

## Real Estate Funds Five keys to success... and how we can help



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# The backdrop — A changing and challenging environment

In today's environment, existing and newly formed real estate funds face many challenges. The tumultuous economy has made it difficult for existing funds to continue to perform at the superior risk-adjusted returns that investors have come to expect. On the other hand, while certain new funds find it more difficult to raise new capital needed to get their products off the ground, funds dedicated to investing in distressed real estate assets and debt securities are focused on taking advantage of a robust pipeline of opportunities in today's domestic and international real estate markets. Both existing and new funds understand the potential for attractive returns that can be achieved by taking advantage of the current valuations present in today's market. Thus, today's capital environment presents fund principals with great challenges and opportunities.

We are here to help.

This booklet sets forth five keys to success and how Deloitte can support our private equity real estate fund clients in pursuit of their goals.

## Success — The five keys

Based on our experience working with clients and our involvement in the industry, we believe the following five categories of focus lead to success:

- Attracting capital
- Sourcing and qualifying investment opportunities
- Fund and investment structuring
- Operational excellence and investor reporting
- Exit strategies

As used in this document, "Deloitte" means Deloitte LLP and its subsidiaries. Please see [www.deloitte.com/us/about](http://www.deloitte.com/us/about) for a detailed description of the legal structure of Deloitte LLP and its subsidiaries.

# Success — The five keys

## Attracting capital

- Build and sustain an exceptional investment yield track record to obtain access to qualified investors.
- Build and maintain an eminent and well-regarded team of advisors, including accountants, bankers, lawyers, and other specialists.
- Draft an effective fund offering memorandum with relevant fund investment strategy and objectives, sponsor information, financial projections, tax structure and information relevant to potential investors.
- Establish, promote, and protect a brand that exudes quality, skill, and integrity.

## Sourcing and qualifying investment opportunities

- Do the right things to make people want to do business with you: Demonstrate that you understand the important issues, conduct due diligence effectively and efficiently, and have credibility to close and close quickly if necessary.
- Build a network of domestic and international joint venture partners who are trustworthy and skillful.
- Navigate the current challenges in the purchase of distressed real estate assets and notes to maximize returns.

## Fund and investment structuring

- Structure investments that are suitable, attractive, and efficient for domestic individuals, tax-exempt institutions, and a variety of foreign investor profiles.
- Establish best practice fee and promote structures that align your interests with those of your investors and joint venture partners.
- Determine the right degree of leverage, interest rate risk, and foreign currency exposure on investments and for the fund overall.
- Structure investments to manage federal, state, and foreign income and transfer tax costs, thereby providing favorable after-tax yield to investors and you.

## Operational excellence and investor reporting

- Closely oversee results to ensure properties are being developed and operated efficiently and effectively.
- Implement information technology, processes, internal controls and management reporting to protect investor capital, enhance sponsor credibility and drive operational excellence.
- Restructure maturing debt in an efficient manner.
- Build and retain a skilled team at the advisor level.
- Understand legislative developments and comply with financial and tax regulatory matters in a timely fashion.
- Provide investors with timely financial reports, tax reports and performance information with management insights that address investor needs and expectations.

## Exit strategies

- Effectively liquidate assets and recycle capital.
- Consider Initial Public Offering (IPO) or Real Estate Investment Trust (REIT) strategies.
- Consider recapitalization strategies.



# Attracting capital

- Build and sustain an exceptional investment yield track record to obtain access to qualified investors.
- Build and maintain an eminent and well-regarded team of advisors, including accountants, bankers, lawyers, and other specialists.
- Draft an effective fund offering memorandum with relevant fund investment strategy and objectives, sponsor information, financial projections, tax structure and information relevant to potential investors.
- Establish, promote, and protect a brand that exudes quality, skill and integrity.

## Deloitte's role in supporting and enhancing your success

### Attracting capital

- Deloitte has long been recognized as an organization of quality and integrity.
- Deloitte has credentials for serving domestic and global real estate funds, with a dedicated team of professionals both in the United States and around the globe. For more information, see Appendix 1.
- Deloitte can work with fund managers to address tax and other financial complexities that may be of concern to potential domestic and foreign investors.
- Deloitte can help you aggregate prior investment performance return data for presentation in a manner consistent with Global Investment Performance Standards (GIPS).



# Sourcing and qualifying investment opportunities

- Do the right things to make people want to do business with you: Demonstrate that you understand the important issues, conduct due diligence effectively and efficiently, and have credibility to close and close quickly if necessary.
- Build a network of domestic and international joint venture partners who are trustworthy and skillful.
- Navigate the current challenges in the purchase of distressed real estate assets and notes to maximize returns.

## Deloitte's role in supporting and enhancing your success

### Sourcing and qualifying investment opportunities

- Deloitte can quickly mobilize experienced engagement teams with global capabilities and best-in-class credentials to assist you with due diligence activities, including tax, accounting and lease diligence. We assess critical issues and opportunities and identify any “deal breakers” early in the process. For more information, see Appendix 2.
- Deloitte can help you vet potential investment opportunities through highest and best use studies, market studies, and lease abstractions. For more information, see Appendix 2.
- We can provide cost segregation, lease advisory, and valuation services. For more information, see Appendix 2.
- Our global team can assist you in gaining an understanding of foreign markets, meeting with local professionals, and understanding business practices. Deloitte can assist in assessing investment opportunities and/or joint venture partners. For more information on the locations of our foreign teams, see Appendix 1.



# Fund and investment structuring

- Structure investments that are suitable, attractive, and efficient for domestic individuals, tax-exempt institutions, and a variety of foreign investor profiles.
- Establish best practice fee and promote structures that align your interests with those of your investors and joint venture partners.
- Determine the right degree of leverage, interest rate risk, and foreign currency exposure on investments and for the fund overall.
- Structure investments to manage federal, state, and foreign income and transfer tax costs, thereby providing favorable after-tax yield to investors and you.

## Deloitte's role in supporting and enhancing your success

### Fund and investment structuring

- Working closely with your legal counsel, Deloitte can help you develop an effective fund structure suitable for taxable and nontaxable domestic and foreign investors. For more information, see Appendix 3.
- We can assist you in determining and implementing leading practices in fund governance.
- Our services include working under the fund sponsor's supervision to build a model, which may include:
  - Integrated financial and tax functionality
  - A cash waterfall model that calculates and tracks distributions for each of the different classes of investors and for the fund sponsor
  - Analysis of specific acquisitions, dispositions, financing, and refinancing on cash flow and internal rate of return calculations
  - Sensitivity analysis functionality
- As you source investment opportunities, Deloitte and its affiliates stand ready to assist you in developing investment structures beneath the fund to pursue a tax-efficient structure and favorable yield and cash flow, all while addressing financial reporting objectives. Specific tax planning considerations include:
  - Structuring to enhance after-tax returns for nonprofit and foreign investors, international tax and state tax planning, and unique issues related to complexities in acquiring properties in REIT structures. For more information, see Appendix 3.
  - Evaluation of allocations to assess and track carried interest, monitor potential legislation on taxability of carried interest, and confirm tax efficient structuring.
  - Evaluation of target allocation schemes to make sure that allocations comply with the "economic effect equivalence" or "partners interest in the partnership" rules prescribed in the regulations under IRC Section 704(b).

Specific financial statement reporting issues include:

- Investment company reporting and supplemental financial reporting
  - Consolidation or off-balance sheet presentation of real estate investments
  - Fair value reporting
  - Accounting for preferred return on carried interest
  - Business combinations-ASC 820 (formerly SFAS 157) and ASC 805 (formerly SFAS 141R)
- We can help you assess the impact of International Financial Reporting Standards (IFRS). For more detail, please see Appendix 4.



