The Real Estate Roundtable

Real Estate Roundtable Policy Priorities —Fall 2023

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This document provides relevant information on The Real Estate Roundtable's key policy issues, including fact sheets and detailed issue briefs. The majority of the document consists of brief 1-2-page summaries of national policy issues currently facing the industry, The Roundtable's position on the issue, and helpful links for where to find additional information and details regarding The Roundtable's advocacy efforts. The document also includes multiple Roundtable-produced fact sheets distilling key legislation or regulations.

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Tax Policy
Taxing Unrealized Gains ("Billionaire Tax")

Issue

President Biden and certain key lawmakers, including Senate Finance Committee Chairman Ron Wyden (D-OR), have proposed a mark-to-market regime for capital assets in which built-in gain is taxed on an annual basis, regardless of whether the asset is sold. President Biden's proposal would impose a minimum 25% tax on the combined income and unrealized gains of taxpayers with $100 million in income or assets.

Taxpayers would report the total basis and estimated value of their assets on December 31 of each year. Tradable assets (e.g., public stock) would be valued using end-of-year market prices. Real estate and other less liquid assets would be valued at (a) the greater of original or adjusted cost basis, (b) the last valuation event from investment/borrowing/financial statements, or (c) other undefined methods.

Under the President's proposal, "illiquid" taxpayers, defined as taxpayers whose tradable assets make up less than 20% of their wealth, could elect to pay the minimum tax only on their tradable assets, with a deferral charge of up to 10% when gains on non-tradable assets are eventually realized.

Minimum tax payments would be treated as prepayments creditable against subsequent tax liability on realized capital gains. The tax in the first year would apply to prior, built-in gains and could be paid over a 9-year period. The tax in subsequent years could be paid over a 5-year period.

In the last Congress, efforts to include a version of the mark-to-market regime in tax reconciliation legislation were unsuccessful when they ran into resistance from moderate Congressional Democrats.

In June 2023, the U.S. Supreme Court granted certiorari in a case involving a 2017 tax on unrepatriated foreign earnings, *Moore v. United States*, that challenges the federal government's constitutional authority to tax unrealized income. The Moore case could have important implications for legislative proposals to tax unrealized gains.

The Roundtable's Position

Taxing unrealized gains would upend over 100 years of federal taxation, require an unprecedented IRS intrusion into household finances, and create unknown and likely unintended consequences for the U.S. economy.

- At its core, the proposed tax on unrealized appreciation is a federal property tax that would apply year-in, year-out, regardless of whether one's property (real estate, stock holdings,

paintings, jewelry, etc.) is generating any actual income, earnings, or profits for the taxpayer.

- The tax would require the IRS to police households as they identify, tabulate, and value all their worldly possessions. The tax would thrust the IRS into a new and unwelcome role. The agency would become a permanent, live-in accountant and watchdog over every aspect of households' finances, consumer activity, and economic life.
- Tens of thousands of taxpayers will need to prove that their wealth falls below the relevant threshold ($100 million).
- Supporters of the tax want to extend it to an even larger number of taxpayers. Senator Wyden’s original proposal would have applied the tax to the unrealized gains of households with $1 million in income or $10 million in wealth.
- History suggests the tax would eventually apply to everyone. In 1913, the federal income tax applied to 1/3 of 1% of Americans. Ten years later, it applied to seven million Americans. Today, it applies to more than 150 million households.
- Revenue generated by the tax ($38 billion/year) is insufficient to make even a dent in the budget deficit ($1.5 trillion in 2022).
- Past attempts at wealth taxes in other countries have failed overwhelmingly because they were fraught with administrative problems, lacked public support, and had very little impact on income distribution. Of the 12 comprehensive wealth taxes that existed in the developed world in 1990, only three remain today.
- The tax will trigger wasteful disputes and litigation, detracting from productive economic activity. Annual valuation requirements will require costly appraisals. Valuation disagreements will be a constant source of audits, disagreements, and administrative appeals with tax collectors.
- The potential unintended and unknown consequences of taxing unrealized gains are immense. The longstanding principle that taxes are deferred until a gain is realized encourages taxpayers to put capital to work on projects that won't pay off for many years. By taxing business assets and investments annually, the tax will remove one of the major incentives for patient, productive capital investment. The differential tax treatment of liquid and illiquid investments will distort markets and give rise to wasteful new tax shelters and taxpayer games.

