Navigating Rate Increases of the Taxpayer Relief Act of 2012

What they mean for real estate earnings

By Dean Glick, Vice President, Taxes, High Company LLC

In what has become an annual course of events, 2012 came to a close with income taxes again getting the headlines in Washington. On January 2, 2013, the President signed the American Taxpayer Relief Act of 2012, the country averted the “fiscal cliff,” and life was good, right? Not exactly. While the Act did contain many extenders favorable to taxpayers, it also put into place the most significant income tax increases on some taxpayers in over a decade. Combined with the additional Medicare tax (passed in 2010 under the health care legislation with a start date of 2013), the need for good tax planning is more important now than ever.

If 2013 happens to be the year you were planning to finally close that big deal or sell that piece of appreciated real estate, and your income is pushed

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High Hotels Celebrates 25 Years

A recognized leader in the hotel industry, High Hotels Ltd. is known for setting the highest standards in guest service and product quality of its properties in the Mid-Atlantic and Northeast regions. As an owner-operator, the company develops, acquires, owns, and operates hotels franchised through Hilton Hotels Corporation and Marriott International, Inc.

Since its inception in 1988, High Hotels associates and properties have earned more than 100 awards from the Hilton and Marriott organizations. Among them is the prestigious Diamond Circle Award, earned by only approximately 15 of the more than 850 Courtyard by Marriott hotels worldwide for top performance in guest satisfaction and other key indicators.

“Hire the heart,” says president and chief

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Pictured: The High Hotels Management Team and Staff of the Courtyard By Marriott, Lancaster. Standing, Left to Right: Jeremy Geib, Hotel Operations Manager; Missy Jacobs, Bistro; Ben Larsen, Area General Manager; Mike Fruin, President and COO; Sue Thomas, Director of Sales; Stephanie Reese, V.P. of Sales and Marketing; Russ Survance, Guest Services; and Zelda Rowley, Housekeeping. Seated, Left to Right: Diane Parker, Executive Housekeeper; and Laurel Rolle, Regional Manager.
President’s Column

Welcome to the digital Real Estate Matters from High Real Estate Group LLC. Like our award-winning print newsletter, this publication is designed to inform you about key real estate issues that affect your business, to provide you trusted insights and perspectives on these issues, as well as bring you the latest industry news.

Real Estate Matters is available as a printable file download and an online magazine offered at highrealestategroup.com. Please share it with your friends and associates. Tell us what you think of it in our online survey.

High Real Estate Group and its affiliates are proud to be your partner in addressing real estate-related decisions and challenges. Our team is constantly on the lookout for new opportunities and innovative solutions for industrial / commercial brokerage, leasing, development, asset and property management, strategic planning and consultation, corporate real estate services, appraisal services, construction services, architectural design, hotels, and real estate investments. We hope you will count on us as your full-service real estate resource.

As always, thank you for your business, and for making it all possible.

Sincerely,

Mark Fitzgerald
President and Chief Operating Officer
High Real Estate Group LLC
717.293.4466

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Acadia Neurorehabilitation Services Marks a Quarter Century

Congratulations to ACADIA Neurorehabilitation Services Inc., a Greenfield Corporate Center tenant, as it celebrates 25 years of serving Lancaster County as a provider of neurorehabilitation services for adults with brain injuries. For more than 20 years, Acadia has been part of the business community at Greenfield and has partnered with High Associates to provide quality facilities for ACADIA’s residential and day-treatment programs.

High co-workers have been gratified to work with ACADIA to provide state-of-the-art customized living environments at both the Greenfield Corporate Center and its Bentley Ridge apartment community, in addition to clinical facilities within Greenfield. These facilities have supported ACADIA in its mission to optimize the rehabilitation process and enhance opportunities for successful return to community life following brain injury.

At a recent celebration luncheon, several of High’s staff members were recognized by ACADIA’s executive team with awards in recognition of their long-term partnership. High Real Estate Group’s various affiliates have provided assistance to ACADIA in the areas of development (securing necessary land-use approvals), architectural design, and construction services.