# Operational excellence and investor reporting

- Closely oversee results to ensure properties are being developed and operated efficiently and effectively.
- Implement information technology, processes, internal controls and management reporting to protect investor capital, enhance sponsor credibility and drive operational excellence.
- Restructure maturing debt in an efficient manner.
- Build and retain a skilled team at the advisor level.
- Understand legislative developments and comply with financial and tax regulatory matters in a timely fashion.
- Provide investors with timely financial reports, tax reports and performance information with management insights that address investor needs and expectations.



## Deloitte's role in supporting and enhancing your success

### Operational excellence and investor reporting

- Deloitte & Touche LLP (“Deloitte & Touche”), Deloitte Tax LLP (“Deloitte Tax”) and the Deloitte Touche Tohmatsu Limited (“DTTL”) member firms team will work with your personnel to help you manage financial reports and tax reporting information in a timely fashion, both locally and globally.
- Our global teams will meet with you to share knowledge regarding developments in international, domestic, and local tax and accounting issues to help you evaluate the impact on your business operations and ensure compliance with new rules.
- We can help you evaluate internal controls with respect to your investor reporting and operations.
- Our Lease Advisory Services practice provides assistance to assess whether the proper rent and expense escalations are being charged to the lessee under the lease provisions. For more information, see Appendix 4.
- Deloitte Financial Advisory Services LLP (“Deloitte FAS”) professionals can help you determine the allocation of tangible assets associated with the purchase price to determine tax and financial statement depreciation deductions, and assist with the implementation of leading industry fixed asset management practices. For more information, see Appendix 4.
- Deloitte FAS valuation professionals can assist in valuing your investments, provide insight regarding your valuation process, and provide valuation support as part of your financial statement preparation and audit process.
- Deloitte FAS professionals provide specialized resources to assist clients with the delivery of capital construction projects including green building developments. For more information, see Appendix 4.
- Deloitte Tax transfer pricing specialists can assist you with your determination of related party fees, interest expense, and other charges to manage tax efficiency and to comply with local tax laws. For more information, see Appendix 4.

- For the sponsors and its executives, Deloitte Tax can provide tax planning and compliance assistance.
- Deloitte Tax can provide expatriate tax services for your executives.
- Deloitte Tax — working in consultation with our human capital professionals at Deloitte Consulting LLP (“Deloitte Consulting”) — can help you design a variety of equity compensation packages, including partnership profit interests, to bolster retention efforts for specific employees and principals.
- The Deloitte & Touche finance transformation team can assist with streamlining your finance and control functions. For more information, see Appendix 4.
- Deloitte & Touche can assist you in the evaluation, preparation and implementation of IFRS. For more information, see Appendix 4.
- Deloitte can implement proprietary investor and debt instrument reporting technology designed to streamline processes and reduce costs. For more information, see Appendix 4.
- Deloitte can assist you with restructuring maturing and distressed debt in an efficient manner. For more information, see Appendix 4.

# Exit strategies

- Effectively liquidate assets and recycle capital.
- Consider IPO or REIT strategies.
- Consider recapitalization strategies.

## Deloitte's role in supporting and enhancing your success

### Exit strategies

- For recycled investments, like-kind asset exchanges may be efficient. We have world class credentials dedicated to complex exchange situations. For more information, see Appendix 5.
- Sale/Lease back analysis
- Fairness opinions
- Understanding and modeling partnership allocations, capital account maintenance, carried interest calculations, and overall yield which may influence strategies with regard to redeploying capital or liquidating the fund.
- Debt restructuring. For more information, see Appendix 5.
- Initial public offering readiness services. For more information, see Appendix 5.
- Use of joint venture strategy to recapitalize portfolio. For more information see Appendix 5.



### Deferring gain under §1031

Section 1031 provides that a taxpayer shall defer gain or loss from an exchange of like-kind property held either for productive use in a trade or business or for investment that occurs within a specified time frame.

Like-kind exchanges under section 1031 offer an effective ways to defer taxes on dispositions of real estate and many other assets. The requirements associated with these transactions are technical, complex, and form driven. We can help structure and implement individual transactions or an ongoing exchange program, including performing a high-level review of the business plan for proposed asset acquisitions and dispositions — then help you align the transactions with the rules governing like-kind exchanges to comply with section 1031 and defer taxable gain. For more information, see Appendix 5

# Appendix 1:

## Attracting capital: A closer look

### Global and U.S. Real Estate practice at a glance

Through knowledge and experience with business and financial matters specific to real estate investments, Deloitte can offer valuable insights and help you respond to trends, manage issues, and pursue potential opportunities.

We also have an understanding of the challenges, risks, and opportunities involved in structuring and managing real estate investment funds, across the broad spectrum of accounting and tax and business issues. Through our knowledge of the current environment and in-depth technical experience, we serve our clients effectively as a strategic advisor and as a highly knowledgeable technical resource for tax, accounting, compliance risk, and regulatory and legislative issues.

### DTTL member firms' Real Estate practice

- Operates in over 40 countries
- Encompasses a network of firms with thousands of partners and professionals

### U.S. Real Estate practice

- Comprises more than 1650 partners, principals and directors, senior managers and managers
- Practitioners provide audit, tax, financial advisory, consulting, and mergers and acquisition services
- Consists of five sectors: Capital Markets, Owners/Operators (including REITs), Engineering and Construction, Hotel and Resort Owners, and Homebuilding.
- Our largest real estate practice offices include Atlanta, Boston, Chicago, Dallas, Denver, Houston, Los Angeles, Miami, New York, San Francisco, and Washington, DC

### The value of our industry involvement

Many of our real estate professionals have worked in the real estate industry or held government positions, and our real estate specialists actively participate in industry organizations. Our practice and our practitioners have been recognized for contributions to the real estate investment industry and our ongoing commitment to innovative thought leadership and creative thinking.

Our real estate professionals have been actively involved in the organizations both here in the US as well as around the world developing standards for enhanced investor and financial reporting. In the US, Deloitte professionals have been in leadership roles on the Real Estate Information Standards Council, NCREIF accounting and financial performance committees and PREA. In Europe and Asia, DTT member firm professionals have worked closely with INREV and AREV on investor reporting and performance measurement standard setting efforts.

In addition, to help our clients keep ahead of industry and regulatory trends, we regularly develop publications and involve our clients when we participate or sponsor forums and symposiums, including:

- European Tax Bulletin for Real Estate Funds and Investors
- Commercial Real Estate Outlook: Top Ten Issues in 2011
- A Changing Landscape for Leases and Investment Property — Accounting by Lessors
- Can Healthcare Rescue Real Estate?
- Navigating the Credit Crisis: What Borrowers and Lenders Should Know and Do
- The Changing Environment of R&R (REITs and Renewables)
- BNA REIT Portfolio 742-2nd T.M. Real Estate Investment Trusts

Deloitte's Real Estate Services hosts many events throughout the year, including industry updates in various markets around the country, as well as executive forums focused on specific trends in the industry.

Our Real Estate Dbriefs Webcast series and Deloitte Insights podcast programs provide innovative and practical industry research and much more information about the issues facing real estate investors from experienced industry resources.

## A Closer Look at Dbriefs

Dbriefs features topical series that are:

- Informative, with a variety of timely, relevant business topics aimed at an executive-level audience
- Interactive, with immediate and measurable feedback through polls and surveys, including real-time benchmarking with peers
- Convenient, one to two-hour live webcasts
- Flexible, offering archived Webcasts available anytime, from anywhere, for 180 days after the live presentation
- Educational, with Continuing Professional Education (CPE) credit available toward career development for most live Webcasts

Examples of Recent Debrief Topics:

- *A New Wave Of Accounting Changes for Real Estate Companies*
- *Tax Legislation and its Impact on Real Estate: An Overview and Planning Discussion*
- *Real Estate Technology: Catch the Next Wave of Innovation*
- *Globalization of Real Estate: Matching Capital and Opportunities*
- *FASB S167: Too Big for Real Estate Companies to Ignore*

How to join Dbriefs:

- Visit [www.deloitte.com/us/dbriefs](http://www.deloitte.com/us/dbriefs)
- Click on “Join Dbriefs” in the right-hand column

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## The DTTL member firm's global real estate private equity funds network



### Specialist knowledge, locally and globally

The member firms of DTTL serve our clients through a broad range of specialists in functional areas with extensive industry knowledge and experience. Our real estate team works across multiple disciplines and across the globe to bring our clients valuable insights and recommendations for addressing the challenges and opportunities of real estate investment.

