



Cost Segregation & Real Estate Strategies

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Building your Team

- **Broker or Real Estate Advisor**
- **Developer**
- **Attorney**
- **Banker**
- **CPA**



How do you select your team?



Selecting a CPA

- **How many real estate clients?**
- **How many 1031 exchanges?**
- **Do they use cost segregation?**
- **Scope of services?**
 - **Tax Planning vs. Compliance**
 - **Advisory Services**
- **Do you share the same risk profiles?**
- **How many clients are audited?**
- **Who are their main clients?**



Ask for referrals from successful peers



Building wealth

**Building wealth is not
just what you make,
but what you keep ...**

Reduce or Defer Taxes

- **1031 Exchanges**
- **Cost Segregation**
- **Economic Stimulus Package, Tax Credits, etc.**





Cost Segregation: What you need to know

1. Accelerates depreciation expense - **defers income tax**
2. Works for **all types of commercial and investment properties** purchased in the **last 15 years**
3. Average savings **7-10% of building cost** in the first five years
4. Payback on study cost averages **10:1**
5. Ask your CPA and cost segregation firm to analyze the impact





Cost Segregation: Everybody is doing it



**Used by all of the large and regional
CPA firms for years**

**Large developers and property owners
use cost segregation**

**Cost segregation is a legal tax
deferral technique**

Need to follow the rules:

**IRS 2004 Cost Segregation Audit
Techniques Guide**

**Can save a lot of taxes this year and
result in a higher ROI**



What is Cost Segregation?

IRS allows qualifying items of land improvements and personal property to be “segregated from the building structure” for tax purposes

Depreciation useful lives on the qualifying items can be taken over 5, 7 or 15 years for personal property instead of 39 years for commercial buildings and 27 ½ years for residential buildings.

SAVES TAXES

GENERATES POSITIVE CASH FLOW





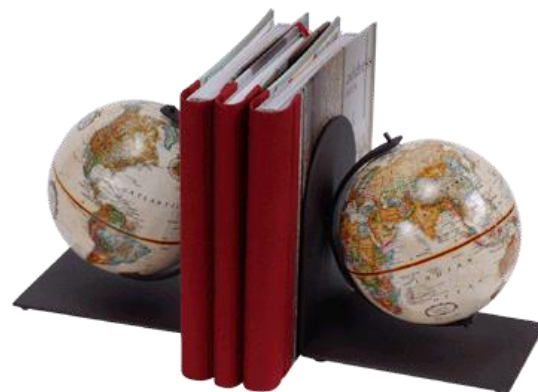
History

1995 – Walgreen’s Drug Stores

U.S. District Court

1997 – Hospital Corporation of America

U.S. Tax Court Case T.C.21



Chief Counsel: “Why is it that commercial property owners in America do not accelerate depreciation based upon their personal property vs. the structural part?”

IRS Representative: “Well the service knows that they should but we’re not going to tell them.”

2004 – IRS Cost Segregation Audit Techniques Guide



What types of costs get reclassified?

EXAMPLES INCLUDE -

Personal Property – 5 Year property

- Fixtures, specialty lighting
- Wiring for specialty equipment
- Carpeting, floor coverings
- Fire sprinkler heads, specialty plumbing
- Non-permanent, moveable walls and partitions

200% Double Declining Depreciation

Land Improvements – 15 Year property

- Driveways, sidewalks
- Landscaping, gardens

150% Declining Depreciation





What Properties are Best for Cost Segregation?

