NJPA
NEW JERSEY PENNSYLVANIA
DELAWARE
Vol. 18, Issue 16 August 25 - September 7, 2006

REAL ESTATE JOURNAL

THE MOST COMPREHENSIVE SOURCE FOR COMMERCIAL REAL ESTATE NEWS

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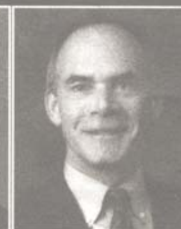
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1031 EXCHANGE

By Jackie Eakin, DeSanto Realty Group

Capital gains tax: Various real estate assets stand to lose a substantial amount

As much of the country has experienced an amazing run in real estate values over the past five years, many groups and individuals began to reap the rewards from the sale of various real estate assets. In turn, they stood to lose a substantial amount of that gain through the capital gains tax.

Jackie Eakin

Enter Internal Revenue Code Section 1031, better know as the 1031 Exchange. This allows gains made on the sale of real estate assets to be reinvested in another real estate asset on a tax differed basis. The investor, after closing on their relinquished property, must identify potential replacement properties with their qualified intermediary within 45 days.

A tenant-in-common (TIC) transaction offers institutional quality real estate assets to investors, while minimizing their risk.

4230 Crums Mill Rd., Harrisburg, PA

At DeSanto, we use our 50-plus year history in identifying profitable real estate investments, to locate and acquire real estate assets that fit the criteria for an ideal TIC property. Our team searches for and identifies for properties in centralized geographic locations across the country that are stable and growth oriented.

These are areas that are vibrant, diverse markets that offer a real opportunity from a real estate investment standpoint. The property must also be aesthetically integrated and have accessible roadway network infrastructure.

The building itself must meet a set of requirements to make an ideal TIC property. We look for the property to be fully developed and constructed, have a distinct look and are an exclusive entity in its location, and most of all, it must have potential for an increase in property value.

DeSanto has recently acquired two Office Complexes in Harrisburg, PA that are a perfect example of a property that meets the requirements for a TIC property. The properties are located in the state capital of Pennsylvania, in close proximity to major metropolitan areas such as Philadelphia, Pittsburgh, and Baltimore.

Furthermore, the properties are 92% leased to established organizations.

There is strong potential value in these properties, with risk minimized for the TIC investor. DeSanto will look for similar assets across the country with similar characteristics, to offer to the growing list of TIC investors.

Jackie Eakin is VP of asset management and acquisitions for DeSanto Realty Group, LLC headquartered in Media, PA. ■

ETC improvements can increase cash flow & the market value of commercial real estate

If you think a Cost Segregation Study is a great way to increase cash flow then listen up. For commercial real estate owners, the Energy Tax Incentives Act of 2005 "ETIA" can help lower operating expenses, defer taxes and increase a property's market value.

Mark de Stefanis

Most often it starts with an aging mechanical system. The affects of time, gravity and wear and tear necessitate a replacement. The replacement offers the owner an opportunity to improve a system's efficiency and the quality of our environment. To stimulate the replacement of these ailing systems and lower greenhouse gases, the ETIA provides a gross deduction between $0.60 to $1.80 /s/f. However, this is only the tip of the iceberg. (Unfortunately, this iceberg is melting since this temporary IRC provision is due to expire on December 31, 2007.)

Got to spend it to earn it!

This is a case where you need to spend some money to make a great deal of money.

On a Cost Segregation Study that we conducted last year on a 140,000 s/f office, our Professional Engineer noted that the chiller had met the end of its useful life. We advised the client of the benefits of upgrading to an energy efficient system and some guidance on how to take advantage of the recent incentives that were enacted under the ETIA to help ease the pain. At closing, the lender withheld $400,000 of replacement reserves for the chiller as recommended by the property condition assessment. The replacement was designed and installed and by early 2006, the project was completed.