To learn more about our real estate practice, please visit us online at [www.deloitte.com/us/RealEstate](http://www.deloitte.com/us/RealEstate).

- Abu Dhabi
- Argentina
- Australia
- Austria
- Belgium
- Brazil
- Canada
- Hungary
- Iceland
- India
- Israel
- Italy
- Japan
- Korea
- Poland
- Portugal
- Romania
- Russia
- Saudi Arabia
- Singapore
- Slovakia

- Cayman Islands
- China
- Chile
- Czech Republic
- Denmark
- Dubai
- Finland
- France
- Germany
- Greece

- Liechtenstein
- Luxembourg
- Malaysia
- Malta
- Mauritius
- Mexico
- Netherlands
- New Zealand
- Norway
- Paraguay
- Peru

- South Africa
- Spain
- Sweden
- Switzerland
- Thailand
- Turkey
- Ukraine
- United Arab Emirates
- United Kingdom
- Venezuela

# Appendix 2:

## Sourcing and qualifying investment opportunities: A closer look

### Merger & Acquisition Services

In the current environment, transactional due diligence and structuring is as important as ever. With more than 30 years of experience and commitment to M&A, we have added value to investments by helping clients:

- Advise on alternative deal structures that enhance long-term returns
- Identify unique tax and accounting issues associated with cross-border transactions
- Identify “deal breakers” early in the process, before significant resources are expended
- Quantify the amounts, timing and uncertainties around expected future cash flows
- Identify ways to effectively reduce the purchase price
- Develop strategies to help improve operating results and after-tax cash flows
- Assess contract provisions with financial or tax consequences, including purchase price adjustment mechanisms
- Integrate the newly acquired operation, including business strategy, risk management, business process integration, human capital and technology implementation
- Plan for Day One readiness and develop effective strategies for firm-wide synergy capture

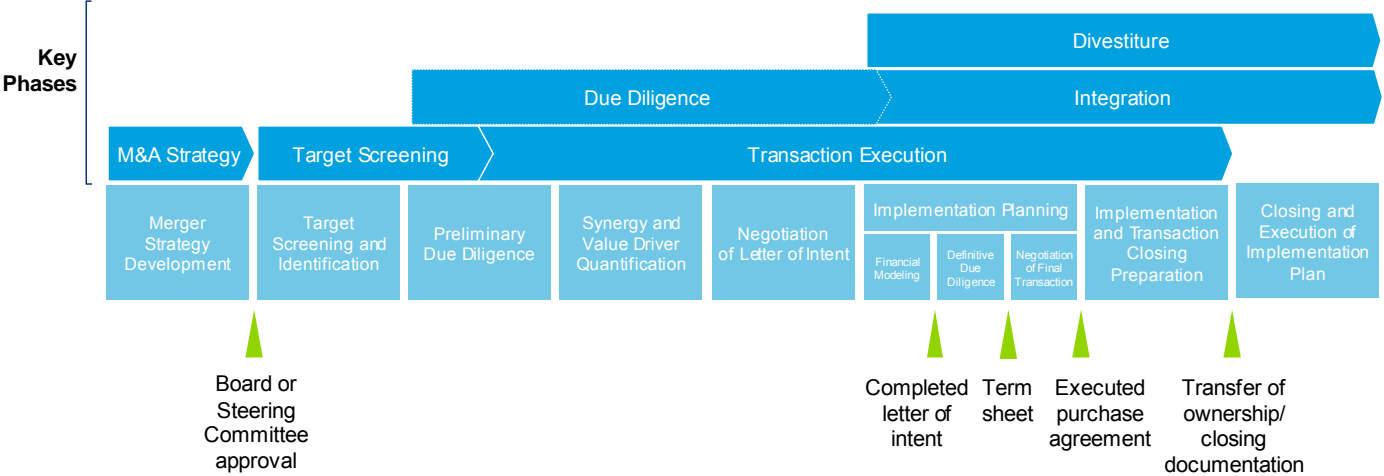
### Distressed Real Estate Advisory Services

Our Distressed Real Estate Advisory Services include:

- Evaluation of real estate assets for acquisition or disposition
- Loan workouts, restructuring, bankruptcy and litigation support
- Evaluating debt capital provided by lenders to the real estate investment community
- Developing your tax strategies for entering, managing, and exiting distressed real estate debt positions
- Analyzing workout activities, including potential for gain/loss arising from debt modification, cancellation of debt or foreclosure
- Analyzing assets (for sale or purchase) for possible impairment

# The M&A life cycle

A multidisciplinary, integrated approach delivered globally across the entire life cycle.



**Deloitte specialists are “on the ground” with you**

- |   |  |   |  |
|---|--|---|--|
| <ul style="list-style-type: none"> <li>• M&amp;A Strategy</li> <li>• Industry</li> <li>• Sales &amp; Marketing</li> </ul> | <ul style="list-style-type: none"> <li>• Accounting/Tax and Valuation</li> <li>• SOX/Governance</li> </ul> | <ul style="list-style-type: none"> <li>• Operations</li> <li>• Finance</li> <li>• Facilities</li> </ul> | <ul style="list-style-type: none"> <li>• HR/ Employee Benefits</li> <li>• IT</li> <li>• Integration</li> </ul> |
|---|--|---|--|

## **Valuation, lease advisory, project/market analysis, and depreciation advisory services to support your investment decisions**

The Deloitte FAS U.S. practice comprises more than 350 full-time appraisers, financial analysts, accountants, economists, statisticians, and industry specialists. Many of our consultants have earned professional designations, including Accredited Senior Appraiser (ASA), Member of the Appraisal Institute (MAI), Chartered Financial Analyst (CFA), Certified Public Accountant (CPA), Professional Engineer (PE), and Counselor of Real Estate (CRE). Our people possess deep functional valuation capabilities, as well as strong personal qualities, including a commitment to responsive service, effective communication and project management skills, enthusiasm, and an ability to think strategically on behalf of our clients.

### **Real estate financial advisory services**

Property is required to support most business enterprises across all industry sectors. Deloitte FAS U.S. serves clients in real estate and related industries, handling many types of property-related issues, including leasehold interests, debt and equity positions, securities, and complex property analysis and valuation. We cover the full spectrum of real estate valuation services from evaluating large and diverse loan portfolios to performing single property appraisals and have experience in the identification and valuation of tangible and intangible real estate-related assets, including in-place leases, above-and-below market leases, and tenant relationships.

Utilizing analysis and evaluation of real property, we advise management on important decisions related to real estate. Deloitte FAS U.S. performs diligence-related services, such as market surveys, site inspections, operating statement analysis, normalization of net operating income to assist clients in assessing cash flow in their underwriting processes, and lease abstract analysis. Furthermore, our real estate financial advisory services include projects designed to assist clients in the capital raising process, as well as single asset or portfolio dispositions, acquisitions or financings through negotiated bids, and competitive sales or securitized transactions. We help clients analyze individual assets, asset portfolios and new business opportunities.

### **Lease advisory services**

When a building or portfolio acquisition is imminent, timing is critical. We can assemble a large number of experienced lease advisors to perform the necessary due diligence to address the critical closing deadline. A combination of accounting, property management, and overall real estate knowledge is used to create a due diligence package of lease abstracts and rent roll reconciliations. These are compared against the base, percentage, and additional rents represented by the seller's pro forma NOI revenues. Operating expenses are compared against supporting documentation, variance analysis, and straight-line rent determination. In addition, detailed samplings may be performed for cash

deposits, aged receivables, maintenance contract terms and conditions to help you evaluate the accuracy and integrity of the seller's supporting documentation.

