Commercial Real Estate
# Hot Topics
*Reduce Taxes. Maximize Cash Flow. Minimize Risk.*

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*CBIZ's Real Estate practice is uniquely positioned to help you minimize risk and capitalize on market opportunities.*

*We work with owners, managers, operators and investors, as well as commercial real estate developers and partnerships in all of the major CRE sectors: retail, office, hotel, multi-family, shopping centers and real estate investment trusts.*

**FINANCIAL SERVICES**
**INSURANCE SERVICES**
**VALUATION SERVICES**

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# TCJA Takeaways on Bonus Depreciation and Cost Segregation

**BY LARRY ROSENBLUM, CBIZ MHM**

Most taxpayers will have had recent discussions with their tax and other financial advisors as the recent corporate and personal tax filing deadlines approached and are now more familiar with key relevant changes of the Tax Cuts and Jobs Act of 2017 (TCJA). Now is the time for individuals and corporate entities alike to begin to develop their tax compliance and management strategies. For commercial real estate owners and investors, there are several advantageous features to consider. Cost segregation studies will continue to be key in identifying and substantiating preferred tax treatments.

1. **Bonus Depreciation**: Bonus depreciation of 100% on qualifying assets (immediate expensing) is a key benefit for real estate owners and investors. Prior to TCJA, bonus depreciation only applied to newly constructed or original-use property. TCJA includes *used* property acquired after Sept. 27, 2017 (through 2022) for this treatment, as well. A cost segregation study will establish what costs will qualify for 100% bonus depreciation.

2. **Importance of In-Service Date:** For newly acquired or constructed property, it is important to know when a binding contract was entered into between the parties, as pre Sept. 27, 2017 contracts may not qualify for 100% bonus even if the property is placed in service after Sept. 28, 2017.

3. **Increased 179 Expenses:** Qualifying property now includes roofs, HVAC

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systems, fire protection, alarm systems and security systems. Additionally, the allowable expense has been increased from $500,000 to $1,000,000 in 2018, with the phase-out deduction increased to $2.5M. These rules now include tangible personal property acquired for rental properties, furniture and appliances and add another benefit and increased value to a cost segregation study.

4. **Pass-Through Deduction:** With the potential 20% deduction for pass-throughs in play for 2018, the effective federal tax rate drops from 39.6% to 29.6% (37% x 80%). While each case is unique, it may be beneficial to take advantage of the deduction against a higher rate of tax in 2017, if possible. You will want to discuss this with your tax advisor.

5. **Look-Back Deductions:** Cost segregation studies can provide significant tax benefits for properties that have been placed in service several years back. A look-back study can help identify costs that can be depreciated over a shorter period of time that are currently being depreciated over longer periods. The look-back deduction can be claimed on the next filed tax return without the need to amend any previously filed tax returns. The IRS considers this an automatic change of accounting method and is prepared by completing Form 3115.

6. **The Tangible Property Regulations (TPR):** TPRs are still in play. There are potentially significant tax benefits in analyzing improvements made to buildings as the TPRs recognize the ability to deduct certain renovation costs as repair expenses if applicable, even if incurred in a prior year.

7. **Partial Asset Dispositions (PAD):** The PAD provides for the ability to take a deduction for the net book value of assets removed resulting from a renovation performed. A cost segregation study can assist in helping identify the original cost of the assets that have been removed, if not previously identified.

In summary, there are significant potential tax savings, utilizing both cost segregation studies and the tangible property regulations. The ability to perform look-back studies as well as to potentially reclassify renovations that were previously capitalized to a repair expense can be facilitated without the need to amend previously filed tax returns.

**Additional resource:**

- CBIZ Eye on Washington Tax Updates connects you with timely analysis, articles, webinars and tax-related issues in the news.

