

Pyramid

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Practical ideas for construction and real estate organizations

Improve cash flow with the Energy Efficient Commercial Building Deduction Legislation accelerates deductions, improving your cash position

What if there was a piece of legislation that could improve your cash flow through tax savings? There is — the energy efficient commercial building deduction. By making your building more energy efficient, you could see significant cash flow benefits. By having this increased cash flow, your company can reinvest or meet current needs.

If your company owns or leases commercial buildings — which includes most types of buildings, such as residential buildings with four or more stories above grade — and you have installed or retrofitted the property to be more energy efficient, you may be eligible for a deduction for part or all of the costs associated with the installation or retrofit. This opportunity allows for the potential immediate expensing of costs that would otherwise be capitalized and recovered through depreciation over 27.5 or 39 years.

Enacted in 2005, The Energy Tax Incentives Act was designed to combat the growing energy crisis and reward conservation by providing \$14.5 billion in incentives and subsidies for projects or actions, such as the purchase of hybrid vehicles, clean coal development, use of wind and alternative energy sources and projects that avoid production of greenhouse gases, among others. As part of The Act, IRC §179D provides a deduction with respect to energy efficient commercial buildings. It allows for the deduction for part or all of the cost of an energy efficient commercial building or certain qualifying commercial building property that is placed in service in 2006 and 2007 (and recently extended to include 2008, Tax Relief and Health Care Act of 2006).

Does your building qualify?

To qualify for a full or partial deduction, the energy efficient commercial building property must satisfy the following conditions:

- Building must be located in the United States
- Installation as part of interior lighting systems, HVAC and hot water systems or the building envelope

(insulation, exterior doors, exterior windows, certain roofing material)

- Certified that installation will reduce total annual energy and power costs by 50 percent or more as compared to Std. 90.1-2001 American Society of Heating, Refrigerating and Air-Conditioning Engineers (ASHRAE) Reference Building
- Energy and power consumption calculation using IRS approved software programs that compare subject facility to the ASHRAE Reference Building
- Certification of the property by a qualified individual, such as an engineer or contractor licensed in the same jurisdiction as the proposed building
- Energy reduction isn't simply generated from a change in use, function or utility of the building

What about cash flow?

When using a reference building as the barometer, the maximum deduction is \$1.80 per square foot of building floor area that qualifies under IRC §179D. The deduction is allowed for prior tax years, including 2006 and 2007, and can include multiple taxpayers. The multiple taxpayers are limited to allocating the \$1.80 among the parties. Also, if your building does not qualify for the full deduction, it could qualify for a partial deduction. Specifically, if your building does not meet the 50 percent energy savings, it could still qualify for 60 cents per square foot deduction if certified to reduce energy costs by at least 16.66 percent.

An example of tax savings derived from IRC §179D would be the construction of a new four story 120,000 square foot office building that has design parameters exceeding that of the ASHRAE reference building in

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Making the most of a down market

A review of recent real estate industry newspapers reveals headlines such as “Foreclosures Reach New Highs,” “It May Get Worse Before It Gets Better for Housing,” and “Investment Deals Seen Dropping In 2008.” To read these headlines one would assume that any real estate professional should be thinking it’s time to initiate a new career rather than initiate a new real estate transaction. Startling headlines aside, the current residential real estate market has clearly cooled down from its peak of a few years ago. However, a cooled residential market need not mean a lack of opportunities, particularly for the developers of affordable housing.

“ Depending upon the total development costs for a project relative to the affordability limits for units in a particular area, a combination of incentives can usually be found to fit the needs of most projects.”

As market demographics have changed, some residential projects have become distressed. In many cases these transactions can still provide financial opportunity, however, by shifting to an alternative strategy of affordable housing development. Federal, state and local government entities are eager to take advantage of this soft market to increase the supply of decent, quality affordable housing in their communities.