Tenant common area maintenance pools are also prepared for revenue validation and, most importantly, ready billing to your new tenants once the transaction closes. These due diligence services also include assisting your analyst with Argus or other modeling tools for pro forma projections.

A client retained our lease advisory specialists to provide due diligence/lease abstraction services, which consisted of rent and expense verification and full operational abstracting for 650 leases in three weeks before the close of the transaction. The detailed abstracting revealed overstated revenues and understated expenses, yielding a \$1.7 million lower NOI than the seller's offering proposal. At a 10 percent cap, this translated into a \$17 million reduction in purchase price for our client.

**Total impact: \$17 million reduction in purchase price.**

## **Highest and best use studies**

Whether part of a larger valuation analysis or a study unto itself for planning purposes, a highest and best use analysis is a fundamental part of understanding real estate assets. Our valuation experience can assist with studies regarding legal permissibility, physical possibilities, financial feasibility and maximum productivity, all of which need to be investigated to best determine the highest and best use of vacant land or improved property.

## **Market analysis and development studies**

The ability to make sound decisions is deeply rooted in the quality of information that is available to the investor. Deloitte can help analyze markets, market assumptions and/or financial indices affecting geographies, real estate assets and businesses. As markets become more complex, so do the real estate transactions within each market. To assist our clients in making the right business decisions, we provide market analyses and development studies, which help analyze economic and/or demographic data within targeted geographies to estimate their effect on a particular investment or development project.

## **Engineering and depreciation advisory services**

Our Deloitte FAS U.S. Valuation practice also includes an Engineering & Depreciation Advisory Services group that helps clients assess ways to effectively recover capital investments and to, potentially, favorably impact federal, state, and local taxes, whether the investments are new construction, renovations of existing facilities, or asset acquisitions. Through the application of our understanding of Internal Revenue Service (IRS) and local-specific regulations, rulings, and tax court cases and, when appropriate, consultation with Deloitte Tax professionals, we seek to assist our clients in making use of depreciation or amortization benefits of project capital costs. Our group has performed cost segregation studies, investment tax studies, property tax exemption studies, energy tax studies, rehabilitation tax studies, purchase price

allocations, financial reporting capitalization studies, and lifting analysis on projects that range from hundreds of thousands to several billion dollars.

### **Tangible asset advisory services**

The Deloitte FAS U.S. Valuation practice provides tangible asset services ranging from real estate financial advisory to engineering and depreciation advisory services. Our real estate practitioners support the investment decisions of real estate and financial services companies through lease consulting, due diligence, and valuation-related services. The services performed by our professionals skilled in construction and capital asset projects benefit clients who own, acquire, or construct capital assets. Our construction and capital asset services often result in reduced project costs, enhanced tax benefits, and more specific accounting and management of clients' capital investments.

### **Business valuation**

Our business valuation team performs valuations of business entities, intellectual property, intangible assets, common and preferred stock and other securities along with partnership interests, private debt instruments, options, warrants, and other derivative products. These services are provided to assist clients with mergers, acquisitions, and dispositions; taxation planning and compliance; financial reporting; bankruptcy and reorganization; litigation and dispute resolution; and strategic planning. Our professionals utilize their knowledge of advanced technical valuation and transaction experience, capital market expectations, and proprietary market intelligence to assist clients.



# Appendix 3:

## Fund and investment structuring:

### A closer look

#### Selected fund design considerations

As advisors on fund design, we always start by listening, bringing in our skills and experience as appropriate. By asking the right questions, we can help you work with your business and financial advisors and attorneys to address the critical business considerations before finally designing the fund. Following are representative questions Deloitte and other professional advisors may ask to help establish preferences and goals.

<b>The fund structure</b>	<ul style="list-style-type: none"> <li>• Will all investors be investing in the same entity?</li> <li>• Will the fund accommodate investor preferences for holding structure?</li> <li>• What type of fund vehicle will be used?</li> <li>• In what jurisdiction will the fund be organized?</li> <li>• Will the fund include the use of tax “blockers” on top of or below the main fund structure?</li> </ul>
<b>Initial target offering size</b>	<ul style="list-style-type: none"> <li>• Initial commitments</li> <li>• Follow-on offerings</li> <li>• Timing of investment of initial commitments</li> </ul>
<b>Sponsor commitment</b>	<ul style="list-style-type: none"> <li>• Will there be a minimum commitment amount that the sponsor will maintain as an investment in the fund?</li> </ul>
<b>Target returns</b>	<ul style="list-style-type: none"> <li>• What level of cash yield and leveraged IRR is expected?</li> </ul>
<b>Term</b>	<ul style="list-style-type: none"> <li>• Will the fund be infinite life, open-ended or will there be a specific term?</li> </ul>
<b>Initial portfolio</b>	<ul style="list-style-type: none"> <li>• What is the expected initial portfolio?</li> <li>• How will it be acquired?</li> </ul>
<b>Exclusivity</b>	<ul style="list-style-type: none"> <li>• What type of priority will the fund have with respect to other investment opportunities identified by the sponsor?</li> </ul>
<b>Leverage</b>	<ul style="list-style-type: none"> <li>• What is the anticipated leverage ratio of the fund?</li> <li>• What will be the limit on leverage?</li> </ul>

<b>Fee Structure</b>	<ul style="list-style-type: none"> <li>• What will be the fee structure?</li> <li>• Will fees be structured as profits interests or as fees?</li> <li>• Fees typically seen include: <ul style="list-style-type: none"> <li>– Asset management fees</li> <li>– Debt placement fees</li> <li>– Property management fees</li> <li>– Incentive performance fees</li> <li>– Cash management fees</li> <li>– Leasing commissions</li> <li>– Construction management fees</li> </ul> </li> </ul>
<b>Redemption feature</b>	<ul style="list-style-type: none"> <li>• How will redemptions be handled?</li> <li>• When will investors be able to redeem?</li> <li>• Will the fund be required to liquidate assets in order to redeem investors?</li> <li>• Will the sponsor facilitate sales of interests?</li> </ul>
<b>Investment criteria</b>	<ul style="list-style-type: none"> <li>• What type of investment criteria will the fund operate under?</li> </ul>
<b>Offering</b>	<ul style="list-style-type: none"> <li>• What will be the minimum initial subscription?</li> <li>• Will there be a limit to the number of investors?</li> <li>• Who are the target/eligible investors?</li> <li>• Will priority be given to existing investors upon subsequent capital raises?</li> </ul>
<b>Restrictions</b>	<ul style="list-style-type: none"> <li>• Are there limitations on property types?</li> <li>• Are there any geographical restrictions?</li> <li>• When can the manager open a new fund?</li> <li>• Can the manager participate in non-fund deals?</li> </ul>
<b>Net asset value</b>	<ul style="list-style-type: none"> <li>• How will net asset value be determined?</li> <li>• How often will net asset value be determined?</li> </ul>
<b>Default</b>	<ul style="list-style-type: none"> <li>• What happens if an investor fails to fund its committed capital?</li> </ul>
<b>Distributions of available cash/dividends</b>	<ul style="list-style-type: none"> <li>• How often will distributions be made?</li> <li>• How will available cash be determined?</li> <li>• What withholding will apply to each of the investors?</li> </ul>
<b>Dividend reinvestment plan</b>	<ul style="list-style-type: none"> <li>• Will there be a Dividend Reinvestment Plan?</li> <li>• If so, how will it be structured?</li> </ul>