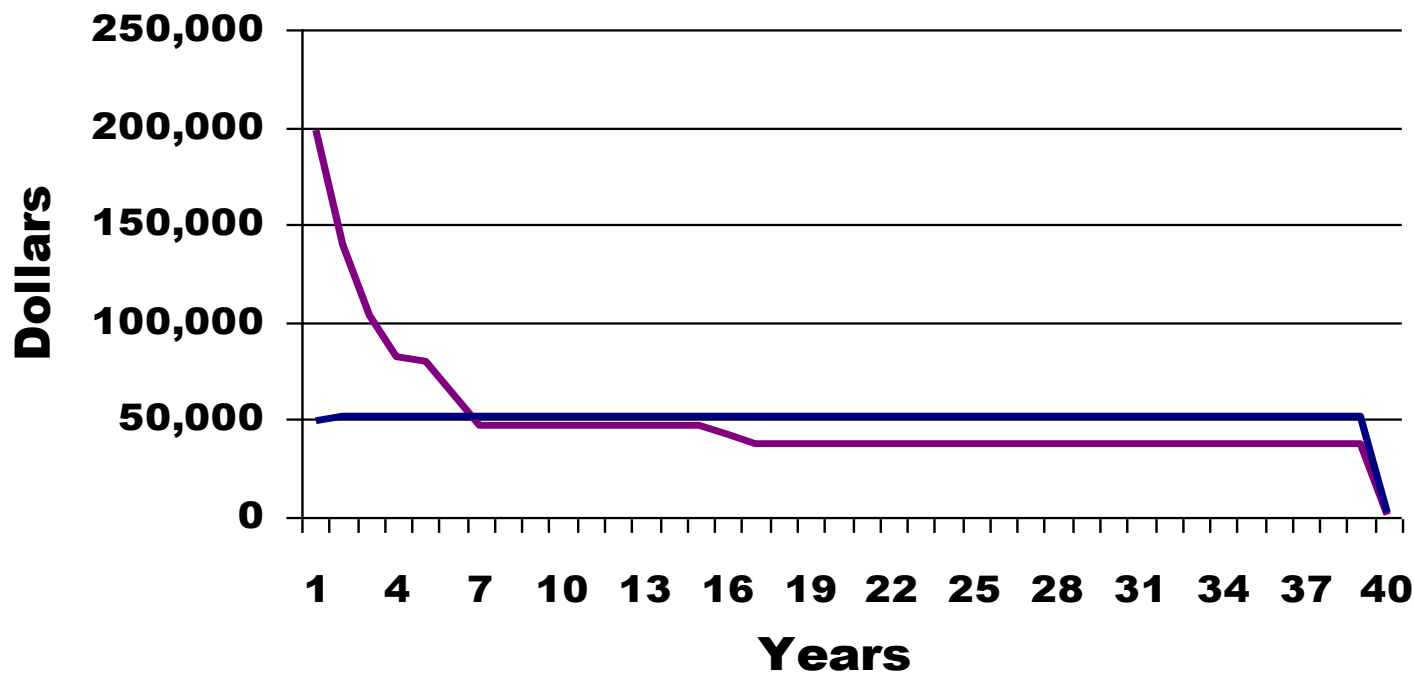
- **Owned by individuals or entities paying taxes**
- **All types of commercial properties & apartment buildings**
- **Properties > \$250K in cost basis**
- **New or existing buildings**
- **Property that has been owned for 15 years or less**



