The Real Estate Roundtable

April 15, 2024

The Honorable Jared Bernstein
Chair, Council of Economic Advisors
The White House
1600 Pennsylvania Avenue, NW
Washington, DC 20500

Dear Chair Bernstein:

Converting underutilized commercial buildings to residences is central to President Biden's plan to build and renovate two million homes, and cut housing costs for America's working families.[1] The *2024 Economic Report of the President*, prepared under your leadership, recognizes the importance of federal financing programs that increase "housing supply and affordability, especially in locations close to public transportation."[2] Domestic Policy Council Director, Neera Tanden, has remarked that strategies to increase residential supplies include "converting property into housing."[3] National Economic Council Director, Lael Brainard, agrees that "place-based policies" supporting housing conversions can create "more resilient, productive, and innovative communities – and revitalize cities."[4] Climate action can tell "the story of renewal and repair,"[5] observed National Climate Advisor Ali Zaidi.

We applaud the drive and creativity that mobilized the White House's release last October of the "Guidebook to Available Federal Resources" ("Federal Guidebook") to support commercial-to-residential property conversions.[6] Reimagining unproductive commercial assets will help shrink the nation's deep housing gap, rejuvenate business districts still recovering from the pandemic, create well-paying jobs, support small businesses, shore-up local tax bases, and reduce carbon emissions from the building sector. The Biden-Harris Administration is on-the-mark to assess agency resources from the *Inflation Reduction Act (IRA)* and the *Bipartisan Infrastructure Law (BIL)* that may help conversions pencil-out. These projects involve assets with diminished values, carry high capital risks, and are prime candidates for federal assistance to attract private sector investors.[7]

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[1] Fact Sheet: "President Biden Announces Plan to Lower Housing Costs for Working Families" (March 7, 2024); Fact Sheet: "Biden-Harris Administration Takes Action to Cut Energy Bills, Housing Costs and Climate Pollution" (Oct. 19, 2023); Statement, "Biden-Harris Administration Announces Actions to Lower Housing Costs and Boost Supply" (July 27, 2023).

[2] Council of Economic Advisers, *2024 Economic Report of the President*, ch. 4, "Increasing the Supply of Affordable Housing) at p. 166 (March 21, 2024).

[3] Neera Tanden Remarks to Press on "Commercial to Residential Housing Conversions" (Oct. 26, 2023).

[4] Remarks by National Economic Advisor Lael Brainard on "Place-Based Growth: Helping Communities Making a Comeback" (Jan. 22, 2024).

[5] Keynote address of Ali Zaidi at 2023 Greenbuild conference, as reported by The Verge (Nov. 2023).

[6] "Commercial to Residential Conversions: A Guidebook to Available Federal Resources" (Oct. 2023, version 1).

[7] "Converting Vacant Offices to Housing: Challenges and Opportunities," Bipartisan Policy Center (July 31, 2023).

Candidly, the Federal Guidebook's featured programs have not lived up to their promise – yet.[8] Our members' experiences reveal that these low-interest loans, guarantees, and tax incentives require key changes to serve the goal to re-purpose obsolete buildings. Attached to this letter is a list of recommendations, developed with our members' input, to refine these credit support programs as meaningful tools to support property conversions.

Many of our suggestions call for executive actions. We encourage the White House to drive the relevant agencies to issue appropriate guidance within their existing authorities as swiftly as possible.

For example, the Federal Guidebook provides that loans under the Railroad Rehabilitation & Improvement Financing (RRIF) program, administered by the Build America Bureau within the U.S. Department of Transportation (DOT), can finance commercial real estate property conversions with a close nexus to mass transit. Developers report it takes a year or longer, following submittal of a loan application, for DOT to issue proceeds to the borrower. That time lag needs to be slashed considerably for RRIF to entice existing lenders on a distressed commercial asset to work-out debt in lieu of foreclosure. While our recommendations specifically address the RRIF program, most will also improve other credit platforms identified in the Federal Guidebook such as Transportation Infrastructure Finance Innovation Act (TIFIA) loans.

Similarly, the Federal Guidebook touts a host of tax incentives authorized by the *IRA* to support building conversions. However, the section 45L tax credit for efficient multifamily construction, the 179D tax deduction for high performance building retrofits, and the section 48 tax credit for real estate investments to cut carbon emissions, all require modifications.