Significant financial incentives or other public enhancements are available to the developers of affordable units. Depending upon the total development costs for a project relative to the affordability limits for units in a particular area, a combination of incentives can usually be found to fit the needs of most projects. Low-income housing tax credits, tax exempt bonds and HUD Section 8 certificates are the most commonly used tools for rental developments. Zoning density bonuses, assisted first-time home buyer loans and Community Development Block Grant funds are the most commonly used tools for homeownership transactions. For either type of transaction located in an area of close proximity to a public transportation hub, additional transportation oriented “smart growth” incentives can often be obtained.

It’s important to plan carefully for any affordable housing development with a strong team. An analysis of the viability of various product types will assist in creating the highest value mix of market and affordable units as well as rental and ownership units. To do this effectively, one must have a clear understanding of the matrix of potential public sector enhancements, as well as, the benefits and pitfalls of each. Frequently, project viability can be maximized by combining various subsidy types. However, one must be very careful to plan for potential negative interactions and to cope with often differing program goals.

If carefully planned, restructuring a distressed residential transaction as an affordable housing development can provide both a reasonable financial strategy for the developer and a benefit to the local community.

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Industry briefs

Eco-friendly drywall could 'revolutionize' sustainable construction

California-based Serious Materials has developed a method for manufacturing drywall that uses 90 percent less energy, thereby producing less greenhouse gas. Traditional drywall is responsible for roughly 25 billion pounds of carbon monoxide entering the atmosphere annually and 1 percent of U.S. energy consumption. EcoRock, Serious Materials' drywall, produces zero emissions. The company, with support from three venture capital firms, will begin selling EcoRock in the summer of 2008. The product's launch coincides with the green movement's mounting pressure on the building industry to implement more green practices. Projects will be more costly to construct than a typical building, but maintenance costs will be lower than average and tenants will not have to pay for electricity. (*Greenwire*, Jan. 8, 2008)

Americans for Balanced Energy Choices research identifies benefits of new coal-fueled power plant construction

Americans for Balanced Energy Choices (ABEC) has identified 120 coal-fueled power plants that are currently under or near construction, permitted, or in the early stages of development in the U.S., contradicting the view that such plants are a dying breed. "During the past 35 years, the use of coal in the

U.S. has nearly tripled, at the same time, air quality improved and emissions from coal-based electricity are 33 percent lower despite this increased use," said Joe Lucas, ABEC executive director. All of the projects listed as under or near construction or permitted are considering the deployment of environmentally-friendly technologies like subcritical and supercritical pulverized coal, clean coal fluidized bed, or integrated gasification and combined cycle. (*PRNewswire*, Jan. 10, 2008)

Integrity Recruits offers 2008 compensation outlook for construction-related industries

Overall compensation for construction professionals will continue to decline this year due to the slowdown in the residential market, according to a report from Integrity Recruiting, an international recruiting firm specializing in construction-related industries. However, compensation for professionals working on public works construction projects, tourism-related industries, and multi-family housing is likely to rise in 2008, the report said. The report also found that construction companies will increasingly focus their efforts on government and commercial construction instead of residential construction this year. In addition to the government and commercial markets, anything to support alternative energy — including solar power and wind energy — is expected to be hot this year, the report said. (*Business Wire*, Jan. 7, 2008)

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all areas, including interior lighting systems, HVAC and hot water systems, and the building envelope. This type of building would allow a first year benefit of immediately expensing \$216,000 rather than capitalizing and deducting over 39 years. The cash value of this upfront deduction using a combined tax rate of 40 percent would be approximately \$85,000 in year one, with an overall net present value benefit of approximately \$55,000 over the life of the building at a 7 percent discount rate.

An example of an allowed partial IRC §179D deduction (\$.60 per square foot) would be the retrofitting of an existing building, using the same building criteria above, by replacing existing lighting systems with high efficiency lights combined with bi-level switching, which could yield an approximate first year benefit of immediately expensing \$72,000. This immediate deduction would result in a cash benefit of approximately \$28,000. The overall net present value over the life of the building would be approximately \$18,000.

The government wants to encourage serious consideration of energy conservation when buildings are being designed and constructed, which is why they enacted The Energy Tax Incentives Act. If you believe you qualify for this deduction and want to increase your cash flow, get in contact with a professional today who can help you reap the benefits of your energy efficient commercial building.

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