LAKESHORE APARTMENT ASSOCIATION
PO BOX 1312
SHEBOYGAN, WI 53082

ADDRESS CORRECTION REQUESTED

LAKESHORE APARTMENT ASSOCATION NEWSLETTER

The Lakeshore Apartment Association publishes this newsletter for its members. Information included was obtained from sources deemed to be reliable and accurate. No warranty or representation is made as to the accuracy thereof and is subject to correction. Members are invited to submit articles and ideas for publication. Items are to be submitted by the 30th of each month prior to publication.

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http://laa.rentals/

PRESIDENT'S MESSAGE

Thank you for electing me president for this term. I'm excited about the upcoming year and happy to serve you. We all have a lot to look forward to. This is a great time to be in the rental business! Legislation is on our side at the highest levels with the new tax reform at the federal level, which you will read about in the coming months, to the reduction of property taxes at the state.

The New Year brings a fresh start to all of us as we look at New Year's resolutions, planning and goal setting in our personal and business life. We also are doing the same with the LAA. We have new members joining every month. This is great! This is a season of growth. Our organization will double and triple in size in a short amount of time. All we have to do is invite other landlords to join. When we each invite one person we double, invite two we triple. It really is that simple. WE CAN DO IT! We all have been in conversations with others to find out that they also own or manage property, yet they may not be a member of our group. So just invite them to join or attend one of our monthly meetings which are the same time and place every third Thursday at lakeshore lanes. Receive a door prize for each guest you bring to our monthly meetings.

We will bring in guest speakers, keep you informed of changes that affect our business and have round table discussions. Within our group we have so much experience and knowledge to share through networking, asking questions, seeking advice and building friendships - we are all on the same side.

Next month you will receive a survey asking for your feedback in many different areas such as favorite vendors and contractors. We want to know what you want and expect from the LAA and also what you can do for it. If you have any questions or concerns, please contact me at your convenience.

Your calls, texts and/or e-mails are always welcome.
920-452-7051
RUFREE1@CHARTER.NET
Respectfully yours,

Jim Longo

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General Meeting Date:
January 18th, 2018 Time: 7:00 p.m.
Place: Lakeshore Lanes Basement

Board Meeting Date:
January 25th at 6:30 pm
Sheboygan Falls

CONGRESS PASSES TAX REFORM

DECEMBER 20, 2017

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Today, Congress passed the Tax Cuts and Jobs Act and the bill will now be sent to the President for his signature. The passage of this act is the most momentous change to the tax code since the Tax Reform Act of 1986.

Unlike the 1986 act however, the Tax Cuts and Jobs Act includes numerous critical victories for the multifamily industry. It provides tax cuts for individuals, pass-throughs (e.g., LLCs, partnerships and S Corporations), and REIT entities, while leaving intact critical provisions promoting the development and operation of apartment housing. For example, multifamily firms will be able to continue to fully deduct business interest and conduct like-kind exchanges while depreciating buildings over 30 years or, in some cases, the present 27.5 years. Finally, in a victory for the production of affordable housing, the Act retains both the Low-Income Housing Tax Credit and Private Activity bonds.

Here is a summary of the key provisions in the Act. A detailed chart can be found here.

Individual Tax Rates and Pass-Through Income: The Act includes seven tax rate brackets applicable to both individual and pass-through income. The rate brackets range from 10 percent to 37 percent in contrast to today's top rate of 39.6 percent. The Act's maximum 37 percent rate is effective for taxable income exceeding $500,000 for single filers and $600,000 for joint filers. The rate reductions expire after 2025.

Not only does the Act reduce marginal income tax rates, but it also enables a portion of **pass-through business income to qualify for a 20 percent deduction, or a top effective rate of 29.6 percent**. The deduction on pass-through income is available through 2025.

For taxpayers earning over $157,500 (single filers) and $315,000 (married couples), the deduction is limited to the greater of: (a) 50 percent of the taxpayer's share of aggregate W-2 wages paid by the business; or (b) 25 percent of the taxpayer's share of aggregate W-2 wages paid by the business plus 2.5% of the unadjusted basis of all qualified property.

