ANDERS REAL ESTATE AND CONSTRUCTION SERVICES

REAL ESTATE INVESTMENT ROAD MAP

Real estate is one of the biggest investments a taxpayer can make. Whether you're a seasoned veteran or it's your first endeavor, having a detailed road map available to help guide you through the purchase, management, and tax ramifications of a real estate investment can significantly increase your odds of success.

STEP 1: PERFORM DUE DILIGENCE

I've found a property I like, what's next?

When you have narrowed down your choices, you should perform background research on the properties, also known as due diligence. This increases your chances of detecting any potential risks and threats to the value of the real estate investment.

- **Title Review:** Examine whether the current seller actually has title to the property. Also, look for any pending litigation or financial obligations attached to the property such as a mortgage or tax lien.
- **Inspection:** Hire a licensed, professional inspector to inspect the property. A professional can review the structural integrity of the property and point out any potential problems.
- **Appraisal:** Have the property appraised by a third-party. If obtaining a loan, the bank will generally insist on an appraisal. Even if paying cash, it's a good idea. The appraisal will tell if the property is worth the amount of money you are about to spend. If the property reveals an environmental hazard, consider ordering an environmental assessment of the entire property.
- **Zoning:** Verify the property is zoned for the purposes you want to use the property. Generally, properties are zoned as either residential or commercial. If the property is not currently zoned in your favor, contact the local zoning authority to see if you have a reasonable chance of having the property rezoned.

STEP 2: DETERMINE OWNERSHIP

How should I own my real estate?

There are several options on how your real estate can be held.

- **Personally:** This is the most common, but also the most risky. You have full personal liability, which means your personal assets are at risk in the case of a lawsuit or accident.
- **LLC/LLP:** By owning your real estate in a limited liability company or partnership, you limit your liability to the assets in the company, and keep your personal assets secured.
- **IRA:** Generally you can hold real estate in your IRA as a method of financing, however this aggressive approach should be discussed with your investment advisor and CPA.

STEP 3: ACHIEVE TAX SAVINGS

What can I do now to achieve tax savings?

Now that you have acquired your real estate investment, explore some options that could present current or future tax savings to you.

- **Cost Segregation Study:** This process identifies and reclassifies personal property assets within the building that are non-structural elements to be depreciated over a shorter tax life than the building. Reducing tax lives accelerates depreciation deductions, resulting in a reduced tax liability.
- **Understand Repair Vs. Capital Regulations:** Having a solid understanding of the rules for what is considered a business expense and what must be treated as a capital expenditure gives you the advantage in making smart spending decisions on your investment.
- **Energy Tax Credits, Rebates, & Savings:** Government agencies, utilities and others offer a variety of tax credits, rebates, and other incentives to support energy efficiency improvements.
- **Historic Tax Credits:** Generous tax credits are offered at both the federal and state level. These incentives usually have an application process and strict compliance rules. A qualified CPA firm should also be involved throughout this process, most importantly before any work begins on the property.

STEP 4: MANAGE YOUR INVESTMENT

How do I manage my investment?

You can self manage your real estate investment property or hire a property management company. The ideal goal is to calculate your budget as if you were going to use a property management company so that when you grow you can afford one.

- **Maintain Records:** It's easy to get behind on paperwork. Keep your accounting current and carefully document and examine your spending, income, and other aspects of your business on a regular basis.
- **Insurance:** Work with a reputable company that understands and fits your needs, they will connect you with the right policy to best protect you and your investment in case of a financial loss in the future.
- **Maintenance:** Things are going to happen and repairs will be needed. If you don't plan ahead for expensive repairs and maintenance, you could be in trouble. It's important to hire the right person for the job. Paying a professional to do the job correctly at a premium can save you money by not fixing mistakes down the road.
- **Documentation:** As your investment grows, you can become a potential target for lawsuits. Your chances of winning a lawsuit generally improve when you are the more organized party. Document everything you can, especially any issues that arise, this way you will be prepared in the event of a lawsuit.

STEP 5: DETERMINE PASSIVE VS. ACTIVE CLASSIFICATION

Determining your level of involvement is key to the tax treatment of the income/losses that the real estate generates. Real estate by definition is a passive investment, but depending on your level of participation, you may be able to treat the rental as active for tax purposes. This may result in the ability to deduct losses the activity generates, or avoid the net investment income tax if the activity generates income. The scope of the passive/active requirements is extensive, but is something you should discuss with your tax advisor in detail.

To learn more about our services or arrange meeting with our team, please contact:

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