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# Real Estate Rate Trends Reflect Last Year's Natural Disasters

**BY JIM JUDD, CBIZ INSURANCE SERVICES**

A string of natural disasters in 2017 is continuing to impact the real estate insurance market. Catastrophic weather events worldwide led to a record-breaking $135 billion in insured losses in 2017, with the U.S. suffering 16 separate billion-dollar disaster events. When considering the overall damage from these weather events, 2017 was the costliest year for catastrophes since the National Centers for Environmental Information (NCEI) began tracking storm costs.

These weather-related events, plus the spike in building fires, resulted in increased claims losses for the property insurance market. In fact, losses and expenses are outpacing overall premium growth for many insurers.

Over the past few years, particularly for multifamily risks, we have seen property rates fall and losses increase each and every year. Capacity for multifamily risks has been plentiful in the past. However, after increases in attritional losses (fires, water damage, tornados, wind and hail) combined with major global catastrophes (hurricanes, earthquakes and wildfires), that supply has diminished greatly.

Instead of the double-digit rate increase that was expected, insurers are continuing to offset losses with

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## Upcoming Webinars

**A complete list of upcoming webinars can be found here.**

*Most webinars are available as a recording after they air.*

### Why You Should Invest in the Financial Wellness of Your Employees

May 15, 2018 | 1-2 p.m. CDT

*Learn about offering the fastest growing benefit in the U.S. - a financial wellness program. From student loan management to retirement planning, now is the perfect time to explore this opportunity to enhance your benefit program.*

### Eye on Washington: Quarterly Business Tax Update

May 15, 2018 | 1-2 p.m. CDT

*Eye on Washington webinars assist CEOs, CFOs, financial executives and advisors, and other interested parties to navigate the complex tax environment - from federal tax reform to IRS guidance and healthcare reform.*

### Webinar: The Latest on the New Partnership Audit Rules

June 5, 2018 | 1-2 p.m. CDT

*The new partnership audit rules are in play for tax years beginning after Dec. 31, 2017. There is still time to amend partnership and LLC agreements, as will be necessary in nearly all cases. Certain critical aspects of the new rules were clarified in proposed regulations that the IRS published recently. As the IRS works to finalize these regulations later this year, businesses should prepare for the potential impact of these regulations, which will be explored in this webcast.*

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capital reserves but are increasing coverage pressure with changes in deductible structures and coverage forms. As an example, many carriers are adding actual cash value endorsements for roofs more than 15 years old. By moving from "replacement cost" to "actual cash value" in policy terms, insurers are able to mitigate exposure for roof-related losses that are typically caused by wind and/or hail. For multifamily properties in convective storm states, there will likely be larger pressures for higher wind and hail deductibles. Ultimately the potential changes in deductible structure and coverage form may result in greater out-of-pocket expense to an owner at the time of covered loss.

The news is better for the retail, industrial and office sides of the real estate space. While we expect high, single-digit rate increases, the changes to deductibles and coverage forms will not be as impactful as they will be on the multifamily side.

Multifamily property owners can mitigate risk and minimize claims by maintaining awareness of conditions at the property and its tenant profile. By performing quarterly inspections of the building, roof, sidewalk, parking lot, stairs and random spot checks on units, owners can become more aware of potential problems that could lead to loss.

Tenant profiles can turn over quickly and impact risk. If property owners start seeing a rash of claims, take time to assess what may be creating those losses. Evaluate tenant history, including credit, criminal, employment, past rental history and the nature of the business (in the case of retail), to ensure tenant profiles fit your business plan.

Consider these options when it is time to renew your policy:

- Deductible options on the all other perils deductible as well as the wind/hail deductible
- Inclusion or exclusion of perils such as flood, earthquake, terrorism and boiler
- Premium credits for locations with superior construction
- Premium debit and/or credits for loss history
- Rate credits for other classes of business, such as lessors risk schedules, office buildings, warehousing, storage and hotel operations
- Limited named storm (or tier one) capacity for preferred clients

### Bottom Line

No one will be surprised that last year's catastrophic events contributed to unusually high losses and are impacting the property insurance market. Losses affect

rates and the ability to obtain insurance. Insurers are making adjustments in coverages and deductibles to avert double-digit rate increases. Taking steps to prevent and reduce losses is good business sense and may give property owners some leverage when policies are up for renewal.