Estates and trusts are eligible for the 20 percent deduction.

The Act's deduction for pass-through income should be a significant benefit to the multifamily industry. While the Senate-passed bill would have provided a 23 percent deduction to pass-through income, the benefit was limited to 50 percent of a taxpayer's allocable wages. **NMHC/NAA made the case that the formula would have excluded many operators who have significant levels of capital deployed relative to wages paid. The alternative limitation for income derived from capital-intensive activities included in the conference report should be beneficial to the industry**.

REITs: REIT dividends are fully eligible for the 20 percent deduction.

Business Interest: While the Act generally includes limitations on the deductibility of business interest, it allows multifamily firms to elect to fully deduct business interest. However, there are consequences regarding the depreciation of multifamily buildings for firms electing to preserve full interest deductibility. Firms with average annual gross receipts under $25 million over the past three years are exempt from limitations on interest deductibility.

Depreciation of Multifamily Buildings: For multifamily firms wishing to retain the full deductibility of business interest, the Act increases the current-law 27.5-year depreciation period applicable to multifamily buildings to 30 years. Firms able to abide by limits on interest deductibility will retain 27.5-year depreciation for multifamily buildings. Notably, the Senate initially sought a 40-year depreciation period for buildings, but **NMHC/NAA were able to secure an amendment during committee markup offered by Finance Committee Chairman Orrin Hatch (R-UT) to reduce the period to 30 years. This period is retained in the final bill.**

Depreciation of Assets Other Than Buildings: The Act enables multifamily firms to expense assets apart from buildings, such as land improvements and tangible personal property, placed in service from September 28, 2017, through 2022. Bonus depreciation, also known as an additional first-year depreciation deduction, applies thereafter (80% in 2023, 60% in 2024, 40% in 2025, and 20% in 2026).

The Act also **doubles to $1 million the amount qualifying property that a small business may expense in the year of purchased.** The $1 million limit is reduced once investment in qualifying property exceeds $2.5 million. Notably, qualifying property is expanded to include assets involved in furnishing multifamily housing and student housing, such as furniture and appliances.

Like-Kind Exchanges: The Act **preserves like-kind exchanges for real property**. A critical win for the industry, like-kind exchange rules play a vital role in supporting the multifamily industry by enabling investors to remain invested in real estate while still allowing them to balance their investments to shift resources to more productive properties, change geographic location, or diversify or consolidate holdings.

Carried Interest: **The Act requires an asset to be held three years to receive capital gains tax treatment**. NMHC/NAA encouraged lawmakers to maintain the current-law tax treatment of carried interest. Both the House and Senate bills elected to include a three-year hold period. There were efforts during consideration to tax carried interest at ordinary income tax rates regardless of the holding period. NMHC fought to hold the line on the three-year holding period as opposed to extending it further. The provision is effective beginning in 2018.

Low-Income Housing Tax Credit: The Act **preserves the Low-Income Housing Tax Credit (LIHTC) and private activity bonds**. The House-passed bill would have eliminated private activity bonds, jeopardizing the efficacy of the 4 percent LIHTC. NMHC/NAA worked tirelessly to advocate that private activity bonds be included in the final bill. Not addressed, however, is the loss of equity LIHTC would raise as a result of cutting the corporate tax rate to 21 percent.

Estate Tax: The Act immediately **doubles current law's estate tax exclusion ($5.49 million single filer / $10.98 million married couple) while retaining stepped-up basis**. The expanded estate tax exclusion expires after 2025 with the exclusion amount reverting to current law.

Active Loss Provision: The Act includes a brand-new measure from the Senate-passed bill that **limits active income losses of flow-through entities**. Under the provision, a taxpayer can deduct only $500,000 ($250,000 for single filers) of net active pass-through losses against wage or portfolio income. Disallowed losses may be carried forward as part of a taxpayer's net operating loss. Effective in 2018, this proposal sunsets after 2025.