Depreciation Comparison

\$2 Million Building

Impact of Cost Segregation on Depreciation & Taxes



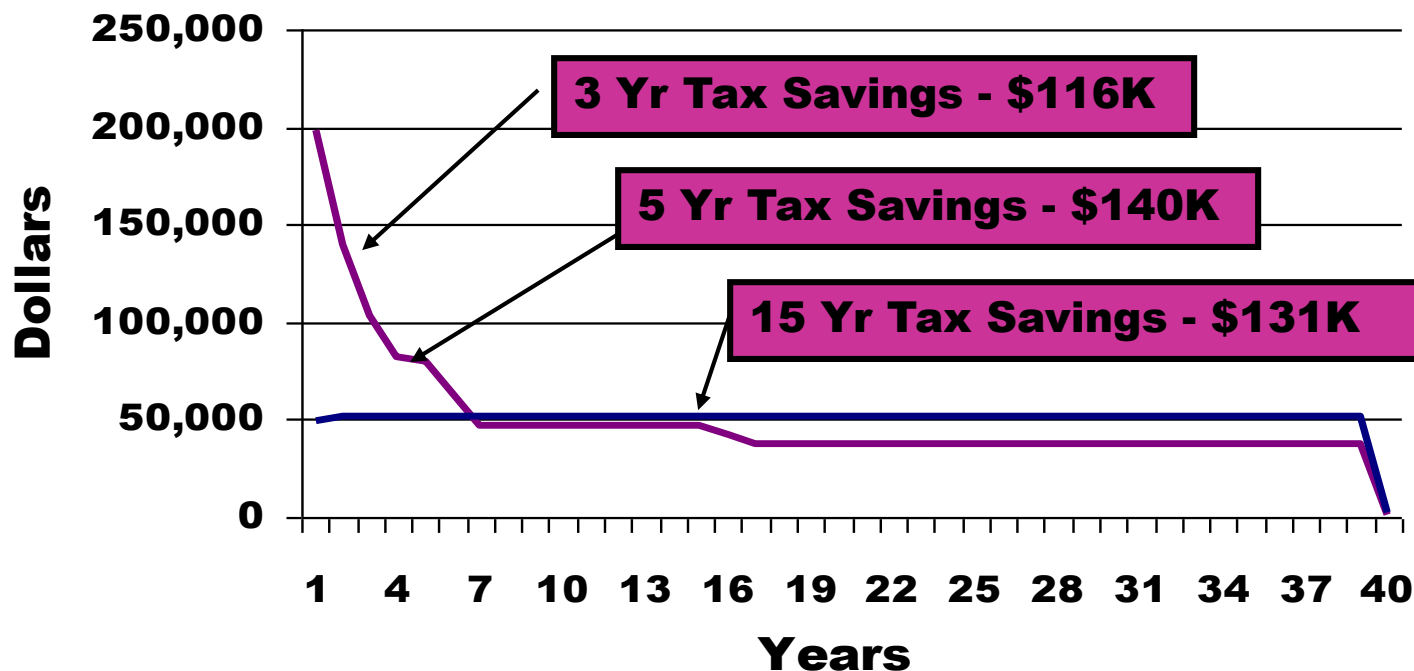
— Cost Seg Depreciation

— Straightline Depreciation



“Catch up” depreciation means \$\$’s in your pocket

\$2.0 Million Building Impact of Cost Segregation on Depreciation & Taxes