Taxing Unrealized Gains ("Billionaire Tax")

- Charities, educational endowments, and churches will suffer. The ability to contribute appreciated assets to public charities and other nonprofits without owing tax on the unrealized gain provides an important economic inducement for philanthropic giving. Taxing unrealized gains on an annual basis will eliminate this economic incentive.
- The proposed tax is quite possibly unconstitutional. Supreme Court jurisprudence has applied a realization requirement to determine whether gains or profits constitute income taxable under the 16th Amendment. Since the proposed tax applies to both realized and unrealized gains, it may go beyond the boundaries of Congress's taxing power.

Capital Gains

Issue

Traditionally, the United States has taxed long-term capital gain at a lower rate than ordinary income (wages, rent, and other compensation). The only exception was a brief three-year period after the Tax Reform Act of 1986 when Congress lowered the top ordinary tax rate from 50% to 28% and created temporary tax parity between ordinary and capital income. Long-term capital gain is currently taxed at a top rate of 20%. However, the rate increases to 23.8% if the income is subject to the 3.8% tax on net investment income. The net investment income tax applies to real estate gains earned by passive investors and not income earned from the active conduct of professionals in real estate.

President Biden's budget proposes to raise the capital gains rate to 39.6%, which would bring it to parity with his proposed top rate on ordinary income. In addition, the president has proposed to increase the 3.8% tax on net investment income to 5% and extend it to the income of active business owners, including real estate professionals; the net investment income tax applies to both capital gains and rental income.

A proposed increase in the capital gains tax rate and an expansion of the 3.8% tax on net investment income were dropped from tax reconciliation legislation in the last Congress at the insistence of Congressional moderates, particularly Sen. Kyrsten Sinema (D-AZ).

The Roundtable's Position

Congress should continue to encourage investment and job creation with a meaningful capital gains incentive.

- Maintaining a reduced tax rate on capital gain decreases the cost of capital, drives long-term investment, encourages productive entrepreneurial activity, draws investment from around the world, and increases U.S. workforce productivity and competitiveness.
- Policymakers should be taking steps to encourage and reward risk-taking and investment in communities where it is needed, not punishing it.
- Capital gains tax incentives are effective in mobilizing capital. Opportunity Zones, which offer the potential to exempt capital gains from tax altogether, facilitated $75 billion in new investment in low-income communities in just their first two years after enactment.

Capital Gains

- Our country's great cities are facing significant challenges. Many cities have an aging infrastructure that can only be fixed with a sustained infusion of capital investment. Public spending alone is not going to get us there. It is going to require partnering with the private sector and private capital. Raising taxes on capital income will make it harder to attract the private investment needed to rebuild our urban centers.
- Risk capital differs in meaningful ways from wage compensation. The entrepreneur who foregoes a traditional job in favor of starting a business and building a capital asset forfeits many protections and benefits offered to employees, most importantly the certainty of a pre-negotiated salary. The capital gains preference partially compensates entrepreneurs for bearing risk and uncertainty, including the potential of a complete loss on the investment of their time and capital.
- Relative to our peers, the United States levies a heavy tax burden on capital income. According to the Tax Foundation, 30 of the 36 developed countries in the OECD have a lower maximum tax rate on individual capital gain than the United States.
- In the case of real estate, the reduced tax rate on capital gain partially offsets the higher risk associated with illiquid, capital-intensive projects. It also helps compensate for the economic effects of inflation.
- Unlike other tax policies, such as immediate expensing, the capital gains preference only rewards smart, productive investments that are economically profitable on their own, irrespective of the tax incentive.

Pass-Through Business Income

Issue

Real estate generally is owned and operated through "pass-through" entities that allow income to pass through to individual owners rather than taxing the income at the entity level. In 2017, Congress reduced the corporate tax rate by 40% and created a new 20% deduction (section 199A) for pass-through business income to avoid putting businesses organized as partnerships, S corporations (S corps), and real estate investment trusts (REITs) at a competitive advantage relative to large C corporations (C corps).