Bentley Ridge currently offers 10 handicap-accessible and ADA-compliant residential units in partnership with ACADIA’s services, and is considering expanding. The units have a property manager available at all times and provide home-like settings so that ACADIA residents can transition to a community and lifestyle experience while still receiving the care they need.

ACADIA’s rehabilitation programs are designed to assist individuals with neurological impairment in dealing with issues such as self care, activities of daily living, communication, socialization, mobility, cognitive competency, and vocational development. ACADIA provides comprehensive day treatment, residential programs, respite care, home and community facilitation, and additional services.

More information is available at www.acadiarehab.com.
above and beyond normal annual earnings, or you just happen to be fortunate enough to earn a good living from your real estate endeavors, your tax bill may be going up. But how do you know? Just what are the thresholds that will result in an increase in your tax bill? As usual, there is no consistency among the various thresholds that can push your tax bill higher. 2013 taxes are generally increasing under three different mechanisms. (See table at right.)

**Income Tax Rate Increases**

The threshold is based upon taxable income (gross income less adjustments, itemized deductions and personal exemptions). While generally the threshold amounts are high enough to exclude many taxpayers, many others will see an increase in the top rate of tax on ordinary income from 35 to 39.6 percent. In addition, the top rate on qualified dividends and capital gains (including gains on the sale of real estate in excess of the depreciation recapture) is going from 15 to 20 percent.

**Medicare Tax on Net Investment Income**

When the Medicare Tax passed in 2010 as part of the health care legislation, admittedly many practitioners did not pay much attention to the provisions, and still many others were hoping that challenges to the legislation would bring a repeal of the tax. Alas, no such luck, and it’s time to pony up. The good news is, the rate is only 3.8 percent. The bad news is, the legislation brings with it a whole new tax calculation to consider, and now that it is implemented, it may only be a matter of time until the need for revenue in Washington results in a rate increase. Essentially, the tax applies to net investment income exceeding certain thresholds. This time the threshold is calculated on modified adjusted gross income. Net investment income generally includes interest and dividend income, capital gains (including the sale of real estate), rental income, and income from passive activities.

So what is a taxpayer to do to navigate through the rate increases? Solid professional help is a prerequisite. A new tax system (the Medicare tax) is upon us, marginal rates have increased, and itemized deductions are again being phased out. Fortunately, there was some good news for taxpayers in the 2012 Tax Act, and some planning opportunities are still available.

**Depreciation Recapture Provisions**

Sometimes the realization that depreciation taken on the sale of a property must be recaptured as income in the year of sale can be harsh reality to a taxpayer cashing in on a property that was held for a long period of time. Generally, when assets are sold, the gain is allocated into one of three buckets, and then taxed at a rate that applies to that bucket:

1. Section 1245 property (personal property such as furniture and equipment with a shorter depreciable life) to the extent of the depreciation taken is taxed at the ordinary income rate.
2. Section 1250 property (most depreciable real property) to the extent of depreciation taken, is taxed no higher than 25 percent. The good news is, the Act made no change in this regard. The rate was 25 percent in 2012 and does not change for 2013.
3. Capital gain (generally the gain on the land and any gain in excess of 2. and 3. above) is taxed at capital gain rates.

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**Itemized Deduction Limitations**

Although they have not been around for a while, limitations on certain deductions are back, and in this instance the threshold is based upon adjusted gross income. Taxpayers with such income exceeding these thresholds will see a reduction in their ordinary income tax rates. The Act extended the opportunity to receive rapid depreciation deductions for certain improvements made to commercial real estate. Generally speaking, if you operate as a landlord (and are not renting to yourself), you can still write off up to 50 percent of certain improvements in 2013 (electrical/plumbing systems, lighting, HVAC equipment, ceilings and doors, etc.) and depreciate the remainder over 15 years (as opposed to a mandated 39 year recovery life for improvements to commercial real estate).