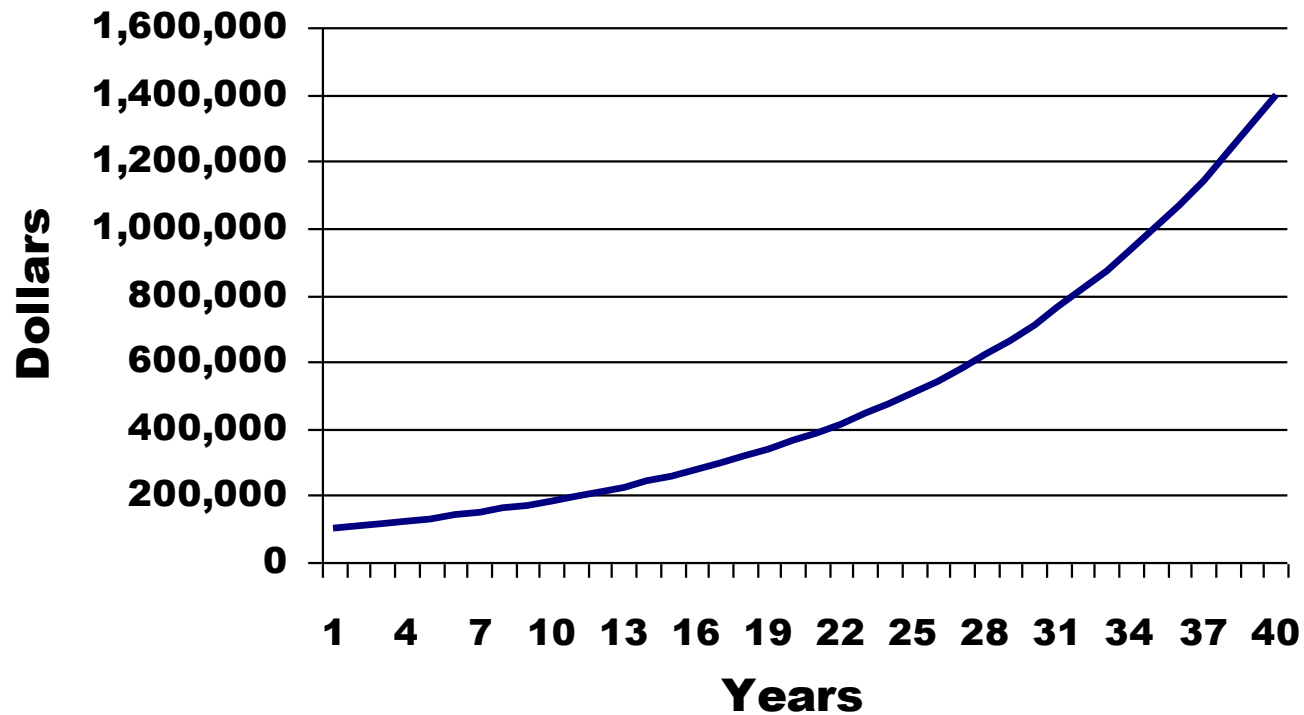


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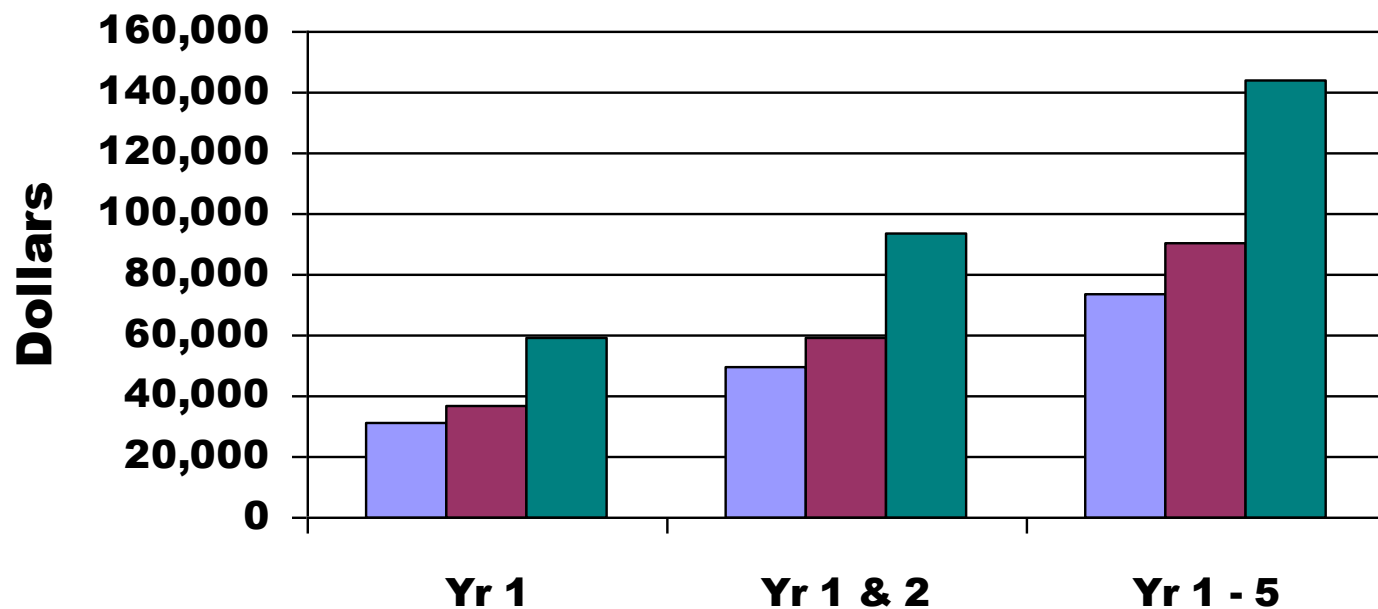
Time Value of Money



— Effect of Compounding over Time



Cumulative Avg Savings



■ \$1.0 M Apartment Bldg ■ \$1.5 Warehouse w/ Office ■ \$2.0 Office Bldg



Simple, right???