### Related resources:

- Complex Insurance Claims – Understand and Work the Process
- Top Ten Insurance Claim Tips

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# Your Leasing Questions Answered

**BY BRADFORD HALE, CBIZ MHM**

Accounting for leases is changing. Beginning in 2019 for public business entities and 2020 for private companies, the new leasing standard will require most operating and finance leases to be recorded on the balance sheet. It also expands the definition of a lease and adds disclosure and presentation requirements. The following may help simplify the implementation process.

### Can I Use a Portfolio Approach to Transition Leases?

Leases can be evaluated and recorded together if they are similar in nature. Keep in mind that application of the guidance to the portfolio should not differ materially from application at the individual lease level.

### Can a Materiality Threshold Help Determine Which Leases to Recognize on the Balance Sheet?

Entities can create capitalization thresholds and items beneath the limit would not need to be recognized on the balance sheet provided that the aggregate effect is not material. Capitalization thresholds for leases should generally mirror property, plant and equipment capitalization thresholds. Existing capitalization policies should also be revisited because right of use (ROU) assets could affect whether aggregated amounts should be capitalized.

### Is a Security Deposit Considered a Lease Payment?

If a nonrefundable security deposit is used to secure the lease, the deposit would be considered part of the paid contract consideration, and therefore treated as a fixed lease payment. Refundable security deposits would not be considered lease payments.

### How Does a Lessee Account for Other Costs in the Lease?

Components of the lease only include activities that transfer the good or service to the lessee. This includes maintenance services but not taxes or insurance. Consideration should be allocated to the lease and nonlease components based on relative standalone selling price.

### How Should Variable Lease Payments Based on an Index or Rate Be Calculated?

Variable lease payments based on specific indices or rates will include the index or rate in the initial lease liability calculation. If the variable lease payment is based

on the change in the rate or index, the index or rate would not be included.

### If a Variable Lease Payment is Based on Performance or Usage, Does a Lessee Need to Estimate the Probable Lease Payment?

First, consider whether the payments are in substance, fixed. If they are truly variable, then such payments are recognized in the period incurred. Variable lease payments based on usage or performance are likely either discrete performance targets or cumulative performance targets. Discrete targets will often be recorded in the period they are met while the cumulative targets will need to factor in the probable payment amount over the duration of the contract and recognize a portion of that obligation each period.

### How Should a Lessee Present the ROU Assets and Lease Liabilities for Operating and Finance Leases in the Balance Sheet?

Operating and finance lease balance sheet items are presented separately from each other. ROU assets are amortizable and should not be separated between current and noncurrent portions. Lease liabilities representing future commitments and the portion of lease liabilities expected to be paid within the year should be presented as current liabilities.

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# Active Shooter – the New Cyber

**BY MATTHEW MERCIER, CBIZ INSURANCE SERVICES**

Much as cybercrime exploded worldwide to staggering impact, workplace violence in the form of active shooter incidents has now emerged as a threat that cannot be ignored or minimized. Although it's a difficult subject, it is important for businesses to consider active shooter/workplace violence insurance to cover gaps and grey areas that exist in standard coverage insurance. Here's why.

According to 2017 data from the Gun Violence Archive (GVA), which compiles data from shooting incidents, America is averaging almost one mass shooting a day. GVA considers a mass shooting any incident in which a gunman shoots or kills four or more people in the same general time and location. It recorded 345 mass shootings in 2017 and as of the date of this article, 64 in 2018.

Even when using the narrower definition of a mass shooting from the Congressional Research Service – the gunman kills four of more people in a public place and the victims were selected randomly – the average is still an astounding one mass shooting a month.

