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Investment Guide

Condo-oasis

Matthew Swibel 06.04.07

Still got the nerve for investment real estate? Snatch a place with built-in tax breaks.

Condo-mania is no more. Gone are the buyers camping out overnight to bid on units. Gone are the speculators who bought property just to flip it a month later. Gone are the double-digit annual price climbs in hot markets like Seattle, Fort Lauderdale and Phoenix.

Today condominium developers offer freebies like flat-screen TVs and pay closing costs to get folks through the door. In 2006 the median condo sales price fell 1%, and it has remained stagnant in the first part of 2007. The nation's condo inventory is 21% higher than it was last year.

But if you're still interested in condos, whether as a residence or an investment, there are even better enticements you may tap: Some municipal governments are offering tax breaks for condo developments, often converted from previous uses. These concessions can greatly lower your costs.

You won't get rich off these favors, but they'll make it easier to wait until the market recovers. City Hall isn't granting the tax goodies, of course, for the Gold Coast. The favored neighborhoods are seedy, and the best thing that can be said is that they show promise. You're betting that your rundown area will gentrify.

That's the case with Jon P. Potvin, who paid \$216,000 in October for a two-bedroom condo in Union Square, a 180-unit development in a former school in Grand Rapids, Mich. The 131-year-old building sports a rooftop pool and is convenient to the city's downtown bar scene and arena. Deserted at night and often in the day, his new neighborhood, designated an "improvement district," is full of rundown industrial buildings. Potvin, 27, is schooled in real estate ways; he's a mortgage consultant by trade. He has rented out the Union Square condo and lives upstairs in a two-bedroom penthouse condo.

If he unloads his rental unit before 2013, the purchaser will receive tax perks, which Potvin thinks will make selling easier. Any potential occupant will get a holiday on state and local income tax for owning in the improvement district, where residents pay only federal income tax and school bond levies, thanks to multiple subsidies from state and local governments. "That's a huge part of why it made sense for me to buy," he says.

Potvin saves \$5,300 a year in property taxes on his rental until 2018 (this benefit transfers to a new owner as well). Because of this break the \$18,000 per year in rent he rakes in more than covers the \$16,800 in carrying costs--his mortgage, home insurance and homeowners association dues. On his income tax return there's one part of these carrying costs that he can't deduct (the repayment of principal on the mortgage), but there's a paper writeoff that he can claim--\$13,500 in depreciation. To fatten that deduction he divided the rental book value into components so he can get faster depreciation on items like countertops.

If Potvin sells at a gain, he'll owe federal income tax, but not too much. Any gain attributable to past depreciation is taxed federally at 25% or more. The balance is taxed at a top rate of 15%.

Tax abatements for residential development have been around since at least the 1990s in large cities such as Philadelphia and New York, when officials were begging builders to rehabilitate vacant buildings in downtrodden neighborhoods. This is a way for politicians on the left and right to micromanage their economies and promote social goals--even to rejuvenate downtowns in cities like Grand Rapids that most people don't think of as having downtowns.

Over the past year high-end condo projects in locales such as Kansas City, Des Moines, Brooklyn, Harrisburg, Columbus, Tacoma, Wash. and Richmond, Va. have dangled similar tax holidays in front of buyers' noses (*see table*). Condo developers

are understandably happy for the boost. For one thing, in a time when home lenders are tightening mortgage eligibility, the tax savings increase the number of folks who can get loan approvals.

"You can spend more and afford to buy more house," enthuses Christina Buchanan, project manager at the City Steps condo a few blocks west of the University of Washington campus in Tacoma. There the developer will reap a property-tax break on what it spent to construct the building on an empty acre of land. The condos include such luxury amenities as granite countertops, private patios with sprinkler systems and natural gas fireplaces. Once a buyer takes over a condo, he assumes the breaks through 2016.

Most of these giveaways last a long time. The Lock Lane condominium in the leafy West End section of Richmond, which became available in April, offers a 15-year tax abatement on the \$15 million worth of restoration to the 1930s-era set of brick apartment buildings. (A developer, Robinson Development Group, purchased the complex in December 2005 for \$11.2 million.) City taxes get phased in between 2018 and 2023 at a 20% yearly clip, until they reach the full assessed value.

If you want to buy a condo for investment, read the fine print. In many new projects developers limit the number of investors--that is, those who don't live there and rent out their units--to as little as 10% of total available units. And that's despite more lenient standards set by Fannie Mae, which buys many condo mortgages from lenders. Fannie Mae permits an investor-owned level as high as 30%.

The View, a glitzy (24-seat, on-site private movie theater; indoor and outdoor swimming pools; 24-hour doorman) building in Kansas City, Mo. caps investor-owned units at 20%. Of the building's \$40 million market value, \$38 million is considered building improvements and is exempt from property taxes.

For View owner Cory Kauffman, 29, that translates to \$77 in yearly property taxes for the next 22 years on his 1,600-square-foot condo, bought last fall. Without the breaks, he'd be ponying up \$3,475.

Tax-Wise Property Plays

A sampling of condo projects with tax abatements.

CITY	DEVELOPMENT	TAX BREAKS EXPIRE ¹
Des Moines	Olive Street Condos	2017 ²
Grand Rapids	Union Square	2013 ³ and 2018 ⁴
Harrisburg	Market Street Lofts	2017 ²
Kansas City	The View	2030 ⁵
Richmond	Lock Lane	2023 ⁵
Tacoma	City Steps	2016 ⁶

¹Assumes 2007 purchase. ²No property tax on building improvements. ³No state or city income tax. ⁴No property tax. ⁵Exemption from property tax gets phased in beginning in 2018.

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