Your Future is Our Focus

RINA accountancy corporation

Real Estate Report

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A Financing Alternative for Energy Upgrades

By: Brad Gai, Stockholder

It has been estimated that 41% of all the energy used in the United States goes to powering homes and commercial buildings. Electricity represents 55% of the energy used in commercial buildings, with 32% from natural gas. The largest uses of energy are for heating (36%) followed by lighting (21%). Estimated potential savings in the commercial building market from cost-effective upgrade projects average 25%. One of the alternative financing programs available to property owners is Property Assessed Clean Energy (PACE) financing.

PACE is a municipal financing program that was originally signed into California law in 2008. Under these programs the property owner enters into an agreement to increase their property tax assessment to repay the amounts borrowed to finance energy efficiency or distributed renewable energy generation improvements that are permanent improvements to the property.

There are different programs in California available to homeowners and commercial property owners, including multi-family properties. The application process is no more involved than a bank loan application. The following is a summary of the key features:

- No money down. The property owner identifies an energy efficient improvement, such as insulation, double pane windows, and high-efficiency HVAC systems, solar, and cool roofs. The project must meet certain energy efficiency requirements.
- The owner selects a contractor. The contractor is subject to approval by the lender.
- Relatively low or no application fee. The application fee, if any, is rolled into the financing, so there is no money down.
- Financing of up to 20% of the property value. The financing agreement to use the property tax assessment to fund repayments gives the PACE financing a priority lien over other financing. This will require cooperation from an existing lender.
- Up to 20 years to repay the loan. Shorter loan terms may be selected.

- The lien stays with the property if the property is sold. The lien is not required to be paid off due to a change of ownership.
- Interest rates will vary with the length of the loan. Interest rates are advertised to be comparable to bank loan rates for similar term loans.
- There may be a prepayment penalty if the owner wants to pay off the lien.

A cash strapped owner with an older building and identifiable energy efficiency needs should consider the cash flow impact of using the PACE program. A substantial improvement which lowers annual operating costs could very well produce cash flow to the owner after the debt service.

PACE programs are available state-wide. Each county or city may have a different provider. Private company funding is used to fund the loans despite the government involvement in the debt service process.

One caution for homeowners that may consider PACE financing for residential property energy improvements is that Fannie Mae and Freddie Mac do not allow their loans to be in a junior position to PACE financing by the terms of their security instruments. They will not purchase the loan of a property with a PACE financing agreement in place.

TPR Implementation - Extended Again

By: Robin Brotman, Stockholder

When preparing calendar year 2014 income tax returns, there was an emphasis focused on the new Tangible Property Regulations (TPRs). Taxpayers were encouraged to analyze depreciation schedules to locate items that were not required to be capitalized under the new regulations for the current and all prior years. A form 3115 was required to make the changes specified which in many cases resulted in a significant deduction for items that were capitalized under the old rules.

In the summer of 2016, these regulations were extended to include 2015 tax returns. There has now been an additional extension put in place for 2016 tax returns.

This means that taxpayers can review their depreciation schedules once again to determine if they contain any items that would be considered repairs under the Tangible Property Regulations. If these exist, the taxpayer can file a form 3115 with their 2016 tax return to allow them to expense the remaining book value of these items as repairs.

Over the last few years, we have seen many taxpayers take advantage of these regulations and it has resulted in a fairly substantial tax savings. Many hope that with the new Presidential administration, tax rates might decrease in 2017. Because of this, accelerating deductions into 2016 has been our focus over the last several months. This would be one area that might allow you additional deductions you might not have already considered.

In prior articles, we presented a more detailed explanation of the definition of what the changes the TPRs and in particular what qualified as an "improvement" with respect to the RAB criteria (Restoration, Adaptation or Betterment of the property). If you have any questions or would like copies of previous articles, please contact your RINA representative.

GAAP's Increasingly Influential Relationship with IRS Treatment

By: Jim Kohles, Principal

There have always been differences between what Generally Accepted Accounting Principles (GAAP) allows or requires and what the Internal Revenue Code may allow or require. Most building owners are familiar with those differences and, for the most part, can deal with them as they have been around for a long time. For example accelerated depreciation versus straight line depreciation, salvage values and different asset lives have been traditions book to tax differences. It has been a reality that there were differences and it was perfectly acceptable to have those as the rules are different and somewhat independent of each other. However, there have been some significant changes in the last few years that have made dealing with the differences much more complex and inter-related. This has occurred as the IRS has finalized regulations governing repairs and capitalization (T.D. 9636) that make certain decisions and elections dependent on what owners do on their financial statements. Not only are some of the regulations dependent on what owner's do on their financial statements but they are dependent on what kind of financial statements owner's prepare. That is, are they internally prepared or are they audited by outside accountants. Having your financial statements audited now gives you an advantage in making determinations of what expenditures you can expense for tax purposes or what you have to capitalize. The expense allowance, those expenditures that can be expensed, amount for those with audited financials is $5,000 but only $2,500 for those that don't. When you realize that this determination is made on a per item or per invoice limit, it can be very significant.

There is another area covered in T.D. 9636 that treatment is different depending on what you do on your financial statements which has to do with what is referred to as the BAR test. If the expenditure results in a betterment, adaptation or restoration (BAR) it cannot be expensed. GAAP requires that an expenditure must add to the useful life of an asset or enhance its function in order to be capitalized. If an owner is inclined to want to capitalize an expenditure for financial statement purposes, it will almost certainly mean that it will meet the BAR test and will not be allowed as an expense for income tax purposes. This conflict always existed but the new regulations make it much clearer that there needs to be conformity with tax and financial statement treatment.

There is an area that hasn't received a lot of attention regarding buildings and its structural components and how to employ the routine maintenance safe harbor. Irrespective of the treatment for GAAP on financial statements, building owners who make expenditures under the restrictions of the safe harbor can expense them. The restrictions are that if an owner reasonably expects to incur the expenditure more than once during the class life of the building (limited to ten years), then the expenditure can be expensed. This may be difficult to prove in hindsight when the IRS is auditing it but good documentation of the expectation and the reasons for that expectation would protect owners from an adjustment at that later date should it not be done more than once in the ten year period.

SAVE THE DATE

Real Estate Advice Series Seminar

Advanced IRC 1031 Exchange

Wednesday, February 15, 2017
11:30 am to 1:30 pm

City Club of San Francisco
155 Sansome Street., 9th Floor
San Francisco

Our Speakers

Mary Cunningham & Teresa Moss Fluegel
Chicago Deferred Exchange Company

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