No, this was brought to you by the same people as



And they don't want to make it too easy for you to save taxes!



Other Factors to Consider...

- **Recapture depreciation needs to be factored in with a sale. Rule of thumb: need to keep the property at least three years**
- **Who ever owns the tenant improvements gets the benefits of cost segregation**
- **Cost segregation is great for estate planning because of the step up in basis**
- **Alternative Minimum Tax? No problem, use 150% depreciation vs. 200%**
- **Cost segregation works great with 1031 exchanges, but adds some complexity**



1031 Exchanges General Rule

Equal or Up in Equity

and

Equal or Up in Value



BOOT & Cost Segregation

- **Cost Segregation creates two categories of depreciable real property in a like-kind exchange:**
 - **Section 1245**
 - **Section 1250**
- **If a cost segregation study was performed on the relinquished property, in order to be consistent with Chief Counsel Advice, a cost segregation study should be performed on the replacement property in order to avoid “not like-kind” boot for Section 1245 property.**



1031 Exchange Tax Computation

Federal Law Determines Tax Consequences

Real Property:
Land
Building
Land Improve.



Real Property:
Land
Building
Land Improve.

Tangible 1245 Prop
(except F,F&E)



Tangible 1245 Prop
(except F,F&E)

1245 Property -F,F&E



1245 Property -F,F&E



(in 000's)

Scenario I

Trade up in Equity & Value

Entire Gain Deferred

	Original Basis	NBV	FMV	+ Cash	FMV New Bldg
1245 Property					
5 Yr Property	2,000	500	2,200	200	2,400
1250 Property					
15 Yr Property	1,000	650	1,100	100	1,200
39 Yr Property	7,000	6,300	7,700	700	8,400
1250 Subtotal	8,000	6,950	8,800	800	9,600
Total Property	10,000	7,450	11,000	1,000	12,000
Total Realized Gain			3,550		
Total Deferred Gain			3,550		



Will cost segregation work for you or your client?

- **Are you paying taxes?**
- **Building purchased in last 15 years?**
- **Do you plan on keeping your building at least 3 more years?**
 - **If not, do you plan on doing a 1031 Exchange?**
- **Can you take advantage of the increased deductions?**
 - **Active business or real estate professional**
 - **Are you limited by passive loss rules**
- **Best way to find out is get a benefits analysis and discuss it with your CPA**



THE Most Frequently Asked Question

“Why hasn’t my CPA suggested cost segregation?”

- No in-house engineering expertise**
- Think an engineering study will be too expensive**
- Think it only works on very large properties**
- Don’t know they can catch up depreciation for previous years in the current year w/ Form 3115**





When won't cost segregation work?

- **Too much deductions - will result in a loss**
- **Tax rate is too low**
- **Passive loss rules apply (not enough income)**
- **Owned property more than 15 years**
- **Cost basis less than \$250K – not enough return**
- **Cost Segregation Study is too expensive**
 - **Go out for bids before you accept this one**





Property Name

Own v Lease

How does cost segregation impact the deal?

OWN		
Purchase Assumptions		
Size (Square feet)	Per sq ft	9,760
Initial Purchase Price		\$2,000,000
Tenant Improvements	\$0.00	0
Total Purchase Price		\$2,000,000
Down Payment	10%	\$200,000
Loan Amount		\$1,800,000
Loan Period		22

Start-up Costs		
Down Payment		\$200,000
Closing costs	0.88%	\$15,840
Cost Segregation		\$10,000
Total out of pocket costs		\$225,840

Monthly Costs		
Mortgage Payment (P&I)	6.250%	\$12,563
Property Taxes	1.12%	\$1,867
Utilities	\$0.15	\$1,464
COA/CAM	\$0.09	\$832
Total Monthly Costs		\$16,725

Net Monthly Ownership Cost, Net of Tax Benefits		
Purchase and Alloc to Bldg	\$2,000,000	80%
	39 yrs	12 mos
Monthly depreciation @	40% tax bracket	\$1,368
Property Tax, Utilities, COA/CAM		\$1,665
Interest Deduction (5 year avg)		\$3,533
Total Tax Benefits		\$6,565
Net Effective Ownership Costs		\$10,160
Net Cost Per SF to Own		\$1.04

