THE VALUE OF COST SEGREGATION

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Given the current state of the economy, most in the real estate industry are seeking new business strategies that reduce costs and increase cash flow. To that end, cost segregation is becoming increasingly popular amongst owners of commercial real estate.

Under current accounting rules, buildings can be depreciated over a 27.5-year or 39-year period. However, according to the Internal Revenue Code, certain categories of fixed building assets can be depreciated more quickly, over 5, 7 or 15 years. Cost segregation ("cost seg") is the process of identifying and reclassifying these eligible assets to accelerate eligible portions of the building's tax depreciation with the goal of reducing tax liability.

The "cost seg" study involves the thorough review of site surveys, blueprints, construction drawings and specifications. An extensive review of all relevant financial records is conducted including, but not limited to, general contractor, architect/engineer and private vendor invoices and change orders. Key personnel are interviewed. The subject real estate is physically inspected and photographed to document critical issues relating to the study.

Eligible assets are systems, fixtures or related elements that are either unnecessary for the operation of the building itself or are temporary structures. They include such elements as decorative lighting or moldings, floor or wall coverings or redundant HVAC systems. Using the guidance set forth in the IRS Audit Techniques Guide, experts in the areas of tax and engineering separate out, or segregate, these elements.

The resulting "cost seg" study is a comprehensive and documented tax and engineering analysis that identifies and segregates these eligible assets, assesses their value and determines the resulting asset classes and corresponding accelerated depreciation.

This process provides maximum tax benefits to property owners with facilities built or bought in the last seven years, as well as those with significant construction in progress, or with newly renovated or expanded facilities.

Cost segregation saves property owners money by justifying larger upfront tax deductions and in turn, lowering their tax payments. For example, a real estate investor with 30 apartment buildings was recently considering whether to do cost segregation studies on one or several of his holdings. Some buildings were upscale garden-style apartment complexes, while others were city-style apartment buildings. Some had been purchased recently, while others had been held for many years. After a short consultation, he decided to proceed with a feasibility analysis on seven garden-style complexes that he had owned for five to seven years. The reasons for this were twofold: first, the garden-style apartments had more assets that could be accelerated from 27.5-years to 15, 7 and 5-years. The second was that older properties generate a catch-up situation (more about that below). The investor chose to analyze the buildings that would generate the most depreciation.

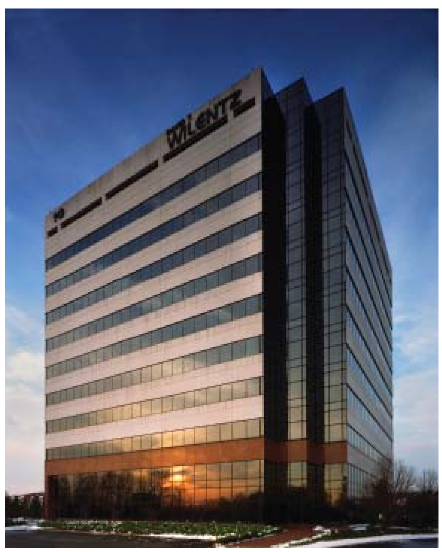
In the case of new construction, it is best to incorporate cost segregation as early as possible in order to save money on federal, and possibly state, tax returns. For existing properties, understated depreciations can be caught up for past construction, purchases, expansions, renovations and qualified leasehold improvements. Owners can recapture these missed depreciations with a simple change in accounting method. Amended tax returns are not required; instead, a "catch-up" depreciation can be taken in one year by filing IRS Federal Form 3115 (Change in Accounting Method, with IRS consent granted automatically).

Without a doubt, a cost segregation study is among the most valuable tax strategies available to owners of commercial real estate.

For more information, please contact Todd Lehder at Wilentz, Goldman & Spitzer or the co-authors of this article, Michael Donini and Eli Loebenberg, at Madison SPECS, a subsidiary of Madison Commercial Real Estate Services [www.madisonspecs.com].

Madison SPECS is a subsidiary of Madison Commercial Real Estate Services, a national organization with divisions specializing in Cost Segregation, Title Insurance, 1031 Exchanges, Lease Abstracts, Lease Administration, CAM Audits, Financial Due Diligence, REO Solutions and Loan Workout Services. Michael Donini is Senior Commercial Counsel for Madison Title Agency, LLC, and Eli S. Loebenberg, CPA, is CEO of Madison SPECS LLC. Working with firms including Deloitte and Touche, KPMG, and Grant Thornton, Loebenberg has handled studies for clients including The New York Times, The Childrens Place, Reuters, BMW and Four Seasons Hotels.

Wilentz, Goldman & Spitzer has extensive experience in commercial real estate law. The firm's Commercial Real Estate Team focuses on all aspects of real estate, real estate transactions and agreements, leases, financing, condominium and planned real estate development law. We encourage you to contact us by calling 732.726.7424 or via email at realestate@wilentz.com Please visit us online at www.wilentz.com.



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