Cost Segregation for REITs

Two primary concerns for REITs are dividend management and funding for future acquisitions. Cost Segregation can make dividends more attractive to shareholders and dramatically increase cash flow for the REIT, making more money available for acquisitions.

Cost Segregation can benefit public and private owners of all commercial property types and does not have to be done the same year as the building and improvements are first capitalized.

Background: It is common practice for those who invest in buildings to account for their building and improvements assets as 39-year property for federal income tax reporting purposes (27.5 years for multifamily properties).

Cost Segregation is an analysis of the acquired or constructed building and improvements for the purpose of reclassifying a significant portion of the assets from Section 1250 real property to Section 1245 personal property with lives of 5, 7, or 15 years.

Cost Segregation engineers rely upon the **Modified Accelerated Cost Recovery System** ("MACRS") section of the **Internal Revenue Code** to identify components of the electrical systems, plumbing, HVAC, interior finishes, and site improvements for shorter tax lives. Accelerating the depreciation of these components reduces the property owner's reported income (and thus their corporate income tax obligations) for the first five to 10 years of the life of the property. The benefit of a Cost Segregation analysis can be quantified as the present value of these tax deferments as compared to tax payments made without a Cost Segregation analysis.

Marshall & Stevens has been providing cost segregation analyses since the implementation of MACRS in 1987. We apply applicable tax code, case law, construction knowledge, and decades of experience in this arena in order to provide the insightful and well-documented engineering-based analysis and report that the IRS expects to receive in every Cost Segregation analysis.

Cost Segregation can benefit owners of all commercial property types and does not have to be done the same year as the building and improvements are first capitalized.

COST SEGREGATION FOR REITS

Because a REIT must pay out a minimum of 90% of taxable income as dividends (many REITs pay out more than 90%), retaining cash to fund acquisitions can be challenging. By

using cost segregation to assign shorter depreciable tax lives associated with Section 1245 personal property (while still not exceeding the 25% threshold), a REIT can substantially increase its depreciation charge thereby decreasing taxable income while increasing cash flow and funds available for acquisitions.

REIT dividends have three components:

1. Ordinary Dividends,
2. Long Term Capital Gains Dividends, and
3. Return of Capital Dividends.

Cost Segregation can increase the dividend allocation towards Return of Capital Dividends, which have a favorable tax treatment from an investor's perspective as compared to Ordinary Dividends.

TAKING IT ONE STEP FURTHER

1. Clients engage us to provide an estimate of the Cost Segregation analysis while they are **bidding to acquire a property** so they understand the potential economic benefit of accelerated depreciation to the investors.

2. **Beware the acquisition allocation**. If you agree to an allocation between real property, personal property and land in the purchase agreement, you cannot restate the allocation in your tax filings. Having us review the allocation prior to execution of the transaction will allow us to advise you of a reasonable allocation of all categories so you don’t miss out on the benefits of Cost Segregation.

3. Clients submit **annual improvement expenditures** for us to determine what costs can be categorized as “repair” (to expense) versus “replacement” (capitalized).

OTHER BENEFITS OF A COST SEGREGATION ANALYSIS

The cost segregation analyses can be reformatted to efficiently provide:

- Insurable Value Report
- Property Tax Report
- Transfer Tax Report

For more information about Cost Segregation or other Marshall & Stevens services:

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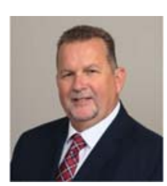

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