<b>Expenses</b>	<ul style="list-style-type: none"> <li>• What fees and expenses will be borne by the fund versus the sponsor?</li> </ul>
<b>Use of affiliates</b>	<ul style="list-style-type: none"> <li>• What limitations or restrictions will there be with respect to services provided by sponsor affiliates?</li> <li>• What type of approval would be required?</li> </ul>
<b>Governance</b>	<ul style="list-style-type: none"> <li>• How will the fund be governed?</li> <li>• Will there be a board of directors or an advisory council?</li> <li>• How many investors will be on the advisory council?</li> <li>• Who will initially make up the advisory council?</li> <li>• Which decisions will require advisory council approval?</li> <li>• How will conflicts be resolved?</li> </ul>
<b>Removal of manager</b>	<ul style="list-style-type: none"> <li>• Under what circumstances can the manager be removed?</li> <li>• What will be the implications of removal of the manager?</li> </ul>
<b>Amendments</b>	<ul style="list-style-type: none"> <li>• What approvals will be necessary to amend fund documents?</li> </ul>
<b>Reports</b>	<ul style="list-style-type: none"> <li>• What reporting will the fund commit to?</li> <li>• How often will the fund provide reports to the investors?</li> <li>• Will ancillary or customized reporting be available to investors?</li> </ul>
<b>ERISA considerations</b>	<ul style="list-style-type: none"> <li>• Will Employee Retirement Income Security Act of 1974 (ERISA) requirements need to be considered?</li> </ul>
<b>Currency</b>	<ul style="list-style-type: none"> <li>• Will the fund be dollar denominated, use another currency, or allow multiple currency subscriptions?</li> <li>• How will currency be dealt with in the invested assets?</li> </ul>

## Avoiding UBIT

Tax-exempt entities are frequent investors in real estate private equity funds and thus the fund manager is often concerned with proper structuring in order to avoid unrelated business income tax (UBIT) resulting from the fund's investments.

## Deloitte Tax approach

Our team of tax professionals is skilled at addressing UBIT issues real estate private equity funds face. We have consulted with real estate private equity funds on how to effectively address UBIT when structuring allocations. An improper allocation methodology can result in allocations of income to the tax-exempt partner being treated as unrelated business taxable income. Proper structuring

requires analysis of the partnership agreement and modeling of the potential allocations resulting from the agreement to ascertain whether tax-exempt allocation requirements have been met.

In addition, the selection of the choice of entity between a partnership and a real estate investment trust can make a difference in the returns realized by the tax-exempt investor. We help clients focus on utilizing a favorable tax-efficient entity type given the fund strategy by analyzing the tax and business consequences of alternative structures.

## **Multistate tax planning**

For private equity funds that operate in a number of states, effective management of state and local taxation is essential to overall tax planning. As state and local governments increase their focus on expanding the tax base, real estate companies operating through pass-through entities and REITs have been affected.

### **Our approach**

For real estate companies expanding or contracting in multiple jurisdictions, Deloitte Tax has a team of consultants that can work directly with you to understand and address the state and local tax impact.

Deloitte Tax has a national group of multistate tax real estate specialists that focus on the real estate industry and operates through our network of local specialists. Our multistate tax specialists understand the real estate industry and have technical knowledge of state tax laws affecting the industry. We work with clients in creating a favorable operating structure to manage the impact of state and local taxes by consulting with respect to income and franchise tax, realty transfer taxes, sales and use taxes, and credits and incentives. Our multistate tax real estate service offerings include restructuring planning, state strategic tax reviews, due diligence assistance, acquisition and disposition planning, sales and use tax consulting, and credits and incentives.

### **State strategic tax review**

Our State Strategic Tax Review is a review of state and local taxes by our multistate tax real estate specialists. Our systematic approach involves the assessment of opportunities to effectively manage your state and local tax burden. Our review focuses on income tax, franchise tax, realty transfer tax, sales and use, and credits and incentives.

### **State income and franchise taxes**

States are increasingly moving toward imposing entity-level income tax on partnerships and other pass-through entities which can result in unexpected taxes at the fund level. Additionally, almost 40 states impose withholding taxes on partnerships with respect to nonresident partners.

Our multistate real estate specialists can assist taxpayers with the following services:

- Assessment of opportunities to restructure current operations into a tax-efficient structure
- Potentially reducing taxes by acquiring property in a tax-efficient structure
- Potentially reducing tax on dispositions of property
- Understanding conformity to federal income tax issues including like-kind exchanges
- Assistance with withholding tax issues and compliance

## **Real estate transfer tax**

There are 37 states and the District of Columbia that impose a transfer tax on the transfer of real property along with various local jurisdictions. As each jurisdiction's rules can vary, we can assist with understanding and potentially reducing the real estate transfer tax associated with transactions, including:

- Property acquisition and disposition
- Mergers and acquisitions
- Private to public offerings
- REIT formation and UPREIT conversions
- Like-kind exchange transactions

## **Sales and use taxes**

Real estate companies are subject to unique sales and use taxes. We can assist with addressing sales and use tax compliance issues with respect to the following:

- Management fees
- Construction activities
- Real property maintenance and repair
- Leasing of tangible and real property
- Parking fees
- Utilities

## **Credit and incentives**

As real estate private equity funds expand into new jurisdictions, our state and local credits and incentives specialists can assist in pursuing benefits available to potentially reduce overall tax exposure. Our credits and incentives services include assessment, application, negotiation support, utilization and implementation of tax credits and incentives offered by federal, state, and local economic development agencies.

## **International tax planning**

For real estate private equity funds with an international footprint, managing foreign income and withholding taxes is critical for efficient global tax planning. In addition, funds investing in the U.S. but with a substantial non-U.S. investor base must carefully structure the fund and its investments to optimize the after tax investor yield. Deloitte Tax can assist with important tax considerations such as

the choice of entity, the use of holding companies for withholding tax, exit strategy management, and debt placement.

## **U.S. tax issues**

For partnership structures and REIT structures, the United States check-the-box legal entity classification allows flexibility in planning. The check-the-box regime may also facilitate the five primary goals of a U.S. investor in foreign real estate:

- United States and local country tax reduction
- Efficient use of foreign tax credits
- Recirculation of offshore cash
- Repatriation of offshore cash
- Reduction of antideferral regimes

Deloitte Tax's international tax planning specialists have the knowledge and experience to help clients assess whether utilizing check-the-box opportunities are useful in taking advantage of potential tax benefits.

## **Considerations for partnership structures**

Deloitte Tax professionals have recognized experience and can provide valuable guidance on important considerations for U.S. partnerships, such as:

- Whether tax treatment in various countries make a partnership or trust structure a viable tax planning tool.
- Whether investing overseas through a partnership or trust allows for the flow through of income and losses; investing in a corporation results in the current inclusion of income in certain circumstances if cash is not distributed.
- Whether the use of parallel fund vehicles or lower-tier entities allows for the use of blocker corporations, if needed.
- Whether foreign tax credits paid or accrued by a partnership or trust flow through to the U.S. partners/beneficiaries and are eligible to be used as a credit against U.S. income tax liability.
- Whether contributions of cash and/or property to foreign partnerships or by foreign partnerships are subject to reporting requirements.
- Whether currency gains arise when a flow-through entity using a functional currency other than the U.S. dollar "remits" earnings, or when a flow-through entity enters into a transaction, such as lending or borrowing in a nonfunctional currency.
- Whether the dual consolidated loss provisions prevent the use of a single loss in both the United States and a foreign jurisdiction.
- Whether various loss recapture and gain recognition provisions need to be considered when analyzing potential outbound contributions, sales, or conversions of flow-through entities into corporate entities.

## **Considerations for REIT structures**

Deloitte Tax can assist with important considerations related to U.S. REITs, including:

- Considering whether foreign investment by the REIT should be done through a flow-through or blocker corporation.

