

Revision, not recession

Not recession, but revision.

The U.S. Commerce Department's latest revision to prior economic data now suggests (at least for the moment) that the U.S. economy has finally experienced a quarter of declining GDP. Gross Domestic Product (GDP) represents the economy's estimated total output of goods and services.

The first official GDP estimate for 2008's April-June quarter was a 1.9 percent real (after inflation) annual growth pace, below the consensus view of a 2.3 percent pace. However, the sharp downward revision to 2007's final quarter was more newsworthy.

The Commerce Department now suggests the U.S. economy actually contracted at a .2 percent real annual rate during the October-December 2007 period, versus three prior estimates at or near a .6 percent growth pace. Such a revision provides more substance for those suggesting a recession is currently under way.

The downward revision also now sees U.S. economic growth during 2007 at a 2 percent real rate, the weakest performance in five years. Note that additional revisions to quarterly data are at the whim of Commerce Department number crunchers.

Ahhhh, the life of an economist.

The second quarter's 1.9 percent real annual growth rate was positively impacted by \$78 billion in tax rebates and rising U.S. exports to the world. Consumer spending rose at a 1.5 percent annual rate during the second quarter, outpacing the first quarter's .9 percent rate.

While the economy has now strengthened during the past six months, such a pattern is not expected to continue. The economy is likely to slow during 2008's second half, with a number of forecasters suggesting growth during either 2008's final quarter or 2009's first quarter, or both, could be negative.

The nation's residential construction sector subtracted from overall economic growth for the 10th consecutive quarter, while exports added to growth totals for the eighth time in 10 quarters.

Continuing declines in oil prices would be a key positive for the economy in coming quarters. Conversely, a return to higher oil prices could sap what little energy the consumer has left at this point. Seven consecutive months of American job losses are not exactly a positive contributor to solid economic growth.

Minor Seventh

The American economy recorded more of the same in July, with the loss of another 51,000 jobs. The unemployment rate jumped to 5.7 percent.

The loss of 51,000 net jobs during July was actually less painful than economists' consensus forecast of a loss of 75,000 jobs. Moreover, job data of the two prior months was revised to show 26,000 fewer jobs lost than previously estimated. But that's where most of the good news stops.

The nation's jobless rate jumped to 5.7 percent

in July, a four-year high, versus the 5.5 percent jobless rate of the two prior months. The jobless rate is now one full percent higher than a year ago.

Goods Production Pain

The manufacturing sector lost another 35,000 jobs in July, the 25th consecutive month of job losses, even as exports to the world remain strong. The construction sector also saw additional weakness, with a loss of 22,000 jobs, the 13th month in a row of decline. Natural resources and mining employment rose by 11,000 positions.

Service sectors also struggled, with a net loss of 5,000 jobs. Education and health services continued to add jobs, with 39,000 net new positions. Government (mostly local) added 25,000 jobs, while professional and business services lost 24,000 jobs. Retail trade lost 17,000 positions.

Teens

One of the toughest job markets on record for teenagers continued in July, with the teen jobless rate moving to 20.3 percent from June's 18.1 percent rate. Faulty seasonal adjustments may be part of the culprit here.

Year-to-date 2008 has seen a net decline of 463,000 jobs. An estimated 8.8 million people were considered unemployed in July, up from 7.1 million people a year ago.

Trailing Wages

The average hourly wage rose six cents (.3 percent) to \$18.06 hourly. Unfortunately, the 3.4 percent rise in the average hourly wage from 12 months ago trails the 5 percent rise in consumer inflation during the most recent 12-month period.

As is typically the case, those with higher levels of education were much more likely to be employed, while those with limited educational attainment suffered. Employees with less than a high school diploma recorded unemployment at 8.5 percent.

High-school graduates with no college recorded a 5.2 percent jobless rate in July, while those with some college or an associate's degree had a 4.5 percent jobless rate. Those workers with a bachelor's degree and higher had a 2.4 percent jobless rate in July.

By Comparison

A U.S. economy likely in recession is still trimming jobs at a much less painful rate than during the recession of 2001. The loss of 463,000 jobs during 2008's first seven months equates to an average of 66,000 monthly. Such a decline is much better than the average loss of 181,000 jobs monthly during the 2001 recession.

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Jeff Thredgold

Considering all options in a 1031 exchange

Over the years, working in the commercial real estate industry, I realized that almost everyone I have talked to knows about 1031 tax-deferred real estate exchanges. What I have found, however, is that a minority of real estate investors truly understand the 1031 exchange and all the rules that apply, other than they know it enables them to defer their capital gains tax.

There are currently great benefits for an investor who is looking to sell a property by taking advantage of the 1031 exchange rule. The most obvious benefit is the ability to defer paying any realized capital gains taxes. For example, if an investor purchased a property 25 years ago for \$500,000 and then sold the property in 2008 for \$6.5 million, they would realize a gain of \$6 million over the course of ownership. The tax bill on that gain would currently be at 15 percent, or \$900,000, and if the property was in Utah they would pay an additional 5 percent, or \$300,000, to the state of Utah. By taking advantage of the 1031 exchange rule the investor would be able to defer the payment of these taxes until a later date.

A tax-deferred exchange is a simple method where a real estate investor is able to trade, or exchange, one property for another like-kind property without having to pay federal income taxes on capital gains realized from the transaction. In a normal real estate sale the property owner is taxed on any gain they realize by the sale of the property, but in an exchange, the tax due on the transaction is deferred until sometime in the future. It is important for the investor to realize all the options that are available to them when considering this exchange, not just the most common option of trading one property for another like-kind property.

A recent example of a 1031 exchange came when I had the opportunity to work with the high-profile client who was in the process of relinquishing a property they had owned in Aspen for 25 years. My client had realized a significant gain in value of the property over the time of ownership and could have been burdened with a large tax bill. After consulting with my client and his family, it was decided that the best scenario would be a 1031 exchange.

Communication was the key to making this a successful exchange. The family was interested in continuing to receive cash flow from real estate, but they were look-

ing for a low-maintenance property with long-term tenants. After looking at several individual properties and considering many different possibilities, it was determined that we needed to look beyond a single property exchange and explore a multiple property exchange. This option gave the family what they were looking for in their long-term real estate plan. They were able to defer the tax liability from the sale of their Aspen property, they increased the amount of cash flow they were receiving, enabling them to maintain their lifestyle, and they expanded their real estate portfolio, giving them more security for the future.

Understanding the needs of the client and looking beyond the normal view of the 1031 exchange made this transaction possible. Had we kept our search to a one property exchange we would not have been able to complete the transaction. It was necessary to go beyond the traditional view of the 1031 exchange in order to satisfy the needs of the client.

When looking at multiple properties in a 1031 exchange it is important to note there are three rules that apply.

1. The Three Property Rule: Any three properties regardless of their market value.

2. The 200 percent Rule: Any number of properties as long as the combined market value of the properties does not exceed 200 percent of the market value of the relinquished property.

3. The 95 percent Rule: Any number of properties, of any value, as long as 95 percent of the combined market value is acquired. (This option must be handled carefully, as it is possible for the sellers to void their chance to defer all capital gains tax if they fail to close at least 95 percent of the properties identified).

Looking at more than one property in a 1031 exchange greatly expands the possibilities of completing a successful exchange. It is important to remember that when an investor is relinquishing a property, and would like to defer their capital gains, there are several options to consider. Looking at every opportunity and every possible scenario will help in making sure that a successful 1031 exchange is executed.

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