At the onset of the tax reform debate, NMHC/NAA laid out a number of key tax reform principles aimed at preserving and promoting the multifamily business model. The industry's primary goal was to promote tax reform that fosters economic growth and investment in rental housing without unfairly burdening apartment owners and renters relative to other asset classes. To this end, NMHC/NAA successfully advocated for the multifamily industry's key principles, which included:

- Protecting Pass-Through Entities from Higher Taxes or Compliance Burdens;
- Retaining the Full Deductibility of Business Interest;
- Preserving the Ability to Conduct Like-Kind Exchanges;
- Ensuring Depreciation Rules Avoid Harming Multifamily Real Estate;
- Maintaining the Current Law Tax Treatment of Carried Interest;
- Preserving and Strengthen the Low-Income Housing Tax Credit; and
- Maintaining the Current Law Estate Tax.

Although every piece of complex legislation includes positive and negative provisions, NMHC/NAA believe the *Tax Cuts and Jobs Act* largely reflects the industry's priorities and keeps intact the critical elements of the multifamily business model. Apartment owners and investors should benefit from tax relief brought on by rate reductions and the deduction for business income while being able to fully deduct business interest and conduct like-kind exchanges. While owners will, in some cases, have to depreciate buildings over 30 years and have to hold assets for three years to be able to treat carried interest as a capital gain, the industry worked tirelessly to see that these provisions were as least harmful as possible. On the affordable housing front, the Act maintains the LIHTC and private activity bonds, which should help drive new construction of affordable units. Finally, the Act doubles the estate tax exclusion and maintains stepped-up basis.

The industry will now turn its focus to ensuring that regulations implementing these measures work as Congress intended. We will also focus on making permanent those proposals that would benefit the industry, but are set to expire in 2025 under this Act.

HOW CRE INVESTORS COULD CASH IN ON THE TAX BILL

Many of the provisions passed will have a positive impact on investors by putting more money back into their pockets in terms of tax savings.

Beth Mattson-Teig | Dec 27, 2017

President Trump signed the new Tax Cuts and Jobs Bill on Dec. 22, effectively putting the final seal of approval on the most substantive tax law changes that the country has seen in 30 years.

It may take some time to crunch the numbers to determine just how much tax savings the new tax bill could generate for commercial real estate investors. The general view is that provisions specific to property owners and developers will deliver a net positive result—although not nearly the windfall that corporations will see with a drop in the tax rate from 35 percent to 21 percent.

Looking at the impacts all the way through the tax chain related to individuals, corporations and real estate, it is by far the most significant tax bill since the Tax Reform Act of 1986, notes Timothy Trifilo, a partner and national real estate tax leader at professional services firm CohnReznick.

Many of the provisions passed will have a positive impact on investors by putting more money back into their pockets in terms of tax savings, adds Michael Episcope, co-founder and principal at Origin Investments, a real estate investment firm that acquires primarily office and multifamily properties. Some of the changes to the tax treatment of capital expenditures, for example, will shield a tremendous amount of income for property owners that are making capital investments and improvements in properties, he says.

The industry is also looking at the potential ripple effects the new tax bill could create. On the positive side, many hope that the tax cuts will fuel economic and job growth that will drive demand for commercial real estate. “This stimulus package certainly could extend this cycle for another three, four or five years,” says Episcope. The promised “tax holiday” for offshore funds could provide an incentive to repatriate some of the estimated $2.5 to $3.0 trillion that is held outside the U.S., he notes. “If that finds its way back into the economy, that could very well spur demand in a lot of different areas,” he says.

On the negative side, it is worrisome that this tax bill could add nearly $1.5 trillion to the deficit over the long term. Another potential downside is if the tax bill contributes to higher inflation and a rise in interest rates, which would make borrowing more expensive for real estate investors.

Pass-through income

Potentially, one of the biggest “wins” in the tax bill for real estate will be changes to the way pass-through income is taxed. The change would mainly apply to individuals and family trusts investing in real estate through partnership entities, such as LLPs and private equity funds, as well as individuals who receive income from REIT dividends.