The 20% pass-through business deduction is temporary and scheduled to expire at the end of 2025. At that time, in the absence of legislation extending the 2017 individual tax cuts, the effective marginal rate on pass-through business income would rise by over one-third, from 29.6% to 39.6%.

Tax legislation proposed and considered in the last Congress would have significantly increased the combined tax rate on pass-through businesses. The version of the *Build Back Better (BBB) Act* that passed the House Ways and Means Committee in 2021 would have raised the top marginal income tax rate on many small and pass-through business owners from 29.6% today to 46.4%.

Senate Finance Committee Chairman Ron Wyden (D-OR) has proposed eliminating section 199A for pass-through business owners with more than $500,000 in combined income.

Largely at the insistence of Congressional Democratic moderates, particularly Sen. Kyrsten Sinema, tax reconciliation legislation enacted in the last Congress did not include any changes to the general tax rate on pass-through businesses or new restrictions on the 199A deduction.

The Roundtable's Position

Congress should continue to support small, closely-held, and entrepreneurial businesses that create jobs and spur growth by avoiding tax changes that discriminate against pass-through entities, such as partnerships and S corps.

- Our pass-through regime is a competitive strength of the U.S. tax system. Most other developed countries are heavily reliant on inflexible corporate regimes that provide little ability for an entrepreneur to tailor the capital and ownership structure to meet the needs of the business.
- Small and closely-held businesses are the principal drivers of job growth and entrepreneurial activity in the United States. Entity choice is a differentiator that contributes to our entrepreneurial culture.

Tax Policy

Pass-Through Business Income

- Half of the country's four million partnerships are real estate partnerships. Real estate investment, new construction and development, and rental businesses constitute a significant share of pass-through business activity.
- These partnerships include a wide variety of arrangements that range from two friends who purchase, improve, and lease a modest rental property to a large private real estate fund that raises capital from sophisticated institutional investors.
- Similarly, listed REITs provide the opportunity for small investors to invest in large-scale, diversified real estate operations using the same single tax system available to partners and partnerships.
- Pass-through entities such as partnerships, Limited Liability Corporations (LLCs), S corps, and REITs, are ideal for real estate investment because they give investors flexibility in how they structure the risks and rewards of the business. The benefits of pass-through taxation help compensate real estate owners for the additional risks and challenges associated with the ownership of large, capital-intensive, and relatively illiquid assets.
- Any new tax legislation should avoid the unintended consequences and potential harm caused by the stacking of tax increases on pass-through entities which, when combined, would severely increase the tax burden on these job-creating businesses.
- Congress should preserve the 20% deduction for pass-through income (section 199A). The availability of the deduction is tied to hiring workers and investing in capital equipment and property.
- The 20% deduction is a matter of tax fairness. It helps avoid putting pass-through businesses at a competitive disadvantage vis-à-vis large corporations, which received a permanent 40% tax rate cut in 2017.

Tax Policy

Real Estate Like-Kind Exchanges

Issue

Since 1921, the tax code has allowed taxpayers to defer capital gain when exchanging real property used in a trade or business for a property of a like-kind. The Tax Cuts and Jobs Act of 2017 narrowed like-kind exchanges (section 1031) by disallowing their use in the case of personal property (art, collectibles, etc.).

President Biden proposes to severely limit real estate like-kind exchanges. The President's budget would restrict gain deferred through real estate like-kind exchanges to no more than $500,000 per year, or $1 million in the case of a married couple. In 2021, the Senate unanimously passed a nonbinding budget amendment expressing support for preserving like-kind exchanges. The administration sought to include like-kind exchange restrictions in the most recent debt ceiling negotiations. Congressional Republicans rejected the proposal.

The Roundtable's Position

Congress should support healthy real estate markets and property values by preserving the current tax treatment of like-kind exchanges.

- Section 1031 is integral to the health of today's real estate marketplace: close to 20% of all commercial real estate transactions involve a like-kind exchange. Exchanges help get languishing properties into the hands of new owners who will invest in job-creating capital expenditures and improvements that put properties to their best and most productive uses.
- Exchanges helped stabilize property markets at the height of the COVID-19 lockdown and will facilitate a faster and smoother transition as many real estate assets are re-purposed in the post-COVID economy.
- Like-kind exchanges allow businesses to grow organically with less unsustainable debt by reinvesting gains on a tax-deferred basis in new and productive assets. In this way, like-kind exchanges create a ladder of economic opportunity for minority-, veteran-, and women-owned businesses as well as cash-poor entrepreneurs that may lack access to traditional sources of financing.
- Academic and outside research has found that exchanges spur capital expenditures, increase investment, create jobs for skilled tradesmen and others, reduce unnecessary economic risk, lower rents, and support property values.