<table>
<thead>
<tr>
<th>Top Income Tax Rates:</th>
<th>2012</th>
<th>2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ordinary Income</td>
<td>35.0%</td>
<td>39.6%</td>
</tr>
<tr>
<td>Dividends &amp; Long-term Capital Gains</td>
<td>15.0%</td>
<td>20.0%</td>
</tr>
</tbody>
</table>

**Applies to:**

- Single Taxpayers, if Taxable Income exceeds $400,000
- MFJ Taxpayers, if Taxable Income exceeds $450,000

**Limitations on Itemized Deductions (Reinstated for 2013)**

**Applies to:**

- Single Taxpayers, if Adjusted Gross Income exceeds $250,000
- MFJ Taxpayers, if Adjusted Gross Income exceeds $300,000

*Has the effect of driving the effective rate of your income taxes higher.*

<table>
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<tr>
<th>3.8% Medicare Tax on Net Investment Income (New for 2013)</th>
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**Applies to:**

- Single Taxpayers, if Modified Adjusted Gross Income exceeds $200,000
- MFJ Taxpayers, if Modified Adjusted Gross Income exceeds $250,000

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"Fortunately, there was some good news for taxpayers in the 2012 Tax Act, and some planning opportunities are still available."
Please tell us about your background.

Before joining High Hotels, I spent 24 years with the Marriott organization. My most recent position with Marriott was as vice president, owner & franchise services. In that role I helped establish and then led the TownePlace brand of extended stay service hotels. Growing the hotel business through development has been a passion of mine for a long time. It was a privilege to be able to hone my skills at one of the two premium hotel brands, and then to bring that experience to High.

High Hotels is celebrating 25 years. What’s your secret?

Both the Marriott and Hilton franchises have extremely strong brand recognition, geographic location, and market presence. We build on this by doing everything we can to make the guest experience memorable. It might be a quilt behind the front desk, or remembering a guest’s birthday or anniversary. Or it could be the greeting a guest receives in the lobby. Architectural features, the freshness of the food, the flowers, our people... any and every detail can make a difference and become a take-away that results in a positive memory and customer loyalty.

How has the business changed over the years?

The business has grown from one hotel, which is the Hampton Inn here in Lancaster, to a total of 12 properties throughout the Mid-Atlantic and Northeast. By the way, all but one of them were built by High Construction Company, and all are block and plank construction which provides passive fire protection for our guests. We started with 30 co-workers, and now have 365. Gross revenue has climbed from $1.9 million to $51 million.

Have guest expectations changed over time?

Immensely. The main driver of hotel selection is still location, brand and price, but when we started, hot water and a comfortable bed were about all our guests expected from their stay. We would differentiate with block and plank construction (most competitors are stick-built), wider corridors, bigger breakfasts. You could win just by going a notch up. Today, more owners are willing to make these extra investments.

Guests have become much more experience-oriented. There’s a generational aspect to this. It used to be that business travelers didn’t worry much about how the rooms looked and what amenities were available. The idea was to get in and get out. Younger travelers expect the hotel to help them be productive. These guests do research online, and read reviews. They’re connected. They want to check in with a phone. If someone tweets about a hotel, they may stay there instead.

What has High Hotels done to adapt?

Not long ago, our brands didn’t have breakfast and fitness centers. Now we’re talking about giving up conference rooms to have bigger, state-of-the-art fitness centers with a big screen and an outdoor view. We leverage technology, which is both friend and foe as it improves efficiency but also introduces lots of distractions.

Mainly, we still differentiate through service. The guest’s experience is key. We say “hi” at breakfast, and find ways to make the guest’s day. We know the top 50 guests at each hotel personally. Beyond this, we monitor social media for patterns and comments, and field at least 25 surveys per month.

What distinguishes a guest experience at one of your hotels?

It comes down to recognizing and acting on opportunities that will make the guest’s experience well above their respective brand averages, and strive for the top five or 10 percent.
Messiah College Performance Center Opens

The Janet and Calvin High Worship and Performing Arts Center opened in January at Messiah College in Mechanicsburg, Pa. The venue provides 92,000 square feet of dedicated space for theatre and musical arts programming, and includes an expanded performing arts venue with seating for 825, along with a choir loft seating 140-160 to be used for concerts, public lectures, and chapels. The High Center was designed by Greenfield Architects, Ltd. and constructed by High Construction Company.