- Potentially reducing foreign taxes since foreign tax credits are generally not available to REITs or their shareholders.
- Reviewing the limitations on qualifying income and assets which apply to both foreign and domestic operations.
- Reviewing the tax impact of currency gains and losses and derivative contracts.
- Determining whether the dual consolidated loss provisions prevent the use of a single loss in both the United States and a foreign jurisdiction.
- Determining whether various loss recapture and gain recognition provisions need to be considered when analyzing potential outbound contributions, sales, or conversions of flow-through entities into corporate entities.
- Considering the effect of the “check-the-box” rules for foreign entities that are not directly held and wholly owned by the REIT for U.S. tax purposes (e.g., joint ventures or UPREITs).
- Considering issues related to both United States and foreign withholding tax on interest payments made to foreign lenders.
- Reviewing the impact of various anti-deferral regimes when investing through blocker corporations.

## **Foreign tax considerations**

Each foreign jurisdiction has a different approach to taxing real estate investments. Deloitte Tax and DTTL member firms’ tax specialists throughout the world are experienced with regard to tax considerations in structuring real estate investments. Specific considerations upon investing in foreign real estate include:

- Appropriate investment vehicle (corporation, partnership, investment fund, and foreign REIT)
- Limitations on interest deductibility
- Limitations on making distributions (distributable reserve requirements, for example)
- Withholding taxes imposed on interest and dividend payments
- Tax treaty network
- Capital gain implications on sale of shares or assets
- Capital tax
- Real estate transfer tax, stamp duties, value-added tax, and other indirect taxes
- Depreciation/capital allowance provisions
- Deductibility of service fees and related withholding taxes
- Like-kind exchange provisions
- Transfer pricing provisions and documentation requirements

Many foreign jurisdictions are introducing REITs or similar investment vehicles and other real estate incentives to bring capital into their country. Similar to the U.S., many of the foreign REITs have specific ownership requirements and income/asset tests.

## **Exit considerations**

When investing in foreign real estate, the ultimate exit strategy should be considered up front. Deloitte Tax can assist with the tax aspects of developing a successful exit strategy. The local country taxation of capital gains and transfer taxes should be analyzed for the sale of the underlying property versus the sale of shares of the entity owning real estate assets or shares of the holding company of the entity owning the real property. The three scenarios are often treated very differently. Application of income tax treaties to gains on sale of real estate and real estate companies should also be considered.

The selection of an appropriate holding company structure is crucial to foreign tax management. Different treaties and local statutes may provide different results on the sale of real estate or the shares in a real estate company, and treaty shopping and other beneficial ownership rules may apply.

From a U.S. tax perspective, numerous loss recapture rules must be considered on a branch or partnership disposition. If foreign real estate is owned through a foreign corporation, the income from the sale could be recognized currently in the United States if it is not planned for appropriately.

Deloitte Tax and the other DTTL member firms have the international tax experience and network to consider tax aspects of international investment opportunities.

## **Considerations for foreign investors in U.S. real property interests**

- Consider withholding requirements for operating income distributions.
- Foreign Investment in Real Property Tax Act of 1980 FIRPTA requires withholding tax on sales and other dispositions of U.S. Real Property Interests (USRPIs) by foreign persons.
- A USRPI generally includes an interest in real property located in the U.S. or the Virgin Islands, any interest (other than as a creditor) in any United States corporation which is a U.S. real property holding company (USRPHC).
- Fund structure as equity investment versus a portfolio debt investment should be considered.
- A number of structural considerations may include the use of blockers, domestically controlled REITs and internal leverage structures, among others, to enhance investor yield.

## **Acquiring properties in an UPREIT structure**

Private equity funds often invest in Real Estate Investment Trusts (REITs) and their operating partnerships. Investments in such entities carry many tax issues that must be considered by the fund.

## **Deloitte Tax approach**

Deloitte Tax professionals have experience in dealing with the issues commonly confronting acquirers of REITs. Some of the issues we can help funds address when acquiring properties in a REIT structure include:

- Assessing tax profile and tax effect of property sale covenants of operating partnership partners
- Designing tax-efficient structures to create flexibility for operating partnership partners
- Designing and performing due diligence procedures to determine the validity of the entities' REIT status

# Appendix 4:

## Operational excellence and investor reporting: A closer look

### Lease advisory services

#### **Equity investors**

Commercial real estate is a dynamic industry, growing and changing quickly; therefore, not only is time money, but space is money. Space is a valuable commodity that must be safeguarded; and understanding the value contained in your lease documents and processes are important measures to achieve value. Considering that lease-related revenues are one of the largest elements in determining your company's valuations, analyzing and increasing this is key to improving your bottom line.

The Lease Advisory Services practice of Deloitte FAS focuses on understanding the economics and value in each transaction. Our professionals will assist in your managing values negotiated in your transactions by helping you explore revenue opportunities and track and maintain critical information and improve your lease administration processes. Here is how:

#### ***Reverse lease audit services***

Deloitte FAS lease advisory services provides assistance to the lessor to assess whether the proper rent and expense escalations are being charged to the lessee under the lease provisions. Our lease advisory specialists will analyze your general ledger, specific tenant CAM pools, billing statements, and sample leases to provide you with insights into opportunities for potential incremental recovery enhancements that can potentially add value to the property and the portfolio at large.

#### ***Percentage rent audit***

Deloitte FAS lease advisory services provides assistance to the lessor to assess whether you are receiving fair and reasonable rents from your retail properties. Our lease advisors will analyze your tenants' gross sales reports, percent rent calculations, cash and credit card revenues, employee and customer sales discounts, returns and net sale amounts, and bank statement reconciliations to ensure that rents collected are consistent with the percentage rent terms in the lease.

### ***Lease audit defense***

Our lease advisory specialists are available to assist landlords in disputes involving tenant lease audits which challenge rent escalations that might be considered unjustified. This assistance would include analyzing the tenant's lease audit report, researching the charges, and recommending defensive operational and lease responses and appropriate counter charges and claims.

### ***Lease language review***

Our lease advisory specialists are able to read and comment on specific business terms of your lease and offer recommendations on landlord favorable language. This assistance may include working with your attorneys regarding operating expenses and real estate taxes, base years, pro rata shares, inclusions/exclusions, lease audit rights and windows, and occupancy gross-ups.

### ***Lease abstraction/validation***

Tracking and maintaining critical information is essential to overall data integrity, revenue enhancement reporting and managing your leaseholds. Lease abstraction can help landlords avoid undercharging base and additional rent and missing specific option dates among other issues. Our lease advisory specialists will help evaluate and recommend attributes necessary to create an electronic database using the landlord's existing lease administration software or in conjunction with implementation of new software. Such abstraction and validation procedures should help the landlord assess whether accurate, complete, intelligent and billable data is maintained within the lease management system. Our services include assistance with lease abstracting, documentation of specific lease attributes (i.e., renewal options, right of first offers, etc.), or validation of existing data.

### ***Lease administration advisory services***

Lease advisors will evaluate existing policies, procedures, and personnel in the lease administration department and provide recommendations for improved operations. Deloitte FAS will advise the landlord on procedures that may need to be revised or enhanced based on industry benchmarks including providing assistance in mapping "as is" conditions and "to be" effective practices. These procedures may enhance management reporting and controls and supplement Sarbanes-Oxley 404 work for procedural mapping of lease administration internal controls.

### ***Lease audit and lease administration training***

The Deloitte FAS Lease Advisory Services practice has taught thousands of lease auditors, lease administrators, and real estate executives the fundamentals of lease audits and lease administration. From the novice to the more sophisticated professional, these one-day (nine hours CPE) training programs are regarded as among the best in class.

### Take a closer look: lease data verification

One lease advisory assignment included lease abstracting an entire leased property portfolio, including more than 1,600 leases over a five-month time frame. The project goal was to provide the landlord with a product that comprised relevant lease information (400 attributes per lease) for each of the 1,600 plus leases in a consistent format, which could be loaded into the various electronic lease administration, accounting, property management, and leasing databases. The landlord was provided a consistent product with a high-degree of data integrity that could be maintained by internal landlord staff and immediately usable for tenant billings and overall property operations. The landlord's financial and operational exposure to possible inconsistent monitoring of each lease (i.e., erroneous or untimely rent bumps, overlapping encumbrances, inaccurate commencement/termination of leaseholds) was diminished through the data abstracting project deployed by Deloitte FAS.

