Cost Segregation for REITS

Two primary concerns for REITs are dividend management and funding for future acquisitions. Marshall & Stevens' Cost Segregation services can assist in both of these areas by making dividends more attractive to shareholders and dramatically increasing cash flow.

Cost segregation entails the classification of land improvements and building components into personal property (Section 1245 property) in order to take advantage of the accelerated depreciation treatment prescribed by the Modified Accelerated Cost Recovery ("MACRS") section of the Internal Revenue Code.

Marshall & Stevens is a recognized leader in valuation, serving business owners, managers, boards and trusted advisors throughout the world.

Dividend Growth Is Increased

A significant source of dividend growth is acquisitions. Because a REIT must pay out a minimum of 90% of *taxable income* as dividends, and many REITs pay out over 100% of taxable income, retaining cash to fund acquisitions can be challenging. Cost segregation can help with this challenge.

1. REITs are permitted to identify up to 25% of their building component costs as tangible personal property. By assigning the shorter depreciable tax lives associated with tangible personal property, a REIT can substantially increase its depreciation charge thereby increasing cash flow and funds available for acquisitions.
2. Frequently, we find our clients have identified some of their building components as tangible personal property, such as carpeting and cabinets, in order to capture the dividend and cash flow benefits associated with shorter depreciable lives. Typically this amounts to less than 3% of their building component costs. Meanwhile, the remainder of the facility is assigned a depreciable life of 39.5 years (27.5 years for multi-family) thereby allowing significant benefits to go unrecognized.
3. Marshall & Stevens' familiarity with the applicable Internal Revenue Code, relevant case law, and construction knowledge allows us to identify the internal components in your building's electrical, plumbing, mechanical, and structural systems, etc. that qualify for the shorter depreciable lives of tangible personal property. We then create a report that provides the detail desired by the IRS.

Dividends More Attractive To Shareholders

REIT dividends have three components:

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

Due to the favorable tax treatment of Return of Capital Dividends (taxed at the long-term capital gains rate of 20% and a deferral of the tax payment until the sale of the shares), investors typically prefer dividends with the greatest percentage of Return of Capital.

For More Information on this topic or our valuation services, please contact us at:

Info@marshall-stevens.com

Cost Segregation increases the Return of Capital component thereby increasing the Taxable Equivalent Yield

Building Insurance Savings

Many insurance policies exclude from coverage or reduce coverage for building components at or below ground level, such as underground utilities, foundations, site preparation, off-site costs, and parking lots. Cost segregation can identify those components of your facility that are subject to reduced or no insurance coverage. With cost segregation, a REIT can contract for the insurance it needs while avoiding excess insurance costs.

Property Tax Savings

Non-Value-Added costs are a normal part of the construction process. When a REIT constructs or renovates a facility, cost segregation can identify Non-Value Added costs. When a REIT acquires a facility, cost segregation can identify Super-Adequacy costs. Based on local or state tax code, these costs may be removed from a facility's property tax basis.

Transfer Tax Savings

Many states tax the transfer of a deed based on the value of the real property in the transaction. Although State and Federal definitions of personal property may be substantially different, by applying the appropriate definitions, a cost segregation analysis may reduce this tax through the identification of intellectual property and personal property prior to filing the closing documents.

Our Experience

Marshall & Stevens has experience providing a great deal of tax savings, through the use of cost segregation to numerous real property investors, including REITs. Our property types experience includes office, industrial and manufacturing, retail, multi-family and healthcare.

About Marshall & Stevens

Marshall & Stevens is a recognized leader in valuation and litigation support. We assist our clients with planning, due diligence, negotiation and reporting issues related to financings, mergers, acquisitions, divestitures, restructurings, insurance placement and tax-related transactions. Our in-house specialists provide a full portfolio of valuation-related services, including transaction advisory for machinery & equipment, facilities, real estate, businesses and intangible assets, and debt and equity instruments.