Owners of pass-through entities may be eligible to claim a 20 percent deduction for business-related income. For example, if an LLP owns an office building that provides $200,000 in annual income to its investor partners, those individual investors could avoid paying taxes on $40,000 of that income if they are eligible for the full 20 percent deduction.

The intent behind that deduction was to encourage corporations to create jobs. However, it also applies to invested capital, which opens the door for real estate

investors to benefit from that deduction, according to Jeff Bilsky, technical practice leader in the national tax office partnership group of accounting firm BDO.

1031 Exchanges

The tax bill preserves the 1031 tax-deferred exchange rules that allow investors to defer capital gains on the sale of a property by reinvesting proceeds into another qualifying "like-kind" property. One key change in the new tax bill is that the 1031 exchange can only be used to defer capital gains on the value of real estate property and excludes any value on personal property.

That exclusion will have a negative tax impact on real estate assets that also contain a high amount of personal property, such as restaurants that have significant value tied up in the furniture, fixtures and equipment. "Where as in the past we were able to exchange the full amount, there may now be some tax leakage," says Bilsky.

Carried-Interest

Carried interest tax law has been under fire for more than a decade. Some view current carried interest tax laws as a loophole for hedge fund managers, allowing them to be taxed at lower capital gains rates rather than ordinary income rates. What ultimately passed as part of the new tax framework was a moderate provision that changes the hold period to qualify for the capital gains rate from one year to at least three years.

The focus on carried interest has been of particular importance for private equity general partners and sponsors who received a bigger share of returns as "waterfalls" or incentive pay for exceeding performance targets. In the real

estate context, the change doesn't make much difference to investors who have a long-term hold strategy. However, there are a lot of transactions in the private equity world where appreciation is generated very quickly and assets may be sold before a three-year hold period has ended. The change could also affect real estate investors who operate on a fix-and-flip strategy.

Tax Credits

Another important aspect of the bill is that it maintains the status quo for low income housing tax credits, as well as historic preservation and rehabilitation credits. "That is a positive for those segments of the real estate industry, and I would say that also is important from a socio-economic perspective, because a significant portion of the low-income housing development world is really tax-motivated," says Trifilo. **Change in Depreciation Schedules**

The time that property owners can depreciate a property has been reduced from 27.5 years to 25 years for residential rental properties and from 39 to 25 years for commercial properties.

Asset Depreciation

Businesses will be able to immediately expense the purchase of an asset. On the one hand, the quick cost recovery is a positive, because an investor is deducting an expense rather than recognizing taxable income, notes Bilsky. However, it could be a potential negative for REITs that are making distributions based on taxable income. REITs need to be able to manage their cash flow and a spike created by a 100 percent deduction in year one versus zero the next year could create some pressure from a cash management perspective, he adds.

Some uncertainty lingers

It remains to be seen whether changes to tax treatment could influence how real estate ownership entities are structured going forward. The corporate tax rate will drop significantly from 35 percent to 21 percent. In comparison, an investor that qualifies for the full deduction on income from a pass-through entity will effectively see the tax rate drop from 39.6 percent to 29.6 percent. That raises two questions. One: should taxpayers consider forming a corporation rather than a partnership entity? And two: do the new tax rates make it more desirable to convert from a corporation to a partnership or vice versa, notes Bilsky.

The answers depend on more than just the tax rate. Ownership entities also need to consider other factors, such as how their cash flow is treated. Is it distributed as income to investors, or is the cash flow reinvested into assets until the time of a sale? For those entities that are frequently pulling out cash, pass-through entities, such as LLPs, may not be the most efficient structure. There are also some limitations that may make it difficult for investors to get down to the lowest 29.6 percent pass-through tax rate, adds Bilsky.

To some extent, it may be too soon to tell how some of the different rules will play out. “There are a number of provisions where, realistically, we are going to need some more clarity,” Bilsky says. Added to that, most of the provisions do have a “sunset,” meaning they are not permanent and would either expire in 10 years or need to be extended by Congress. The fact that there is an end-date in sight also ensures that a shift in power in Congress in the next election is not likely to spark a battle to roll-back the new tax laws in a few short years, Bilsky adds.