## Cost segregation services

### What is a cost segregation study?

A cost segregation study identifies building assets which can be depreciated at an accelerated rate using shorter depreciable lives. It is a formal process of performing a detailed cost analysis of capital expenditures or tax basis of assets and allocating the assets into appropriate cost recovery periods. A cost segregation analysis typically results in increased depreciation benefits by properly classifying these costs through distinguishing long-lived property from short-lived property for income tax purposes. It can also:

- Impact your short-term cash flow
- Analyze costs to be expensed
- Document detail for your fixed asset record
- Create a record for audit defense

Cost segregation studies may also be performed on a retroactive basis, usually without filing amended tax returns. Facilities placed in service since 1986 are potential candidates for this type of analysis.

Situations that may trigger an opportunity for cost segregation include:

- Construction of new facilities
- Acquisition of existing facilities
- Construction of leasehold improvements
- Renovations to existing facilities

Property types analyzed include:

- Neighborhood shopping centers
- Business and office parks
- Regional malls
- Power centers
- Manufacturing facilities
- Distribution centers
- Golf courses
- Industrial buildings
- Apartment complexes
- Office buildings

## **How we can help?**

A cost segregation study needs to be sensitive to more complex issues, such as the proper treatment of:

- Indirect costs
- Off-site improvements
- Tenant reimbursements
- Capitalization vs. expense determination

We can deliver insightful recommendations that are tailored to your specific circumstances and apply supportable positions in our analysis.

The Internal Revenue Service (the “IRS”) developed its Cost Segregation Audit Techniques Guide (the “Guide”) to assist service examiners in the review and examination of cost segregation studies. The Guide identifies the principal elements of a quality cost segregation study. Specifically stated within this Guide is that “the preparation of cost segregation studies requires knowledge of both the construction process and the tax law involving property classifications for depreciation purposes.” Deloitte FAS in collaboration with Deloitte Tax has such knowledge.

## **Fixed asset management services**

Our professionals also provide Fixed Asset Management (FAM) services that assist companies in improving the integrity of their fixed asset data. FAM services can help companies implement leading industry fixed asset management practices and satisfy Sarbanes-Oxley compliance requirements. Efficient and disciplined asset management processes are key enablers to effective internal controls over capital assets, appropriate accounting treatment

and quality financial and management information. FAM services are particularly useful to organizations in transitioning industries that are capital intensive, frequently change product lines, upgrade technology, perform extensive renovations and have large property tax liabilities.

## Capital projects consulting

Public and private sector entities undertaking capital construction projects face complex and often daunting challenges. We provide specialized resources to assist clients with the delivery of capital construction projects. Services include project risk assessments; project oversight; independent construction cost and control assessments; contract close-out services and dispute resolution/litigation support.

## Sustainability (“green building”) studies

We can provide real estate consulting services for various aspects related to green buildings, including financing, acquisition and disposition of a green building. Although financing of green development is similar to traditional financing, additional attention must be paid to particular costs, benefits and risks—aspects with which many lenders and investors may not yet be familiar. Construction costs and potential rental revenues for green buildings can be higher than for conventional buildings, while lower operating costs can create more favorable cash flow projections which in turn can lead to more favorable financing terms. Our professionals can perform real estate transaction-related support services to adequately analyze a green property, including:

- Compiling appropriate support for cash flow projections
- Conducting rent, operating expense and market surveys
- Real estate valuation
- Financial modeling
- Performing cost/benefit analysis and benchmarking
- Lease abstract analysis/contract assessment
- Site inspections

## Finance transformation

Our Deloitte Consulting Finance Transformation (FT) team is an umbrella concept designed to help Chief Financial Officers improve their finance organizations — from reporting and controls to finance operations to strategy and execution. FT may help boost a company’s overall performance and drive value.

## Operational imperative

Today’s CFOs and finance organizations must execute on a broad range of responsibilities that go far beyond their traditional role as corporate accountants. New areas of responsibility include finance function effectiveness, information quality and consistency, finance talent management, internal controls and corporate governance, business performance management and more.

## Potential benefits of Finance Transformation

- More reliable, accurate, and timely financial reporting

- More robust and efficient financial controls
- Improved risk awareness and strategic decision-making ability
- More effective talent management programs for finance professionals
- Better execution of the business strategy
- Greater value contribution from finance
- More efficient finance organization

## Transfer pricing services

The Internal Revenue Code (I.R.C.), U.S. Treasury Regulations, and Internal Revenue Service (IRS) published guidance provide that transactions between related parties must be carried out at arm's length. I.R.C. § 482 and the associated treasury regulations govern the determination of the arm's length pricing. Failure to identify and properly establish the pricing of transactions between affiliates within a private equity fund complex can lead to:

- Inaccurate modeling of profits and cash flows
- Exposure to unanticipated foreign or domestic taxes
- Significant tax penalties

For several years now, members of Deloitte Tax's Transfer Pricing Service line have been working closely with our real estate specialists in assisting clients in evaluating the transactions between affiliates in complex fund structures. This close working relationship involving transfer pricing tax specialists, and Ph.D.-level transfer pricing economists, has enabled us to evaluate the transfer pricing for clients, taking into account their unique situations and tax positions. Our experience encompasses the full range of investments, from holding apartment properties, office properties, retail shopping malls, hotels and timber property.

We have been involved in real estate related transfer pricing in a wide variety of situations, including:

- Performing analysis of existing transactions to evaluate the arm's length nature of the pricing, and documenting the analysis for purposes of both providing the I.R.S. or foreign government with a contemporaneous analysis supporting the pricing, and for purposes of addressing a necessary requirement for avoiding the 20 percent or 40 percent transfer pricing penalty of I.R.C. § 6662(e) & (h).
- Assisting clients with evaluating their current transfer pricing paradigm to propose changes that might permit the client to take advantage of more tax-efficient transaction or pricing models.
- Analysis of transactions between REIT and its TRS in order to properly document support for the transfer price and potentially avoid the 100 percent penalty prescribed under the REIT rules for redetermined rents from a TRS and redetermined deductions of a TRS.

## IFRS in real estate

Real estate has long been a global business with a steady, international flow of capital for many years despite the bumps and friction caused by different currencies, languages and accounting from one country to the next. However, one of those friction points may soon be removed as the world moves rapidly toward a single set of accounting and financial reporting standards, known as the International Financial Reporting Standards or IFRS.

IFRS represents a new way of thinking about financial reporting with a focus on transparency of financial information using extensive disclosure. IFRS is more principles based than the heavily rules-based U.S. GAAP. This means there is less guidance on accounting for specific transactions under IFRS, allowing more judgment and choices in the application of accounting principles, but also requiring more disclosure to make the accounting clear and transparent to investors and others.

Today, IFRS is used in more than 100 countries. Since 2005, IFRS has been required across all European Union countries and Mexico, Canada, and India have each announced future mandated use. About 40 percent of the Global Fortune 500 companies currently use IFRS, and that number is expected to grow as countries such as Canada, Mexico, Argentina, Republic of Korea, and India adopt IFRS during 2011 or 2012. On November 14, 2008, the SEC issued its long-awaited proposed IFRS “roadmap” outlining milestones that, if achieved, could lead to mandatory transition to IFRS by U.S. issuers in the near future. Decisions about the mandatory use of IFRS in the U.S. and Japan are expected in 2011 and 2012 respectively.

