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Don Greenhalgh - New England commercial real estate market stabilizing, but tax issues raise questions

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The commercial real estate industry in New England appears to be finding its footing.

Valuations are firming up and first-class office space is even beginning to increase in value. Previously, valuations were so uncertain, lenders were reluctant to lend, because they feared that the value of the property could slip below the amount they were lending.

Remove uncertainty and business gets done. With stable valuations, lenders are returning calls and even signing deals. A full spectrum of financing deals are taking place, ranging from foreclosure transactions to clean refinancing of debt, with extensions and new terms.

New construction remains all but non-existent, but property owners are beginning to enhance the value of their portfolios by making improvements. In the New England market, some enterprising firms are exploring special niches, as well as opportunities for mergers and acquisitions.

Fewer property owners than anticipated are receiving debt forgiveness, but lenders are now taking a realistic view of the market and the number of debt forgiveness cases is likely to increase over the next six to 18 months.

Mortgage-backed securities, which have been at the heart of the financial crisis, are increasingly being cleaned up and sold off in public markets, which will result in some funds being recovered by bond holders.

We're still not seeing dynamic growth, and don't expect to for several years, but progress is taking place. This recent activity contrasts with the past two years, during which communication between lenders and commercial property owners was virtually one way, with property owners making all of the contact.

Keep Taxes in Mind

With valuations stabilizing, the impact of taxes may be the greatest uncertainty facing the industry.

Those who have succeeded in negotiating debt forgiveness still have to worry about paying their taxes, since debt forgiveness and property foreclosures are considered to be taxable events. Banks may be willing to forgive debts when circumstances warrant it, but the Internal Revenue Service is not.

Property owners that are negotiating concessions from their lenders should seek advice from their tax advisors as there may be options to defer the income.

The impact that paying taxes on debt forgiveness will have on already fragile businesses remains unclear, but a bigger concern is the overall tax environment of the next few years.

Given that the United States is moving past its $14.3 trillion debt ceiling, it's likely that new taxes will be passed to offset debt. But even if there were no new taxes, property owners would be affected by tax provisions that are scheduled to expire at the end of 2011 and 2012.

The economy is still struggling and few jobs are being created, but there has been no talk about extending tax relief and there has been plenty of talk about new taxes to help control the budget deficit.

One tax benefit scheduled to expire is 100% write-off for bonus depreciation during the first year. While it does not apply to commercial buildings or other assets that ordinarily are depreciated over more than 20 years, it does apply to leasehold improvements, such as interior upgrades and redesigns, and landscaping.

In addition, an exclusion from the alternative minimum tax (AMT) for qualified stock is scheduled to expire at the end of 2011. Currently, property owners and others can exclude up to $10 million in capital gains from qualified stock. Many taxpayers who qualify are subject the AMT, but qualified stock issued before the end of this year is exempt from the AMT.

Various other tax cuts scheduled to expire last year, but extended by Congress, are now scheduled to expire at the end of 2012, including the current 15% capital gains rate and the 15% rate for dividends.

Property owners should talk to their tax advisors about taking advantage of these provisions before they expire and about what to do to prepare for when they do expire.

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