We commend your staff who are focused on advancing our shared goals to accelerate property conversions that boost the nation's residential stock. They have been accessible and enthusiastic to learn from owners and developers through listening sessions that address the unique challenges posed by adaptive reuse projects. Our dialogue has been productive and we look forward to further collaboration.

Please continue to contact Duane Desiderio (ddesiderio@rer.org) and Ryan McCormick (rmccormick@rer.org), Senior Vice Presidents with The Roundtable, to further the jobs, economic, and environmental benefits generated by housing conversions.

Sincerely,

Jeffrey D. DeBoer
President and Chief Executive Officer

Cc:
The Honorable Lael Brainard
The Honorable Neera Tanden
The Honorable Ali Zaidi

[8] "Why a White House Plan to Fund Office-to-Housing Conversions Isn't Working Yet," Bloomberg Citylab (March 2, 2024).

Recommendations to Improve Railroad Rehabilitation & Improvement Financing (RRIF) Loans

- ***NEPA categorical exclusion for property conversions:*** Navigating the National Environmental Policy Act (NEPA) process is enormously time consuming. It discourages investments in low-carbon real estate that must move quickly in the underwriting pipeline to minimize capital and permitting risks. The environmental and emissions benefits of re-purposed buildings, such as avoided carbon embodied in construction materials and proximity to mass transit, are valued by the Administration.[9] DOT and the Council on Environmental Quality (CEQ) should issue a NEPA categorical exclusion for conversion projects with no or a *de minimis* increase to the building's existing footprint. A NEPA exclusion should encompass pre-acquisition property entitlement and pre-development activities necessary to transform diminished assets into housing.

  Furthermore, any NEPA exclusion for property conversions developed by DOT in the context of RRIF (or TIFIA) should sync with like-kind exclusions developed by HUD, EPA, and DOE for their respective programs in the Federal Guidebook. Where a commercial reuse project can layer multiple federal incentives, White House CEQ should issue guidance providing that one agency takes the lead on environmental reviews with sister agencies to speed the NEPA timeline. The lead federal agency should also coordinate with state and local bodies to streamline their "mini-NEPA" reviews.

- ***Clarify Eligible RRIF Costs for a Property Conversion:*** The RRIF statute states that loans can be used "to finance economic development, including commercial and residential development, and ***related*** infrastructure ***and activities*** ….."[10] Agency guidance is needed to clarify that "related activities" for RRIF-supported conversions should harmonize with TIFIA-eligible costs[11] for essential pre-construction tasks like site planning, feasibility analyses, revenue forecasting, environmental reviews, permitting, and building engineering/design activities. Excluding such pre-construction "soft costs" from RRIF would make the program infeasible for housing conversions, because they comprise a large share of project outlays where the building's primary "core and shell" remain intact.

  Guidance should also explain that costs for lease buy-outs and other efforts to relocate commercial tenants are RRIF (and TIFIA) eligible. The governing RRIF statute states that loans shall not be used for "***railroad*** operating expenses."[12] It does ***not*** state that ***building*** operating expenses are ineligible. We believe that agency guidance can clarify RRIF's inclusion of commercial tenant relocation expenses.

- ***Clarify RRIF lien priority issues vis-à-vis other federal loan programs, local PACE property tax liens, and other non-federal debt:*** RRIF loans cannot be subordinated to any other debt obligation.[13] The U.S. government must therefore occupy a prime lending position on the asset (in this case, a converted building) where it is pledged as collateral to secure a RRIF loan.[14] Generally speaking, the

[9] White House Council of Economic Advisers, "Commercial-to-residential Conversion: Addressing Office Vacancies" (Oct. 27, 2023).
[10] 49 U.S.C. § 22402(b)(1)(F).
[11] 23 U.S.C. § 601(a)(2).
[12] 49 U.S.C. § 22402(b)(2).
[13] *Id.* § 22402(l)(1).
[14] Pledging collateral is not a requirement but can reduce the credit risk premium that the RRIF borrower must pay upfront. *Id.*, § 22402(f)(6)(A); RRIF Express Loan Agreement, p. 3, "Security."

