USING COST SEGREGATION TO ATTRACT OR RETAIN BUSINESS

WHAT IS COST SEGREGATION?

- The IRS approved method to classify acquisition or construction costs of real property for depreciation purposes (IRS Code Section 1250 - Real Property & Cost Segregation Audit Techniques Guide).
- Assets are depreciated over 5, 7, or 15 years (vs. 27_ or 39 yrs).
- Allows property owners to take greater tax deductions by accelerating depreciation in earlier years (increases cash flow).
- Provides "Go Forward" and "Retroactive" tax benefits.
- Primarily benefits RE owners who purchased or constructed commercial real estate (office, industrial, retail, etc.) after 1993.
- Requires professionals with construction cost estimating expertise (Architects, GC's, etc.) conduct a Study's "engineering" section.
- Provides an accurate valuation of real property assets.

WHAT TYPES OF PROPERTIES BENEFIT?

Any depreciable real property owned by a taxable entity…

- Constructed buildings:
  - ✓ New buildings
  - ✓ Additions
  - ✓ Renovations
  - ✓ Previously acquired buildings
- Leasehold improvements:
  - ✓ 50% "bonus" depreciation (per the Economic Stimulus Act) for properties placed in service between January 1, 2008 to December 31, 2009.
- Properties acquired as far back as 1987.

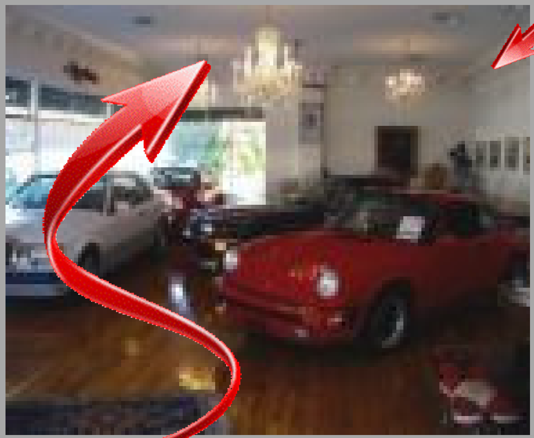
PROPERTY TYPES INCLUDE…

Auto Dealerships
Assisted Living Facilities
Cinema
Dental Offices
Fitness/Health Spas
Hotels _ Full Service
Industrial _ Dist./Warehouse
Medical Research Centers
Mobile Home Parks
Multifamily _ High Rise
Office _ Buildings
Office _ R&D
Pharmaceutical Plants
R&D Facilities
Retail Malls _ Regional
Restaurant _ Franchise
Restaurants _ Quick Service
Service Stations

Agricultural Facilities
Banks
Day Care Facilities
Drug Stores
Hospitals
Hotels _ Limited Service
Industrial _ Manufacturing
Mixed Use
Multi-Family
Nursing Homes
Office _ Parks
Office _ Warehouse
Printing Facilities
Retail _ Big Box
Retail Mall _ Strip
Restaurants _ High End
Self Storage Facilities
Veterinary Clinic

COST SEGREGATION - EXAMPLES

39 Year Property

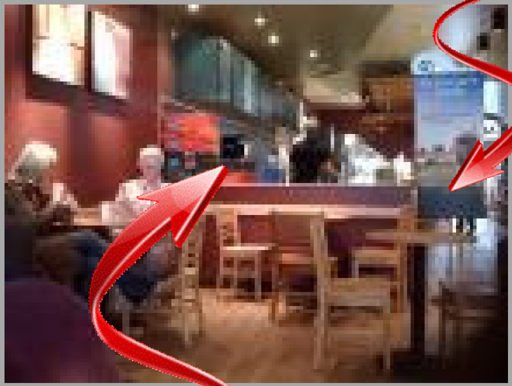


5 Year Property

Example: Auto Dealer

Example: Starbucks

39 Year Property



5 Year Property

HOW DOES THE IRS VIEW COST SEGREGATION?

The IRS now endorses Cost Segregation Studies and their COST SEGREGATION AUDIT TECHNIQUES GUIDE (published in 2004) describes Cost Segregation as follows:

"When only lump sum costs are available, cost estimating techniques may be required to segregate or allocate costs to individual components of property (e.g. land, land improvements, buildings, equipment, furniture, and fixtures, etc.). This type of analysis is generally called a cost segregation study."

IRS' primary concern; Studies must follow the methodologies specified in the COST SEGREGATION AUDIT TECHNIQUES GUIDE.

NOTE: RSH Consultants assisted the IRS in writing the COST SEGREGATION AUDIT TECHNIQUES GUIDE.

IRS
Department of the Treasury
Internal Revenue Service

HOW DO CPA’S VIEW COST SEGREGATION?

JOURNAL OF ACCOUNTANCY (Excerpts - August 2008):

“Cost Segregation can provide real estate purchasers with tremendous tax benefits…”

“CPAs should routinely recommend the use of cost segregation studies whenever the expenditures for an acquisition, including leasehold improvements, equal or exceed $750,000.”

“The benefits of cost segregation overwhelmingly outweigh the drawbacks.”

“…there can be astounding differences in outcomes between using and not using it (Cost Segregation).”