Additional Tax Benefits Available with Cost Segregation		
Monthly Ownership Benefits (Estimated)		
Tax Benefits	40%	
Incr Cost Segregation Deprec Benefits (5yr)	264%	\$3,610
Property Tax, Utilities, COA/CAM		\$1,665
Interest Deduction (5 year avg)		\$3,533
Total Tax Benefits		\$8,808
Net Effective Ownership Costs with Cost Segregation		\$7,917
Net Cost Per SF to Own		\$0.81

Appreciation Benefits of Ownership		
Rate of Assumed Appreciation per Year		3.0%
Appreciated Value Year 1		\$2,060,000
Appreciated Value Year 2		\$2,121,800
Appreciated Value Year 3		\$2,185,454
Appreciated Value Year 4		\$2,251,018
Appreciated Value Year 5		\$2,318,548
Appreciated Value Year 6		\$2,388,105
Appreciated Value Year 7		\$2,459,748
Appreciated Value Year 8		\$2,533,540
Appreciated Value Year 9		\$2,609,546
Appreciated Value Year 10		\$2,687,833

LEASE		
Lease Assumptions		
Size (Square feet)		9,760
Lease rate per RSF		\$1.60
Monthly lease cost net of utilities		\$15,616
Monthly utilities	\$0.15	\$1,464
Monthly lease cost plus utilities		\$17,080

Start-up Costs		
Prepaid Rent		\$17,080
Security Deposit		\$17,080
Total out of pocket costs		\$34,160

Monthly Costs		
Lease Payment	Per sq ft	\$15,616
Property Taxes	0.00%	\$0
Utilities	\$0.15	\$1,464
COA/CAM	\$0.00	\$0
Total Monthly Costs		\$17,080

Net Monthly Lease Cost		
Tax Benefits	40%	
Depreciation Benefit		n/a
Property Tax, Utilities, COA/CAM		\$586
Lease Deduction		\$6,246
Total Tax Benefits		\$6,832
Total Effective Monthly Lease Costs		\$10,248
Net Cost Per SF to Lease		\$1.05

Impact of Inflation on Lease Costs		
Rate of Assumed Inflation per Year		3.0%
Monthly Lease Costs - After 3 Years		\$11,198
Net Cost Per SF to Lease		\$1.15
Monthly Lease Costs - After 5 Years		\$11,980
Net Cost Per SF to Lease		\$1.22
Monthly Lease Costs - After 10 Years		\$13,772
Net Cost Per SF to Lease		\$1.41

For additional information, please contact:
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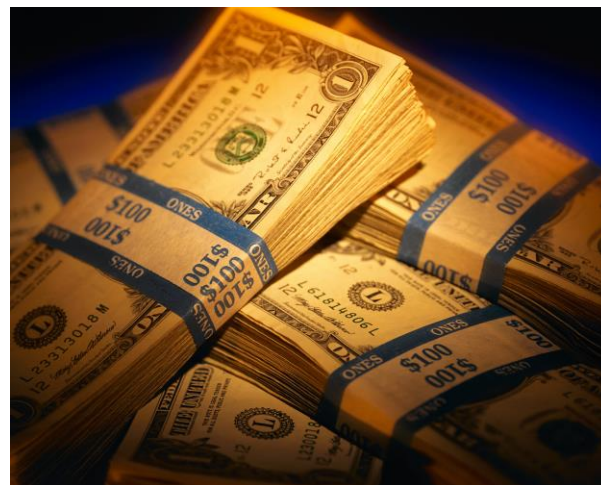


Paying Taxes ...



Arthur Godfrey

I am proud to be paying taxes in the United States. The only thing is I could be just as proud for half of the money.





Cost Segregation Services, Inc.

- **National firm specializing in cost segregation studies**
- **High quality and affordable engineered studies**
- **Nearly 4,000 Engineering Studies performed**
- **To date, none of our studies have been challenged by the IRS**
- **We support CPA firms and their clients, we don't offer competing services**