3-Fold Benefits of the Chiller Upgrade

The system has been in place for several months and the savings generated by the new "efficient" chiller is significant and comes from three specific sources:

#1) *Increase in NOI:* The upgrade has translated into a 30% reduction in our client's energy costs. The hard dollars involved equates to an increase in annualized Net Operating Income "NOI" of $100,000.

#2) *Section 179(D)a Deduction:* The client was entitled to a partial deduction under Section 179D(a) which translated into $84,000 for the current year; and

#3) *Additional Project Value:* The additional NOI of $100,000 capped at 7.5% is equal to $1.3 million of additional market value in the property since the property was purchased based upon a lower NOI as a result of an inefficient system.

What's Involved?

Specific criteria for obtaining the deduction centers around the efficiency of the new system or systems versus a referenced building meeting the minimum requirements as outlined under the ASREA Standard 90.1.2001. The complex calculation must be completed and certified by a Professional Engineer licensed from the state where the work is being completed. The law specifies that a property owner can qualify for either the entire $1.80 /SF deduction, subject to total Section 179 deductions, or a partial amount thereof.

Criteria Required for the Entire Deduction of $1.80/s/f

To qualify for the entire $1.80/SF deduction, the owner

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By Edward Lifshitz, Amper, Politziner & Mattia, P.C

1031 Exchange let the buyer beware

In their zeal to avoid current tax liabilities, many real estate investors have lost focus in two of the basic premises that govern prudent real estate investing. That is, balancing risks and rewards and patient investing. It is the adherence to these principles that helped investors reap substantial capital appreciation on their real estate investments. However, in many instances, faced with a federal capital gains tax of 15%, the investor is abandoning these principles only to make less prudent investment decisions.

Edward Lifshitz

Real estate sponsors and financial advisors recommend a wide array of investment opportunities to 1031 candidates that ordinarily might not be available to a regional investor. Passively managed replacement properties such as Single user commercial properties attract investors with high leverage and promises of high net yields. Savvy real estate investors perform their due diligence based on the experiences derived from their years in the industry. However, these products are more comparable to financial instruments, with a high degree of interest rate sensitivity, where the basic fundamentals in analyzing these real estate opportunities are inherently flawed. Investors need to navigate through the myriad of corporate financial statements and disclosure documents of public companies to ascertain the viability of their future revenue stream.

Numerous investors that have utilized code section 1031 are currently sitting with highly leveraged vacant Wynn Dixie shopping centers and obsolete warehouses. The most relevant criterion that was overlooked by these investors was "am I comfortable investing the entire proceeds in the future economic viability of an entity that is out of my control?"

In addition, special use properties with triple tenants with long term leases have credible risk. The 100,000 s/f Home Depot distribution center may not be a viable structure at the end of its twenty-year lease. Although the investor is currently maximizing his after tax cash flow returns through the term of the lease, the residual after tax disposition value should be a cause of concern that can negatively impact the internal rate of return on the overall investment.

Historically, seasoned real estate investors placed little merit on the internal rate of return. The predominant investment criterion was " how soon will we be able to get our money out through refinancing?" However, these fixed cash flow products, combined with a rising interest rate environment, have placed the internal rate or return in the forefront of sound 1031 exchange due diligence.

Less than 10 years ago long-term capital gains tax rates stood at 28%. The state of the economy combined with a possible change in the current political leadership does not preclude a future increase in capital gains tax rates. These factors should weigh heavily in the decision making process of the 1031 candidate. We, at Amper, recognize that section 1031 is an extremely valuable tax deferral technique especially when coordinated with the investors' comprehensive estate plan. Tax and financial professionals need to assist clients who are considering 1031 exchanges in making valued long-term decisions. Financial models should factor in interest rate fluctuations, capital gains tax rate increases and the risk tolerance of the investor.

Edward G. Lifshitz, C.P.A. is an officer of Amper, Politziner & Mattia, P.C. specializing in tax structuring of real estate investments. ■