Real estate fund executives have particular reason to pay attention as characteristics of the real estate industry make it a prime candidate for early IFRS conversion:

- Real estate is global
- Real estate is capital intensive
- Real estate is competitive

## Transition to IFRS

Deloitte & Touche professionals can assist real estate companies and funds with a smooth transition to IFRS by helping to:

- Establish a plan for adoption and implementation — we leverage lessons learned in Europe and elsewhere around the world to help companies chart a favorable course, determine the pace of the conversion process, and avoid some detours and potholes.
- Understand the key areas of U.S. GAAP and IFRS, and assist in assessing the accounting policy impacts of differences specific to the real estate industry— our broad exposure to the global real estate industry and financial reporting under IFRS will help you assess the accounting policies and disclosures that best present your financial results, respond to the information needs of your investors, and conform to IFRS and industry standards.
- Leverage your technology infrastructure and existing projects — recent enterprise resource planning or finance transformation may be leveraged to adapt your chart of accounts and report mapping, organize your financial data

warehouse, and utilize new system modules built to accommodate IFRS implementation.

- Conduct trial runs — implementation of IFRS in phases or in markets where implementation is required can help develop a company's process for IFRS implementation.
- Design shared service centers and reduce your overall costs — geographically dispersed finance offices may be using dozens of local GAAPs. Centralizing the service centers will help facilitate the implementation of a consistent set of accounting standards that takes advantage of tax incentives, payroll savings, and facilities cost reductions.
- Strengthen controls — decentralized structures may have led to reduced oversight and weakened controls. IFRS offers the opportunity to implement standardized frameworks and processes to enhance the overall control environment.
- Prepare your organization — we can help you prepare your organization for IFRS implementation with internal and stakeholder communication strategies, awareness programs, and employee training.
- Improve your access to capital — when it comes to raising capital, trends are clearly global. IFRS can potentially improve liquidity and access to capital by offering greater transparency in the form of consistent, full and uniform disclosure to investors under a set of standards increasingly familiar to and often the choice of global capital providers.

## Innovative investor and debt instrument reporting

Deloitte Tax can assist you in the allocation and reporting of complex waterfall and tax accounting information for distribution to your investors by employing our K-1 suite of technology solutions. In addition, we can assist you with their tax accounting and information reporting needs by implementing our proprietary Tax Accounting and Information Reporting for Distressed Debt Investment (TARDI) system. Our team help you analyse and report the impact of loan modifications, original issue discounts and gain or loss on the loan dispositions.

## Debt restructuring

Given the downturn in the markets, it is important for owners/operators of real estate to closely examine their real estate projects to determine whether a debt restructuring may be required. Modification of debt instruments can subject the parties to immediate taxation under the Internal Revenue Code.

Owners of commercial real estate may seek to defer immediate recognition of cancellation of indebtedness income by utilizing various deferral provisions contained in the Internal Revenue Code. In addition, debt workout scenarios often create situations where structure foot faults create unanticipated tax consequences.

## Consulting and planning

- Deloitte Tax can help with organizational tax structuring prior to the modification of debt instruments in order to pursue beneficial tax effects. Once the debt instruments are modified, we can help review the debt instruments to assess if there was a significant debt modification for tax purposes and the tax consequences associated with the significant debt modification.

## Tax reporting

- We assist in the assembly of information to complete Form 982, Reduction of Tax Attributes Due to Discharge of Indebtedness for purposes of complying with the federal income tax reporting requirements.

### **Your benefits**

- We can help explore the tax deferral opportunities available.

# Appendix 5:

## Exit strategies: A closer look

### Like-kind exchange transactions

Like-kind exchanges under Internal Revenue Code Section 1031 offer an effective way to defer taxes on dispositions of real estate and many other assets. The requirements associated with these transactions are technical, complex and form driven. The challenge is to successfully navigate these rules.

### Our approach

Owners seeking to utilize Section 1031 to defer tax on dispositions need guidance from tax specialists. Like-kind exchanges can be structured as either traditional simultaneous or deferred exchanges or as “reverse exchanges” in which an investor acquires property or begins to develop it before the disposition of property to be exchanged. In either case, availability of the tax deferral benefits of a like-kind exchange is subject to compliance with a number of technical and timing requirements imposed by the Internal Revenue Code. Even large companies with sophisticated internal tax staffs often lack the internal resources to manage these detailed requirements. Deloitte Tax specialty areas include:

### Consulting and planning

We can help structure and implement individual transactions or an ongoing exchange program, including high-level review of a client’s business plan for proposed asset acquisitions and dispositions — then align the transactions with the rules governing like-kind exchanges to achieve deferral of taxable gain. We are familiar with all varieties of real estate and personal property exchanges, including deferred, reverse and built-to-suit transactions, as well as the special issues faced by partnerships, tenants in common, consolidated groups, REITs, and single-member limited liability company ownership structures.

### Supervision

We assist in monitoring and managing like-kind exchange programs, including recommending experienced qualified intermediaries and exchange accommodation parties as well as coordinating the internal company functions (including real estate acquisitions/dispositions, finance and tax) which must be involved in an exchange transaction.

## **Tax reporting**

We assist in assembly of information necessary to create Form 8824 (like-kind exchanges) for purposes of complying with the federal income tax reporting requirements for like-kind exchange transactions, including tracking relinquished properties with replacement properties, calculation of deferred gain, calculation of tax basis by property, and allocation of tax basis between land and improvements for purposes of determining depreciation deductions.

## **Your benefits**

We can help you explore the tax deferral opportunities available through use of like-kind exchanges and avoid running afoul of the many technical traps associated with these transactions.

## **Initial Public Offering through use of a REIT**

Real estate private equity funds may wish to exit a portfolio through an initial public offering (IPO). In order to take advantage of the tax benefits afforded Real Estate Investment Trusts (REITs) under the Internal Revenue Code an IPO strategy may be used in conjunction with the formation of a REIT. REIT formation could be accomplished by converting the fund into a corporate entity and electing REIT status or by use of the “UPREIT” structure.

## **Our approach**

Formation of the REIT can be a taxable or nontaxable event depending on the long-term goals of the current and future owners of the entity. Proper structuring requires careful consideration of ownership structure of newly created and surviving entities along with the nature of the properties they own. In addition, proper structuring also must consider certain organizational requirements particular to REITs. State income and transfer tax implications also should be reviewed to properly quantify their impact on the transaction.

In addition to the structuring issues surrounding the initial formation of a REIT, an entity seeking to qualify as a REIT must meet certain operational tests on a quarterly and annual basis. The quarterly tests include the testing of the REIT’s assets for compliance with several Internal Revenue Code requirements and the annual tests include testing the nature of the REIT’s income for Internal Revenue Code compliance. In addition, REITs must meet certain annual distribution requirements in order to maintain their REIT status.

## **Structuring**

Our team of Deloitte Tax professionals assists in the proper structuring of both IPO and REIT formation strategies. We help clients navigate through the REIT organizational requirements as well as assisting in the monitoring of the quarterly and annual REIT tests.

## **Tax reporting**

We assist in your assembly of information needed to meet the IRS and shareholder information gathering and tax reporting requirements of the REIT.

## **Your benefits**

We can help explore the tax opportunities available and the elimination of a layer of tax with the benefits of a REIT.

## **Use of Joint Venture Strategy to Recapitalize Portfolio**

Real estate private equity funds may wish to recapitalize a portfolio through use of a joint venture strategy where a portfolio is contributed into a new joint venture with an outside partner who contributes cash which is later distributed to the Fund along with a portion of refinancing proceeds

## **Our approach**

The joint venture strategy can be a taxable or nontaxable event depending on the long-term goals of the current and future owners of the entity. Proper structuring requires careful consideration of the nature of the properties contributed and the timing of contributions and distributions. State income and transfer tax implications should also be reviewed to properly quantify their impact on the transaction.

## **Structuring**

Our team of Deloitte Tax professionals assists in the proper structuring of joint venture recapitalization strategies to make sure that the Fund's objectives are met in an efficient manner.

## **Tax reporting**

We assist in your assembly of information needed to meet the IRS tax reporting requirements of recapitalizations involving contributions and distributions to and from newly formed joint ventures.

## **Your benefits**

We can help explore the tax opportunities available to recapitalize your portfolio and extract cash while deferring tax.

