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Leveraging real estate offers value in booming commercial real estate market

May 28, 2015 - Spotlights

New England's commercial real estate market in is enjoying a great 2015 so far. Property values are at extremely high levels, and the growth of cities like Boston and the surrounding areas means that investors are reaping the benefits of owning property in the region.

This boom has also led to many investors selling out of their investments to take advantage of these property value increases. While selling out can be a wise decision from a strategy perspective, there is another alternative that can be just as valuable: leveraging up a property.

Why Leverage Up a Real Estate Investment?

There are a few common reasons that investors decide to leverage up their property investment instead of selling it. First and foremost, it allows the investor to hold onto the asset. In a market where property values are going up, selling too early can cause you to miss out on some serious profits later on down the line. However, when you do leverage up a real estate asset, it allows you to get cash out of your asset as if you had sold it, which gives you the best of both worlds.

Additionally, the lending market is very competitive right now. Interest rates can be as low as 3.5 to 4.5% with terms as long as ten years. Many lenders are offering no prepayment penalties and no recourse guarantees, which greatly minimize the risk that property investors face when leveraging up their loan.

Generally speaking, there is no tax due on leveraging up an asset, which is another significant reason that many investors decide to go this route instead of selling off their property.

However, if you are thinking about leveraging up a real estate property there are a few things that you should sort out with your advisors before you move forward and increase the mortgage on the property.

Things to Consider Before Leveraging Up An Asset

* Tracing interest. The IRS requires investors to trace interest by keeping track of what you do with the cash differential that you got from financing a property. For example, if you own a property and refinance your original loan, you will need to trace where the cash is spent to determine its deductibility.

* Debt Financed Distributions. Many investors own their real estate through partnerships or S-corporations. These pass-through entities have similar interest tracing interest rules as discussed above, but take it a step further. If the entity refinances its loan and then distributes the excess cash, the entity is required to provide certain information to the partners, including the amount of interest expense on the distributed cash, so the partners can determine how to deduct that portion of the interest. These rules are essentially requiring the individuals to trace the cash as well as the entity. There are ways to plan around these rules. Work with your advisor to help you limit your exposure to

the interest tracing and debt financed distribution rules.

* Is it the right time? Are you planning on keeping the property for a while, or selling it in the short-term? It's usually best to leverage up if you plan on keeping the property for a while, but there are always exceptions.

* Comparable interest rates. What kind of rate could you get on a loan to leverage up your property? Is it higher than your existing interest rate? Also consider fees and other money that you may owe for refinancing the loan early. These prepayment penalties are usually deductible, but they are still cash out of your pocket as an investor.

* Loan covenants. You have to consider whether or not there will be any loan covenant in place on the new or old loans. One common covenant is the debt-service coverage ratio, which compares your income to the amount of debt and interest that you have to pay off. Be sure to check with current and potential lenders to find out about covenants that might impact your refinancing.

When executed properly, leveraging up your assets is a great way to improve your cash flow while minimizing taxes and holding on to the valuable real estate in your portfolio.

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