-insensitive way. The first is the renter-by-choice: higher-income households who may qualify for a mortgage but have actively decided not to take one. Their demand does not evaporate simply because interest rates shift. The second is the downsizing older renter: households in their late fifties and sixties who have sold larger homes, sit on real equity, and want single-level living without maintenance hassles or the commitment of another purchase. Neither group is renting because they lack alternatives; that behavioral distinction supports long-term cash flow underwriting.

4. Geography and Operating Cost Stability

Build-to-rent communities in supply-constrained Midwestern markets may carry a structural operating cost advantage relative to markets with higher weather-related risk profiles, though this varies by specific location and property insurer. Severe insurance repricing across Gulf Coast and Southeast markets has been widely documented and has reduced net operating income at properties underwritten on pre-2020 premium assumptions. Midwest markets have generally not faced the same catastrophic weather exposure driving those coastal increases, though investors should review property-level insurance underwriting for any specific community. The implication for a 1031 investor: income stability depends heavily on where the replacement property sits.

SECTION 7

The Planner’s Perspective

Wealth managers, estate planning attorneys, and CPAs increasingly encounter clients caught in active ownership structures. The underlying asset is performing, but the investor is not. The cumulative management burden, insurance exposures, and deferred maintenance liabilities are showing up in conversations that are ostensibly about portfolio allocation but are actually centered on client quality of life.

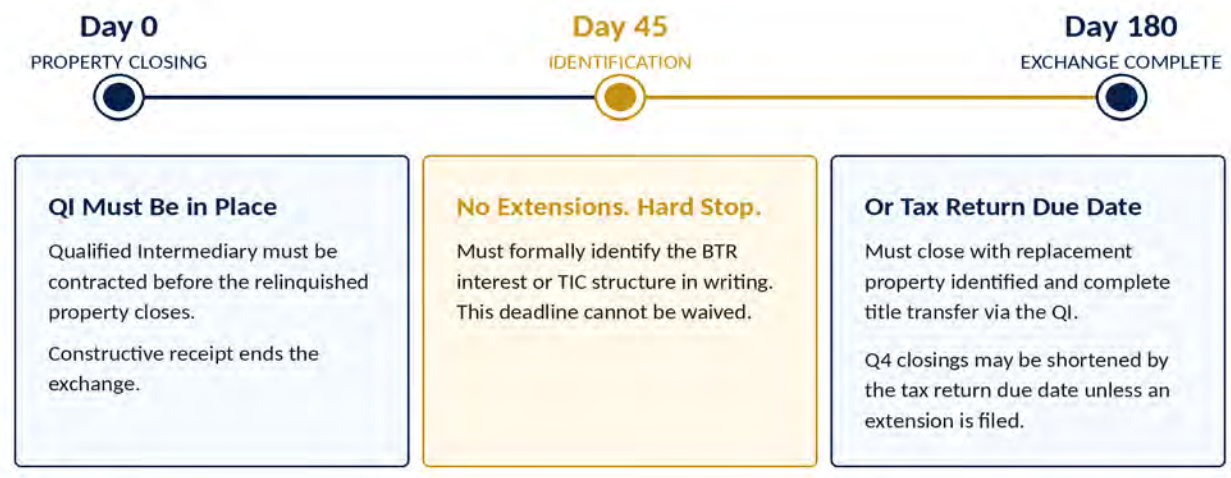
The 1031 exchange into a build-to-rent interest belongs directly in that conversation alongside the estate plan, the charitable giving strategy, and the generational wealth transfer discussion. It is a capital positioning decision, and the timing constraints built into the tax code make it a decision that benefits significantly from early, proactive planning. Figure 4 below details the critical statutory window an investor and advisor must navigate from property closing to completed exchange.

An investor who begins exploring replacement property options only after accepting a purchase offer on their relinquished property has a mere 45 days to identify and, depending on the closing date, as few as 60 to 70 days to complete the exchange. That is a dangerously narrow window in which to evaluate sponsor track records, conduct institutional due diligence, and make a considered allocation decision. Advisors who surface this conversation in advance, well before a sale is imminent, give their clients a materially safer, better-vetted set of options.

Three operational guardrails are vital for financial fiduciaries:

- **Prevent Constructive Receipt:** The Qualified Intermediary must be contractually bound and fully in place before the sale of the relinquished property closes. If cash touches the investor's bank account even briefly, the exchange fails and recognition of the deferred gain may be triggered immediately.
- **Navigate the Tax Return Trap:** The 180-day closing window is cut short if the investor's tax return due date arrives first. Taxpayers who file a standard six-month extension can restore the full 180-day window. For transactions closing late in the fourth quarter, advisors should confirm whether the taxpayer plans to file an extension and plan the exchange timeline accordingly.

FIGURE 4 | The 1031 Execution Window



- **Mitigate Counterparty Risk:** The IRS does not license, regulate, or bond Qualified Intermediaries. Because the intermediary holds client capital during the identification window, advisors should conduct due diligence on the QI's fund segregation practices, professional liability insurance, and corporate history.

For advisors whose clients hold appreciated real estate and are within ten years of the point where management burden becomes a quality-of-life issue, this conversation is worth having long before it becomes urgent.

CLOSING

A New Conversation About Old Capital

The wealth that built America's secondary rental housing stock is aging alongside the people who own it. That stock is twenty, thirty, or forty years old in many cases. The investors who assembled it made excellent decisions

over long time horizons, but exiting outright and paying a combined federal and state tax bill that can approach 30 percent of gross proceeds is frequently one of the less efficient outcomes available. Individual tax circumstances vary, and the figures in this paper are illustrative.

The 1031 exchange has existed since 1921. What is new is the replacement property landscape. Build-to-rent at institutional scale, located in supply-constrained markets, featuring professional management and new-construction quality, is a relatively recent development. It did not exist as a viable 1031 vehicle in 2005; it does today. The conversation between aging capital and this modern asset class is still in its early stages, which means the investors and advisors who understand this structure now are in the best position to act when the timing is right.

That timing, in many cases, is closer than it looks.

SOURCES AND DISCLOSURES

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