FBI data surveying a period of 16 years shows that casualties from active shooter incidents have increased from seven in 2000 to 212 in 2016 and are most common in educational settings (22%) and commercial enterprises open to pedestrian traffic (43%). Retailers and offices open to the public are at the highest risk of an active shooting and liability for both civil and regulatory action.

As these numbers continue to increase at a stunning rate, businesses and organizations have begun to consider that their risk management program must include ensuring a safe environment for staff and visitors. Additionally, mitigating the risk of a violent incident of this magnitude would not have been imagined just a few years ago.

### Active Shooter and Workplace Violence Insurance

Understandably, as this new class of risk has emerged, there is a misconception among clients that their general liability insurance policy covers an active shooter event. The reality is that standard coverage – even terrorism insurance – cannot be depended on to respond to active shooter situations.

Many incident-generated expenses can be anticipated but many are often unexpected. Independent crisis management and security, employee counseling, public relations, salaries for victim employees and

replacement employees, and medical care and/or rest and rehabilitation for employees – these are often unforeseen.

Today, there are a number of underwriters offering active shooter or workplace violence insurance. There may be some differentiation between active shooter and workplace violence programs and providers; for example, you will want to compare triggering events, third-party liability coverage, first-party coverage for losses, as well as expenses and post-event services.

In addition to premium cost, consider the following when deciding what is best for your business:

- Limit Amount
- Claims Expense Coverage (damages, monetary awards, settlements)
- Crisis Response Service
- Funeral Expense Reimbursement
- Security Review Audit & Vulnerability Testing

Additionally, carefully read the policy to determine if there is anything that may restrict coverage. Some of the common issues are related to:

- Coverage Triggers – For instance, the policy could require a specific number of casualties before it will kick in.
- Terrorism – The best protection is for the policy to NOT exclude terrorism.
- Weapons – Make sure the firearms or deadly weapons definition is clear and understandable as to the type of weapons covered.

### Crisis Management Services

One thing to pay specific attention to in relation to crisis management services is any policy wording that states prior approval or review is required. Because post-incident

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crisis management is a crucial step in protecting the organization's reputation and mitigating future claims, make sure the company can respond immediately. Approval language may cause a delay in response.

Additional items that should be clearly defined and provided for by your coverage include:

- Investigation – Conduct an independent investigation into the active shooter event. The results can help drive crisis response planning as well as identify possible third-party liability exposures.
- Crisis Management Support – Provide advice and support on managing the issue, including a response hotline, crisis counseling, public relations and other crisis communications.
- Temporary Security Measures – If needed, arrange for armed or unarmed security personnel to enhance security.

### Risk Management – Not Solely Insurance

Heightened security concerns have focused significant attention on crisis response plans, and more firms now have plans in place for terrorism, bomb threats, fires and natural disasters than at any point in modern history. Conspicuous by its absence from many of these plans is a workplace violence response plan.

A true insurance partner will provide value-added risk management services such as a security review. This should include a risk assessment to identify any security gaps followed up with a risk management plan to address those gaps. The risk advisor should also have a variety of resources available to help prevent and mitigate risk instances, as well as to help educate and train personnel.

### Additional Resources:

- Seven Steps to Implementing a Workplace Violence Response Plan, LPM Insider.
- Active Shooter Emergency Action Plan Guide and Template, Homeland Security.

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GUEST COLUMN

# Commercial Real Estate – The Fourth Asset Class?

**BY BILL FLORENT, CFO, SELEQUITY**

Has real estate joined the big three asset classes — stocks, bonds and cash — as a key investment option? It certainly seems so for institutional investing. Now, individual and family-office investors are seeking the same advantages that attracted institutional investors, namely portfolio diversification, competitive returns and investment access. And, real estate's low correlation to other assets provides portfolios with protection against a volatile cycle, as well as an inflation hedge.