Lakeshore Apartment Association

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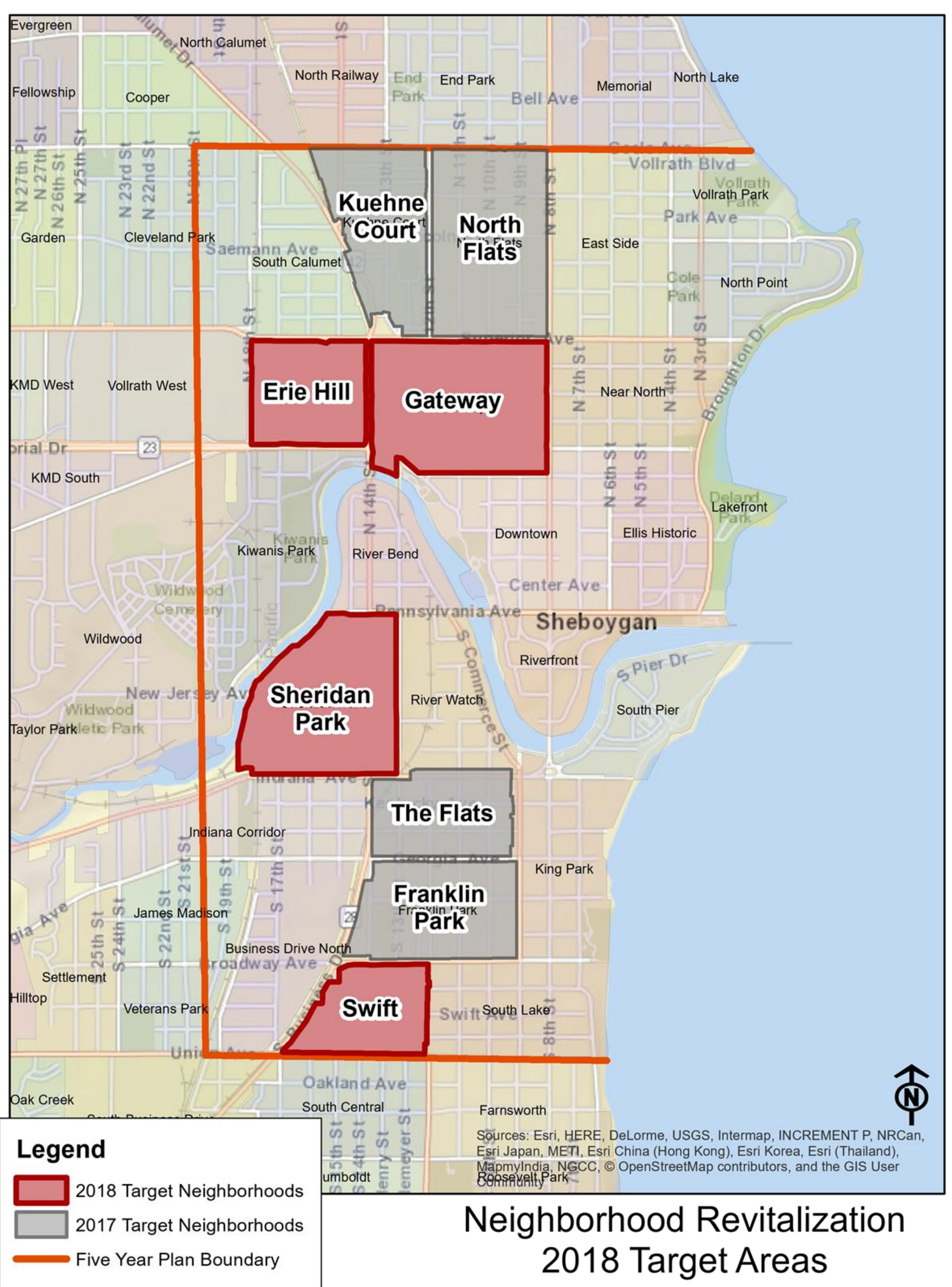
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