

## **A CPA's Perspective to Investing in Commercial Real Estate**

By Jake Lynch

If you are planning to invest in commercial real estate, it makes good business and financial sense to enlist the counsel of a trusted Certified Public Accountant (CPA) throughout the complete process; from contemplation to acquisition and beyond.

Assuming you have already identified a property for investment that meets the typical criteria of “location, location, location,” don't wait until tax time to discuss an investment made last year. There is no such thing as “too early a time” to evaluate tax implications. You may be surprised to find out that the tax loss you were counting on cannot be used for one reason or another or that the entity of choice was the “wrong type”, the “wrong ownership allocation” and the “wrong one” for estate planning purposes.

Today, the familiar ring of “wrong” to the investment buyer is evident, as tax laws are continuously changing. More importantly, a CPA can advise whether the timing of the purchase is beneficial as it may have some bearing on potential depreciation deductions that ultimately will impact after-tax cash flows.

It makes sense to leverage the expertise and experience of someone who “understands the numbers,” but more importantly, all the implications associated with the purchase of a piece of commercial real estate.

The perspective of a CPA can be helpful in getting the buyer to ask the right questions as well as gather some recent and past financial information. A CPA finds all data available for the buyer. It is “out there” somewhere, whether on a well-organized spreadsheet, or in some cases, a used napkin. And, although that may seem like an attempt at humor, it's amazing to contemplate the ways that records are sometimes kept!

Audited financials may be available. If that is not the case, perhaps compiled financial statements and tax returns may be available.

There are a number of questions that should be asked during a potential acquisition. Initially, you will want to know who it is that represents the seller. It may be a commercial realtor, a business advisor, or a combination. The more information you have about who is on the “other side,” the better equipped you will be in the transaction. It's also advisable to know who the seller's CPA is, and what his/her reputation is like. One of many advantages of having a CPA at your side through a transaction such as this is that your CPA may already know the other side's firm. Beyond that, there are a number of ways to perform some quick ‘due diligence’ on the CPA firm, including Chambers that they belong to, trade references, even their D&B rating.

With that basic starting information at hand, you and your CPA should determine the answers to the following questions, including:

- Has the property had a recent appraisal? With the real estate market as a “work in progress,” it makes sense to have the very latest appraisal available. This document will take into effect the latest valuations given the current market. An appraisal that dates back six months or a year, for example, may be seriously outdated.
- Can the seller provide tenant and expense history, rent rolls, utility bills, and real estate taxes? Along with that, ask if you can review a list of additional expenses associated with the property.
- How much repair work has been done, and what types of improvements have been made? Are there environmental issues to be considered?
- Examine at the fixed asset and depreciation schedules. What was the nature of professional fees spent over the years?
- Look at the bills! Ask yourself, was there difficulty financing the property in past years? What about looking at the history of the property especially during the last real estate recession.
- What are the industry trends of the tenants? Ask to see a variety of types of industries in practice. What has been the policy for common area billings, terms of leases etc?

With these questions asked, there is a benchmark from which one can assume the property’s value. From this point, the analysis can begin.

The impact of depreciation is critical along with interest rate assumptions and of course, the down payment. A preliminary allocation of land and building should be made. Land is not depreciable. According to IRS rules and regulations, land and building improvements and contents can be depreciated. A recent trend in computing depreciation is having a cost segregation study performed. This study, performed by qualified individuals (usually engineers), should maximize the amount of costs assignable to shorter period of write off. Accelerating depreciation can have a dramatic impact on the cash flow in the early years, when it is needed the most.

The most common used tool for real estate analysis is spreadsheet modeling. Performing “what if “ scenarios can be extremely important. A spreadsheet may show vacancy illustrations, worst case and or best case, etc. CPA’s use these spreadsheets as benchmarks or budgets as time goes on after acquisition.

Remember, due diligence on a property that meets the location, location and location criteria is important. With location information an offer can be adjusted either up or down depending on the situation, the expected rate of return and the risk associated with the property.

A CPA can assist with commercial investment decisions regarding property by advising the client to ask the right questions and assist with the choice of entity, computer modeling and tax consequences. The location, location, and location criteria is best left to the real estate professionals.

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