American Subcontractors Association Recognizes High Construction Company

High Construction Company received the American Subcontractors Association (ASA) 2012 National Construction Best Practices Award. The award recognizes firms that perform work as prime contractors and that have demonstrated an extraordinary level of commitment to best industry practices. The evaluation was performed by the ASA Task Force on Ethics.

High Associates Named Accredited Management Organization of the Year

In December, 2012, High Associates Ltd. became the first South-central Pennsylvania winner of the Accredited Management Organization (AMO) of the Year. Awarded by the Institute of Real Estate Management (IREM), the AMO is the real estate industry’s highest honor in property management. The award is based on the high level of performance, experience, and financial stability among real estate management firms throughout eastern Pennsylvania and Delaware.

High Hotels Partners with AMERIgreen to Offer EV Charging Stations

High Hotels Ltd. has introduced electric vehicle charging stations at its properties in Greenfield Corporate Center in East Lampeter Township, Lancaster, Pa. Guests of the Courtyard by Marriott, at 1931 Hospitality Drive, and the Hampton Inn, at 545 Greenfield Road, can fully charge their all-electric or plug-in hybrid vehicles in two to four hours. The two new charging stations join a third station in Greenfield Corporate Center next to the offices of AMERIgreen Energy, a Lancaster, Pa.-based wholesale energy provider. Green Plus™-Certified High Hotels sought the eco-friendly amenities as part of an ongoing focus on sustainability and environmental stewardship.

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Mill Creek Square shopping center along Lincoln Highway East in East Lampeter Township, Lancaster County, continues to attract exciting new retailers. The new stores bring Mill Creek Square’s Phase I occupancy to 99 percent; overall, with Phase II, the shopping center is 91 percent leased.

Anchored by Kohl’s and featuring national retailers Bed, Bath, & Beyond/buybuyBABY, Christmas Tree Shops, Ross Dress for Less, Petco, and Staples, Mill Creek Square welcomed Tran Nailery & Spa, providing superior nail care services, to a 1,672-square-foot space in November. Kiwi Yogurt, a family-owned fresh frozen yogurt chain, opened a 1,633-square-foot space on January 31. HoneyBaked Ham, specializing in premium handcrafted spiral-cut ham, will open a 1,955-square-foot store in March. And Noodles & Company, a casual restaurant featuring Asian, Mediterranean, and American-inspired fare, will open a 2,740-square-foot restaurant this spring.

The Noodles building was designed by Greenfield Architects Ltd., and the site and shell building is a project of High Associates Ltd.’s Construction Services Group. Leasing was by High Associates’ Brokerage Services.

The following High® properties have been awarded or are eligible for the ENERGY STAR:

- The Corporate Office of the High companies, Greenfield Corporate Center, Lancaster, Pa.
- Courtyard by Marriott, Lancaster, Pa.
- Courtyard by Marriott, Middletown, N.Y.
- Hampton Inn, Harrisburg, Pa.
- Hampton Inn, Lancaster, Pa.
- Homewood Suites, Harrisburg, Pa.
- Mallard Pointe, Class-A office facility, Charlotte, N.C.
- SpringHill Suites, Ewing, N.J.

Kiwi Yogurt opened a new store featuring frozen yogurt treats.

Tran Nailery & Spa opened its Mill Creek Square location in November, 2012.

buybuyBABY is now a featured “store-within-a-store” at Mill Creek Square’s Bed Bath & Beyond.

HoneyBaked Ham, a cafe-style restaurant and permanent location for picking up holiday hams and other foods, opened in time for Easter.

Noodles, a Denver, Colo.-based casual fare restaurant, is located on the pad site by the entrance to Mill Creek Square.
Care should be exercised in allocating gain to the appropriate categories to minimize tax.