Federal Credit Reform Act and OMB Circulars require the federal government to occupy a senior position over other lenders for any loan or guarantee issued by a U.S. agency. White House guidance is needed to address the federal lien position when multiple credit programs catalogued in the Federal Guidebook are deployed to finance various elements of a single conversion, within each agency's loan authorities (*e.g.*, DOT, HUD, DOE and/or EPA).

Also, borrowers should be encouraged to layer RRIF (and other federal) loans with Property Assessed Clean Energy (PACE) financing offered by state and/or local governments. PACE models generally allow property owners to finance up-front costs for green building improvements through payment of real estate taxes over time. Because unpaid taxes would place a lien on the property, the Administration should clarify that RRIF (and other federal) loans for conversions allow limited PACE encumbrances to shore-up property tax revenues for the municipality.

With regard to other non-federal debt, guidance should clarify that a U.S. agency loan can be held *pari passu* with any commercial mortgage on the property. That is, if a bank's mortgage covers 60% of the overall debt and the RRIF loan is 40%, the borrower should make $6 repayments to the bank and $4 repayments to DOT for every $10 repayment.

- ***Tailor credit risk premium amounts to the financials of a transit-oriented project:*** RRIF currently requires borrowers to pay a credit risk premium ("CRP") before proceeds are disbursed to offset the risk to taxpayers in the event of default.[15] DOT has wide discretion to determine CRP amounts by estimating the total long-term cost to the federal government of the RRIF loan or guarantee.[16] Guidance is needed to ensure that CRP calculations translate specifically to real estate conversions, and not only large rail projects within the program's traditional scope. For example, HUD insurance[17] against loss on loan defaults would mitigate significantly risk on a RRIF loan. In that context, where a conversion layers HUD and DOT support, the CRP for the RRIF loan should be 0% (or close to it).

  Likewise, although RRIF does not have an affordability component, conversion projects that achieve low-income housing goals should be afforded a CRP preference in the low-end of the range. For example, a RRIF-supported conversion with 20% or more units dedicated to low-income residents should be afforded a CRP preference of 0% - 1% of the federal obligation.

  Significantly, DOT has proposed a rule to implement the *Bipartisan Infrastructure Law* that would avoid the CRP requirement with an additional spread above the RRIF loan's normal interest rate, as pegged to the U.S. Treasury rate for comparable-term securities.[18] DOT should finalize this rule in a manner that provides tailored, practicable guidance for transit-oriented property conversions – where the relevant revenue streams are not tolls or freight fees, but rental income generated by residential tenants.

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[15] 49 U.S.C. § 22402(f)(1),(4). Statutory factors to guide DOT's determination of CRP amounts include "the circumstances of the applicant, including the amount of collateral offered, if any"; "historical data on the repayment history of similar borrowers"; "consultation with the Congressional Budget Office"; and "any other factors [DOT] considers relevant."

[16] 49 U.S.C. § 22402(f)(2). CRP amounts are typically between 0% and 5% of the debt. Congressional Research Service, *The Railroad Rehabilitation and Improvement Financing (RRIF) Program* (Jan. 31, 2018).

[17] The Federal Guidebook (at pp. 31-34) catalogues HUD mortgage insurance programs as a key resource to assist property conversions.

[18] 89 Fed. Reg. 4,880 (Jan. 25, 2024).

If RRIF has any realistic chance to move the needle to increase housing supplies agency policy must guide CRP calculations unique to transit-oriented developments, and issue a reasonable interest rate alternative to upfront CRP payments, that resonate specifically with property conversions.

- ***Streamline Buy America Requirements:*** Buy America requirements administered by the Federal Transit Administration (FTA) direct that RRIF loans should not be obligated unless the massive quantities of steel, iron, manufactured goods, and construction materials used in major rail projects are produced in the U.S. Where other pressing policy goals – like addressing the nation's housing crisis – are undermined by Buy America requirements, FTA can issue a waiver. The Roundtable submits such a waiver is warranted at least for furniture, fixtures, operating supplies, and equipment ("FFE") that is not permanently affixed to the structure of a converted building.

  For non-FFOSE, DOT's loan documents should include a post-closing covenant that Buy America must be met where construction and other materials exceed 30% of the conversion project's overall costs.

  Similarly, many low-carbon building technologies (like electric heat pumps) are predominantly manufactured abroad. The Administration should issue a Buy America waiver to account for products and equipment produced overseas that help solve the climate crisis by making buildings more efficient and less carbon intensive.

