October 12, 2022

The Honorable Debbie Stabenow
U.S. Senator
731 Hart Senate Building
Washington, DC 20510

The Honorable Jimmy Gomez
U.S. Representative
1530 Longworth House Building
Washington, DC 20515

Dear Senator Stabenow and Representative Gomez:

The economic strength and resiliency of the United States heavily depends on the real estate industry. Real estate not only drives private sector job growth, but also contributes significant tax revenues to all levels of government, especially municipalities struggling to raise much-needed financing for critical public services. Today, many buildings are being reimagined and repurposed to address a severe shortage of housing and meet other post-pandemic business needs. The undersigned organizations commend your introduction of the *Revitalizing Downtowns Act* (S. 2511, H.R. 4759) and encourage you to consider certain enhancements and expansions of the bill. These improvements would help mobilize greater private investment for the conversion of older buildings to new uses.

The conversion of underutilized and often vacant buildings offers a tremendous opportunity to improve the built environment and lift a surrounding locality. Property conversions are a cost-effective means to develop new housing supply, create jobs, and generate critical sources of local property tax revenue. These projects can occur in a variety of settings, from central business districts and suburban office parks to rural communities and industrial facilities. The repurposing of existing structures can save energy while reinvigorating communities and reigniting economic growth where it is most needed.

The litany of economic and social benefits arising from the 'adaptive reuse' of older buildings include the following:

- *Reduced housing costs.* The underproduction of housing in the United States has driven up housing costs to unsustainable levels. Today, 24 percent of renter households spend more than half their income on housing (rent and utilities). The conversion of older commercial buildings to residential use can produce new housing supply and reduce the cost of rental housing.

- *Energy and climate savings*. An old building can consist of materials with lifecycles greater than its initial occupancy. The unnecessary demolition of an existing building is a waste of material and energy. Real sustainability is achieved by optimizing the use of existing structures and preserving their embedded energy through adaptation and repurposing. Extending the useful life of a building through a conversion reduces demands to consume and transport construction materials, avoids industrial energy consumption, and lowers net greenhouse gas emissions and pollution.

- *Reduced pressure on infrastructure*. Conversions provide the ability to meet the needs of a growing population while conserving land and reducing the need for new infrastructure and commuting corridors.

- *Small business expansion*. Because the adaptive reuse of buildings costs less than new construction, renovated spaces are often made available at lower rents to start-ups and other small businesses.

- *Jobs*. Property conversions are labor-intensive, creating well-paying jobs for skilled individuals engaged in all aspects of the redevelopment process, including architects, engineers, skilled tradesmen, general contractors, and many others. The underutilized real estate asset, once converted to its new use, will serve as a more durable source of permanent employment for property managers, employees, contractors, etc.

- *Increased productivity*. Demands on the built environment are rapidly changing. From the nature of physical stores and workplaces to the growing need for logistical facilities and affordable rental housing, U.S. real estate must adapt to meet these needs. The conversion of an older building is a detailed process that involves upgrading and enhancing the performance of building to suit modern standards and changing user needs while preserving most of the original structure. When a property conversion is successful, the end result is a more productive and economically efficient mix of real estate assets.

- *Investment in neglected areas*. Property conversions are most likely to occur in otherwise neglected and historically overlooked neighborhoods and communities, where underutilized and vacant buildings are prevalent. In this way, supporting the adaptive reuse of buildings is an effective way to drive private sector investment towards areas—urban and rural—most in need.

- *State and local tax revenue*. The depressed asset values of underutilized buildings are a drag on state and local tax revenue. Underperforming buildings translate into less property, sales, and business taxes for a locality; fail to generate the level of activity needed to support a local economy; and undermine the surrounding community's vitality. Property conversions restore buildings to their best use—lifting asset values, economic activity, and state and local tax revenue that finances critical public services like schools and law enforcement.

Unfortunately, a combination of economic, legal/political, and practical factors frequently deter the adaptive reuse of older buildings. The conversion of a building is typically more complex than projects that start with a blank slate and follow a typical ground-up, development path. Property acquisition, permitting, development review, toxic contamination, property age and code conformance, and a "not in my backyard" (NIMBY) sentiment, are all obstacles that frequently arise and must be overcome. On a very practical level, the structural elements of an existing structure—columns, beams, floor layouts and size, ceiling height, etc.—often pose hurdles that add cost and extra delays to an otherwise desirable repurposing of a building. Unexpected and sometimes expensive issues can arise related to wiring, water pipes, materials and many other variables. All of these factors create additional risks that complicate the financing of a property conversion and raise the cost of capital for property owners and developers.

The inherent risks and elevated costs associated with property conversions, combined with the numerous social and economic benefits of conversions that flow to the broader community, justify proactive government policies that incentivize owners to adapt existing properties to new uses. Unfortunately, overly restrictive permitting, zoning, and land use rules and regulatory red tape at the local level regularly act as a major constraint on even the most beneficial projects. Clearly, an additional impetus is needed to unleash the badly needed solutions that smart property conversions can provide. The *Revitalizing Downtown Act* is an important first step toward spurring greater capital investment in property conversions by providing that impetus.

The *Revitalizing Downtowns Act* would provide a 20 percent tax credit for qualified property conversion expenditures. The credit is modeled on the historic rehabilitation tax credit and can be used for office buildings that are at least 25 years old at the time of the conversion. Under the bill, a conversion to housing may qualify for the credit if the project provides at least 20 percent affordable housing (*i.e.*, housing dedicated to households whose income does not exceed 80 percent of the Area Median Income (AMI) and offered at a rent affordable to such households); or is subject to an alternative affordable housing arrangement under state or local policy, ordinance, or agreement.