Like-Kind Exchanges

If you’re considering a sale of real estate and want to defer the tax, the opportunity to do so is still available under Section 1031. It requires a taxpayer to essentially take ownership in like-kind property instead of receiving cash (or paying off a mortgage). The opportunity remains available, and is now a bit more valuable considering the increases in tax rates. Of course, one must be willing to acquire real estate instead of cash, and although the definition of like-kind is a fairly expansive concept, the mere fact that properties exchanged both constitute real property does not entirely determine whether they are of like-kind. It is best to consult your tax advisor in the early stages of planning for any such transaction.

Installment Sales

Noting the various income thresholds that a taxpayer must now consider in planning for higher tax rates, installment sales may become more attractive. If the gain attributable to the sale of a piece of real estate can be spread over a number of years through the use of an installment sale, it may keep the taxpayer below the income thresholds that exist under the 2012 Tax Act or the Medicare tax.

Cost Segregation Studies

These studies can be used to accelerate depreciation deductions on developed or acquired real estate. They involve hiring a consultant who specializes in such studies to identify assets within a building that, using an engineering-based approach, can be depreciated over a shorter life. These studies continue to be viable to maximize the tax benefits of real estate, and while there is a cost to obtaining them, the benefits usually far outweigh the cost. There are some considerations in applying this technique, if flipping the property in the not-too-distant future is in the cards:

- The increase in depreciation can result in a higher tax bill at time of sale under the depreciation recapture provisions.
- Certain property identified in such a study is not eligible for installment sale treatment.

Consult Your Tax Advisor

With the myriad of thresholds and income tax rate increases along with the new Medicare tax on investment income, taxpayers should be thinking now more than ever about appropriate tax planning strategies to minimize their 2013 tax bills. If you run a successful business or are contemplating a transaction in 2013 that can push your income higher, consult your tax advisor earlier rather than later in the year.

A Passion for Legendary Service

Your company is Green Certified. How does sustainability fit in?

Sustainability is an initiative that has been undertaken by every High company. It’s important to our customers, even if they don’t know what it means to their experience with us. Four of our properties have earned the ENERGY STAR, which means they are more energy efficient than most comparable properties. Every property has a light touch housekeeping model.

The fact is, if you’re traveling, you’re burning energy. Our goal is to work with our brands and suppliers to minimize this impact by measuring and reducing our carbon footprint. Going forward, we’re evaluating LEED-NC for new properties. Something innovative and different we completed last fall is our electric vehicle charging stations, one each at our Courtyard by Marriott and Hampton Inn properties in Lancaster. They’re among the first in our area, and they’re free to the public.

What does the future hold for High Hotels?

All indicators are that each coming year is going to be better than the last, just not as dramatically different as in the days before the recession. Supply has not grown, but the economy is slowly expanding so we’re cautiously optimistic and have begun to plan for new properties. We prefer to build, which introduces more risk but also more control of final product. We also recognize that if we buy, there is a better return opportunity but the upside is probably moderated. It comes down to economics, and a potential seller’s motivation.

Most importantly, we’re partnering with our brands and local attractions to create programs and promotions that build loyalty. We’re doing our best to provide our guests with an outstanding experience. We continue to emphasize employee satisfaction, guest satisfaction, and product excellence.
operating officer Michael Fruin. “We’re in the business of taking care of people, so we’re careful to bring on employees who are passionate about what they do.”

Fruin takes pride in his organization’s well thought-out and well executed culture. “Our employees have a voice in how we do business. We engage with our guests to better understand their needs, and address any issues on the spot. We want to make their day, and we get a thrill out of making a difference.”

“I’d love to be able to snap my fingers and instantly be in any of our hotels to talk to our guests,” says Fruin.

High Hotels has expanded its footprint of business from a single hotel property to 12. As it has grown, the company has embraced the principles of responsible stewardship of the environment and the greater community that are shared by all High companies. High Hotels is a Green Plus Certified company. Several of its properties have been awarded the ENERGY STAR. The company was among the first to introduce electric vehicle charging stations, which are available to guests at its Lancaster-area properties.

As for the future, expect more hotels. “It’s good to be an eternal optimist, but all the indicators are that each coming year will be better than the last,” says Fruin. High Hotels’ commitment to employee and customer satisfaction will continue to drive its success.