- ***Streamline Uniform Relocation Assistance (URA) Requirements:*** URA is a law that HUD oversees. It establishes minimum standards to assist families and workers displaced from their homes, businesses, or farms as the result of federally-funded projects. URA's worthy objectives were not created with commercial conversion projects in mind – where the goal is to ***create*** (not displace) more housing. Yet, URA applies as a DOT loan condition. The agencies should issue guidance stating that commercial tenants "rolling-off" the building's lease accounts, before construction begins on a conversion, should not be subject to URA evaluation. Also, commercial tenants who have negotiated and received lease buy-outs from the project's developer should be deemed "made whole" and fairly compensated for URA purposes. DOT coordination with HUD is essential on these points to avoid duplicative or contradictory agency approaches that implement the URA mandate.

- ***Develop Template Loan Documents for Conversions:*** DOT's Letter of Interest, Application Form, and Express Loan Agreement have been drafted with large rail and infrastructure projects in mind. They have not been crafted with terms that speak to transit-oriented real estate conversions. DOT should develop template credit agreement documents – with input from the commercial development community – specifically geared to assist the agency's staff reviewing RRIF (and TIFIA) applications to assist housing conversions. An "express" loan agreement template should be prioritized. The Roundtable can activate leaders in our industry to help DOT develop such model documents.

- ***Lock-In the Original RRIF Loan's Terms for Subsequent Buyers of the Converted Asset:*** RRIF documents currently include a covenant that prevents a borrower from selling an asset without DOT's approval.[19] If DOT approves an asset sale it has discretion to change loan terms – including higher

[19] See RRIF Express Loan Agreement, p. 6 ¶ 6,"Sale of Assets."

interest rates – for the new buyer to assume. Conversions are already risky enough. Re-purposed buildings will stagnate in the marketplace unless subsequent buyers of converted housing receive stability on interest rates and other key loan terms. DOT's underwriting documents should clarify – at least for conversion projects – that the agency will maintain the original RRIF interest rate, keep the same maturity date, and respect other terms of the original loan where a new buyer agrees to the same debt service coverage ratios to which the initial borrower agreed.

- ***Bring Land-Use Equity to RRIF Geographic Eligibility:*** A RRIF-eligible transit-oriented conversion project must be within the ½ mile zone of an intercity or commuter rail station.[20] It can take years to design, engineer, permit, and build such a station. DOT should issue guidance that an intercity or commuter rail station that has received all necessary government land-use approvals – but is not yet finally completed – meets RRIF criteria.

  Moreover, the planning and growth patterns of many American cities intentionally built freight stations in manufacturing and industrial hubs that lie a distance away from residential communities, outside the "½ mile zone." RRIF loans have potential to encourage sustainable and equitable land-use patterns, but that will require the Administration to support policy changes that allow more localities to revitalize their downtowns using DOT's program. For example, the RRIF statute should be revised to adjust the "½ mile zone" in appropriate cases based on population density of certain cities. Also, changes should allow RRIF developments to fall within ½ mile of ***light rail*** stops.

Recommendations to Improve
Inflation Reduction Act (IRA) Clean Energy Tax Incentives

The Federal Guidebook describes tax incentives authorized by the *IRA* to support efficient construction, including property conversions. However, these incentives will not scale to achieve significant reductions in energy consumption or emissions in private sector buildings, for conversion projects or otherwise, without additional improvements.

- ***Section 45L Tax Credit for Multifamily:*** 45L provides a tax credit for new or significantly re-habbed single- and multi-family energy efficient homes certified under EPA's ENERGY STAR residential program. Office-to-residential conversions are theoretically eligible. But the statute is drafted in such a manner that makes little sense for multifamily developers trying to access the 45L credit.