“Greater tax savings will be possible with an engineering report that clearly identifies property…”

FAQ'S ABOUT COST SEGREGATION

Q. Is Cost Segregation a "high-risk" tax shelter?

A. NO - If cost components in the engineering report are well-documented, Cost Segregation is no more aggressive than using permissible depreciation methods under IRS Codes._

Q. If a Cost Segregation "Look Back" Study is performed, does this require the filing of an "amended" income tax return?

A. NO – Changes in depreciation (from a Cost Segregation Study) are treated as a "Change in Accounting Method" which prohibits the filing of "amended" returns. The tax benefits (refunds) are realized on the next tax filing.

NOTE: **RSH retains "Enrolled Agents" (former IRS agents) to validate any information a client requires**

*Source: Journal of Accountancy _ August 2004, Re-published in 2008

COST SEGREGATION

CASE STUDIES

OREGON ECONOMIC DEVELOPMENT ASSOCIATION

Advocating for Oregon's Economy

MANUFACTURING COMPANY

Plant Constructed in 1994.
Substantial Modifications in 2001.
$23,574,000 Depreciable Cost Basis.

Pre-Engagement Estimate:

- Reallocate $9.26 million to shorter recovery periods
- First year savings: $84,479
- NPV ten year savings: $1,759,994

Actual Savings:

- Reallocated $14.71 million to shorter recovery periods
- First year savings: $148,341
- NPV ten year savings: $3,372,533

MULTI-TENANT BUILDING

165,000 Square Feet.
8 Acres of Land.
$15.5 Million Depreciable Cost Basis.

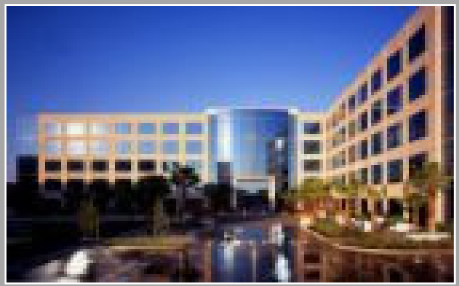
Pre-Engagement Estimate:

- Reallocate $2.94 million to shorter recovery periods
- First year savings: $29,145
- NPV ten year savings: $562,435

Actual Savings:

- Reallocated $5 million to shorter recovery periods
- First year savings: $53,422
- NPV ten year savings: $896,880

OFFICE BUILDING



5 Story Office Building.
Acquired in 2005.
$11.7 Million Depreciable Cost Basis.

Pre-Engagement Estimate:

- Reallocate $2.2 million to shorter recovery periods
- First year savings: $22,000
- NPV ten year savings: $477,000

Actual Savings:

- Reallocated $4.2 million to shorter recovery periods
- First year savings: $38,000
- NPV ten year savings: $677,000

LEASEHOLD IMPROVEMENT “LOOKBACK”

Medical Equipment Company.
Signed Lease in 2003 for 24-Year Term.
Lessee Paid $10 Million for Improvements.

Pre-Engagement Estimate:

- Reallocate $6.0 million to shorter recovery periods
- Deduct 50% of costs classified as 5-year property

Actual Savings:

- Deducted additional $3.5 million of depreciation expense in 2009
- Reduced U.S. and state tax liability by $1.4 million
- NPV value of tax savings = $715,000

POTENTIAL BENEFITS

- Source of capital for a business to reduce expenses and/or debt (i.e. tax refunds as an interest free loan).
- Reduce estimated quarterly tax payments (in lieu of tax refunds).
- Absolve prior depreciation errors (by the "Change in Accounting Method").
- Increase after tax cash flow for a company or RE investor (by increasing the Depreciation deduction).
- Develop a new policy for businesses to reduce tax liabilities for future real estate acquisitions, expansions, development, etc.
- Establish accurate Real Property asset values for IRS purposes.
- Enhance relationships with a constituent business by offering a service that addresses their financial needs.
- Create a tool for economic development agencies to attract/retain businesses in a regional area (without using the agency's funds) or reducing the local tax base.

PROCESS AND PRICING

- ✓ Client completes a one page property information form.
- ✓ Program Administrator prepares a no cost Estimate of Benefits.
- ✓ Program Administrator presents the Estimate of Benefits and Proposal.
- ✓ Fees are based on the Estimate (and do not increase if actual benefits exceed the Estimate). Average fee is 6% of estimated benefit.

WHO CONDUCTS THE COST SEGREGATION STUDY?

- The RSH Group, an economic development and asset management financial services organization located in Irvine, CA. www.thershgroup.com
- RSH is the ONLY service provider exclusively endorsed by the Society of Industrial and Office Realtors (SIOR).
- RSH represents clients in economic development, commercial real estate, aerospace, manufacturing, biotech, electronics, automotive, logistics, retail, hotel and entertainment.
- They are exclusively endorsed by National and International Trade Organizations representing over 125,000 companies. Providing them with site selection and expansion management services.
- International scope _ affiliate offices in Canada, Europe & Asia.
- RSH senior management has prior C-Suite and Fortune 500 experience including:

  <u>National Practice Leader</u> - KPMG and Arthur Andersen
  <u>Corporate VP of Marketing</u> - Fiat, Kia and Daewoo Motors
  <u>Cost Segregation Trainer</u> - Marshall & Stevens (acquired by CBRE)
  <u>Head of Cost Segregation</u> - Dixon Hughes (18^{th} largest CPA in U.S.)

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