Historically, investing in commercial real estate (CRE) had a country-club feel to it rather than being a disciplined investment strategy. Investment opportunities came by way of relationships with owners or operators of properties, often times within proximity to the investor's local geography. Although the investors may not have included their financial advisors in the actual investment process, more often than not the advisors played some role in the transaction, if only after the fact as a consultant regarding how that investment fits within their overall financial plan.

Today, because of recent changes in the law, sponsors can generally solicit beyond the old "friends and families" boundaries, reaching out to accredited investors outside their local connections or geography. At the same time, the growth of the financial technology (fintech) sector has delivered a new paradigm - online platforms for real estate investing.

For investors, online real estate investing brings unprecedented access and diversification options, as well as far greater ability to self-direct real estate investment decisions. However, the attractive yields in real estate carry attendant risk. Not all of these platforms have the experience behind them necessary to evaluate those risks, and there may be little guidance as to the individual investor's overall investment strategy.

For real estate firms and sponsors looking to fill a portion of equity capital real estate, online platforms can be an accessible and flexible means of rounding out financing. As the industry has grown, though, so has

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competition with any number of other opportunities for investor attention.

Bringing the financial advisor into the picture ameliorates both the investor and sponsor positions. The time seems right to put the financial advisor in charge of finding the right investment opportunities for their clients.

### Making the Connection

Real estate investors are typically accredited investors, many of whom are high–net-worth individuals, who engage financial advisors to design their long-term investment strategy. Financial advisors are experienced at evaluating and presenting investment options in traditional classes of stocks and bonds, although they may need some guidance and motivation to bring CRE investment opportunities to clients.

Both investors and advisors can agree that investing in cash-flow products like commercial real estate can be an excellent hedge against a wildly fluctuating stock market and that diversification is a key element of reducing portfolio risk and optimizing returns.

The key to engaging financial advisors is to educate them - show them why it is important to consider direct CRE private placement investments as part of the overall allocation mix of a diversified portfolio. Provide a profile of your projects. Additionally, provide a vehicle for them to retain those assets under management to continue modeling their clients' portfolio and getting paid for their allocation oversight and strategy.

The two overarching goals when working with advisors are:

1. Simplify their due diligence by pre-vetting quality real estate managers, just like they would do when researching mutual funds or other asset classes.
2. Educate advisors as to how single-asset investing can produce higher returns, lower fees and less volatility with a stable current cash flow, as well as opportunity for significant asset appreciation.

### Put the Financial Advisor in Charge

A sensible approach relies on a technologically tweaked version of a traditional model and established relationships that puts the financial advisor in charge of finding the right investment opportunities for their clients. The questions for sponsors becomes how to get noticed by those Registered Investment Advisors (RIAs) and "sell them" on the benefits of CRE investing, particularly their projects.

Cold calling would be hard to scale. By gaining access to RIAs and advisors through investment platforms, you have the opportunity to reach exponentially more investors through a curated advisor network.

A technology-enabled marketing plan accelerates the speed-to-market for raising capital, and lowers the cost by replacing manual, inefficient and expensive private placement activities. Technology platforms not only expand your marketing and educational efforts, they reduce the time to complete the investment process using online tools for execution, retention and reporting.

### The Bottom Line

It's no surprise that CRE assets are becoming a key component of the U.S. investment landscape.

Recent market shocks have investors on edge. After spikes in volatility during the past few months, and the largest one-day drop in the history of the Dow Jones Industrial Average, many investors are wondering if the nearly decade-old bull market in equities is finally coming to an end.

To position yourself to the advisor community as a real estate manager with a strong track record of institutional-quality investment opportunities and maintain that profile 24/7, take a look at the online resources starting to become available and how they can help you achieve that status.

Related Resources

- 3 Years Later, the JOBS Act Continues to Drive Growth in CRE
- How Can Wealth Advisors Remain Relevant in Commercial Real Estate's DIY Era?

**Bill Florent is CFO of Selequity, an investment platform connecting advisors and investors with commercial real estate opportunities from proven sponsors. You can reach Bill at 314.282.9749 or bflorent@selequity.com.**