  The *IRA* states the credit is allowed to an "eligible contractor" for homes they construct that are "acquired" by someone else, such as a home buyer.[21] Multifamily developers seeking 45L credits must meet ENERGY STAR criteria in effect on (or three years prior to) the date the "dwelling" is ***"acquired."***[22] The statute defines the term "acquired" to "include[ ]" – ***but is not limited to*** – when a

[20] 49 U.S.C. § 22402(b)(1)(F)(ii); 49 U.S.C. § 22401(12); Build America Bureau, "Transit Oriented Development Project Eligibility – Frequently Asked Questions" # 2.2.
[21] 26 U.S.C. § 45L(a)(1).
[22] Id. § 45L(c)(3)(A),(B).

home is "purchased."[23] IRS has exercised its interpretive leeway via a notice providing that the date a home is ***leased*** serves as a proxy for when it is "acquired."[24]

This IRS interpretation will render 45L unusable for many multifamily buildings, whether converted from offices or constructed from the ground-up. Multifamily assets are ***designed*** – and permitted by the locality – years before they are ***leased***. Meanwhile, ENERGY STAR frequently updates its residential certification criteria which can change markedly during the time that elapses between "design" and "leasing." The 45L credit will have limited uptake unless ENERGY STAR certification criteria are locked-in when the municipality approves the structure's design. IRS's interpretation effectively requires a multifamily developer to predict what ENERGY STAR criteria will be in effect in the future, when an apartment is finally open to tenants for leasing. The statute does provide a "look-back" period for ENERGY STAR criteria in effect three years before "acquisition" (*i.e.,* "leasing" as per the IRS's current interpretation in Notice 2023-65). However, the upshot is that any multifamily conversion or new construction that takes more than three years to design and build, before it is ready for occupancy, is precluded from 45L qualification.

As explained above, the statute gives the IRS ample discretion to construe when a dwelling is "acquired." Unless IRS construes the term "acquired" as the point when a multifamily developer "***acquires" a building permit*** from the local government that approves the design of the "dwelling," the 45L tax credit will be largely unusable for larger, complicated multifamily projects.

- ***Section 179D Tax Deduction:*** The Section 179D tax deduction for energy efficient buildings needs improvement, especially if it is intended to help finance conversions. 179D's structure as a deduction provides a timing benefit in the form of accelerated depreciation – and does not produce a net benefit to reduce a company's tax liability. Thus, 179D should be converted to a tax credit. Or, subsection 179D(e) should be revised to state the amount of the deduction should not reduce the depreciable basis of energy efficient commercial building property. Congress "turn-off" basis reduction in subsection 179D(e) as it has done to achieve other desired policy outcomes (such as in the contexts of the LIHTC and Section 48 investment tax credit).

- ***179D "Allocation" and 45L "Transfer":*** Section 179D allows government, non-profit, and tribal owners to "allocate" the deduction to third-party architects and contractors "primarily responsible" for the building's design. For-profit owners should get the same treatment under 179D to help reach the Administration's goals for high performance, low-carbon buildings. Similarly, 45L is not among the eleven (11) clean energy credits listed in section 6418(f)(1)(A) that are eligible for transfers to unrelated parties. These limitations render 179D and 45L largely unusable by REITs and other institutional owners of real estate who have limited appetite for tax incentives because of their income restrictions. The Administration should support efforts to reform sections 45L and 179D so REITS and other private owners are eligible for "transfer" and "allocation," respectively, to help reduce U.S. building emissions.

[23] *Id.* § 45L(b)(4).
[24] IRS Notice 2023-65, § 5.01 (p. 20).

- ***Section 48 Tax Credit:*** Nothing in the *IRA* specifically encourages commercial building electrification in the context of housing conversions or otherwise. Air-source heat pumps, induction cooktops, and other electrification equipment for building heating, hot water, and kitchen functions should be added to the list of technologies supported by the section 48 investment tax credit. Section 48(a)(3)(A)(vii) covers geothermal and groundwater heat pumps. Air source heat pumps should be covered, too.

- ***Streamline Prevailing Wage and Apprenticeship Paperwork Burdens:*** The Roundtable has explained that Prevailing Wage and Registered Apprenticeship (PW/RA) requirements seriously undermine the value of bonus tax credits.[25] We reiterate that the Administration can help taxpayers streamline the high paperwork and compliance costs to qualify for *IRA* bonus amounts. IRS should issue guidance that allows developers of housing conversions to rely on sworn certifications that general and subcontractors on the project have met all PW/RA requirements for the laborers and mechanics they have hired directly.

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For information on these comments, please contact Duane Desiderio (ddesiderio@rer.org) and Ryan McCormick (rmccormick@rer.org), Senior Vice Presidents with The Real Estate Roundtable.

[25] E.g., RER Comments to IRS on *IRA*'s PW/RA requirements for "bonus credits" (Oct. 30, 2023).