We urge you to consider certain modifications and enhancements to the bill that would help ensure its success in driving additional investment and bringing down housing costs.

1. <u>Expand the category of properties eligible for the credit to other types of commercial buildings</u>. The legislation is currently limited to the conversion of office buildings. The same economic benefits arise when other underutilized buildings are converted to a new, more productive use. Other types of languishing or vacant properties should qualify for the credit, including but not limited to: malls, shopping centers, industrial properties, and hotels. Doing so could vastly expand the potential of the incentive to achieve its goals.

2. <u>Extend the incentive to real estate investment trusts (REITs)</u>. REITs own close to 15 percent of all commercial real estate in the United States. REIT income is distributed to shareholders, but REITs generally are not able to pass tax credits through to these investors. In certain situations, Congress has structured credits to facilitate their use by REITs, including in the modified energy credits enacted in the *Inflation Reduction Act*. In other situations, states have allowed REITs to treat certain credits as a payment of taxes, refundable to the extent it is in excess of any minimum payment due by the REIT, such as in the case of brownfield tax credits in New York State. In order to achieve its objectives, a property conversion incentive should include a viable option for REITs and other taxpayers that may not be able to benefit easily from a tax credit. The most economically efficient approach would be a direct pay mechanism that allows REITs and other taxpayers to treat the credit as an overpayment of taxes. Alternatively, the credit could be made transferable to other, unrelated taxpayers.

3. <u>Modify the basis increase required to qualify</u>. As drafted, a taxpayer must double the adjusted basis of a building and its structural components during the conversion process to qualify for the credit. This threshold level of investment is too high and will exclude many beneficial and productive property conversion projects from moving forward. We recommend reducing the conversion expenditure requirement to 50 percent of the adjusted basis of the structure.

4. Clarify that the property conversion credit does not reduce other tax benefits. We recommend modifying the legislation to ensure that the property conversion credit does not reduce a taxpayer's low-income housing credit, new markets tax credit, energy-related credits, enhanced deduction for energy-efficient commercial property, or other tax incentives that serve specific policy objectives. Reducing other tax benefits in proportion to the allowable conversion credit would simply cancel out the incentive effect of the legislation and discourage those projects that are most warranted, Including affordable housing and economic development in distressed areas.

5. Provide a bonus credit for properties located in low-income areas. The conversion of older, languishing buildings to more productive uses offers tremendous potential to create jobs, spur small business expansion, and generate affordable housing in communities where it is needed most. However, conversion projects in economically distressed areas require significant resources and involve additional financial risks that often deter investors. To compensate for the additional costs and risks, the low-income housing tax credit provides a bonus credit for projects in qualifying census tracts. Similarly, we recommend that the property conversion incentive include a bonus credit of 10 percent for projects in qualifying, low-income census tracts. A meaningful bonus credit will help ensure that the new tax incentive drives investment and job growth in areas of need.

6. Allow government buildings to qualify. We recommend modifying the legislation to allow the conversion of a government building to qualify, perhaps even if the government office building is less than 25 years old. As drafted, the incentive is only available if the building previously was leased, or available for lease, to office tenants. Allowing the credit to apply to the conversion of governmental buildings (by their new, private-sector owners) will increase the value of those properties and thus the potential revenue for state and local governments from the privatization of underutilized buildings. It will also facilitate an increase in the housing stock, generate additional commercial space for small business growth, and create new jobs.

7. Include costs associated with cleaning-up brownfields. The U.S. Environmental Protection Agency estimates there are 450,000 brownfields sites in the United States. Property conversions can be complicated by the presence (or potential presence) of hazardous substances and contaminants. We recommend modifying the bill to include clean-up and decontamination costs as a qualified "conversion expenditure" at designated brownfields sites.

8. Specify the period during which rental units must be rent restricted. As drafted, the legislation requires that properties converted into residential rental property must be rent restricted. Either 20 percent of rental units must be rent restricted and occupied by individuals whose income is 80 percent or less of area median income, or a building must be subject to a binding agreement with a state or locality. While the second option would presumably include a period during which an agreement is operable, the first option includes no such period. We recommend requiring a 15-year compliance period that is consistent with the low-income housing tax credit's affordable rent restrictions.

9. Further promote the conversion of properties into affordable housing by enabling States to use tax-exempt Private Activity Bonds to reduce financing costs. For conversion projects that are primarily dedicated to providing affordable housing, state housing financing

agencies could be authorized to issue tax-exempt bonds to provide the owner with a lower cost of capital for all or a part of the project. In order to maximize the impact and benefits of the incentive, state housing finance agencies could issue tax-exempt financing following a competitive allocation process and specifically in jurisdictions that have a plan to track discriminatory land-use policies as envisioned by the *Yes In My Backyard* (*YIMBY*) *Act* (S. 1614).

A modified and expanded *Revitalizing Downtowns Act* offers tremendous potential to spur a new wave of productive, private investment in older buildings that leads to the creation of new affordable housing, energy savings, and job growth. Please contact Ryan McCormick of The Real Estate Roundtable at rmccormick@rer.org or (202) 639-8400 if you have any questions or would like more information. We look forward to working with you and your colleagues on this initiative.

Sincerely,

American Hotel & Lodging Association
American Land Title Association
American Resort Development Association
American Seniors Housing Association
Appraisal Institute
Asian American Hotel Owners Association
CCIM Institute
ICSC
Institute of Real Estate Management
Mortgage Bankers Association
NAIOP, the Commercial Real Estate Development Association
National Apartment Association
National Association of REALTORS®
Nareit
National Multifamily Housing Council
The Real Estate Roundtable

CC: Members of the Senate Committee on Finance
Members of the House Committee on Ways and Means