Tax Policy

Real Estate Like-Kind Exchanges

- Roughly 40% of like-kind exchanges involve rental housing. Section 1031 is an important source of capital for affordable and workforce housing. Like-kind exchanges help fill gaps in the financing of affordable housing that are unmet by the low-income housing tax credit (LIHTC). In contrast to LIHTC, developers can use section 1031 to finance land acquisition costs for new affordable housing projects.
- Like-kind exchanges provide critical financing to support economic development and investment in low-income, hard-hit, and distressed communities where outside sources of capital are less available. In addition, like-kind exchanges support vital public services (i.e. police, education, etc.) by boosting transfer, recording, and property tax revenue. Property taxes contribute nearly 3/4 of all local tax revenue.
- Land conservation organizations rely on exchanges to preserve open spaces for public use or environmental protection.
- The ability to defer gain on a like-kind exchange is very consistent with a general policy in U.S. taxation that business-related gains are deferred provided the proceeds are retained and reinvested in the business. The deferral of gain in partnership (sections 721 and 731) and corporate (sections 351 and 368) transactions is allowed even when the proceeds are invested in property that is different from the property that generated the gain.

Tax Policy

Carried Interest

Issue

A "carried" interest is the interest in partnership profits that a general partner receives from the investing partners for managing the investment and taking on the entrepreneurial risk of the venture. Carried interest may be taxed as ordinary income or capital gain depending on the character of the income generated by the partnership. Lawmakers have introduced various proposals to change the tax treatment of carried interest since 2007. In the Tax Cuts and Jobs Act of 2017, Congress created a three-year holding period requirement in order for carried interest to qualify for the reduced long-term capital gains rate.

Legislation introduced by Representative Bill Pascrell (D-NJ), the *Ending Wall Street Tax Giveaway Act* (H.R. 2686), would convert virtually all carried interest income attributable to gain from the sale of real estate to ordinary income subject to both ordinary income tax rates and self-employment taxes.

President Biden has proposed to "close the carried interest loophole so that the hedge fund partners will pay ordinary income rates on their income just like every other worker."

Legislation approved by the House Ways and Means Committee in the last Congress would have extended the current holding period required for carried interest to qualify for long-term capital gains treatment from three years to five years. The extension of the holding period would include an important new exception for a real property trade or business (e.g., real estate). Other aspects of the House proposal would indirectly extend the required holding period by not starting the clock until all assets have been acquired by the partnership. However, the carried interest proposals were dropped from the bill before its passage by the full House.

In the Senate, Finance Committee Chairman Ron Wyden (D-OR) has proposed treating carried interest as an interest-free loan from the limited partners to the general partner that is taxable upon grant, regardless of whether the partnership ever generates any profits.

The Roundtable's Position

- The tax code should continue to reward risk-taking, and Congress should reject tax changes that limit capital gains treatment to invested cash.
- Much of the real estate investment that takes place today uses the partnership choice of entity. Real estate partnerships represent 50% of the nearly four million partnerships in the United States and include over eight million partners.

Tax Policy

Carried Interest

- Proposed carried interest changes would harm small businesses and partnerships, stifle entrepreneurial risk-taking and sweat equity, and threaten improvements and infrastructure in long-neglected neighborhoods most in need of investment.
- Carried interest is not compensation for services. General partners receive fees for routine services such as leasing and property management. Those fees are taxed at ordinary tax rates.
- Carried interest is granted for the value the general partner adds to the venture beyond routine services, such as business acumen, experience, and relationships. It is also a recognition of the risks the general partner takes with respect to the general partnership's liabilities. These risks can include funding pre-development costs, guaranteeing construction budgets and financing, and exposure to potential litigation over countless possibilities.
- Some carried interest proposals would apply retroactively to prior transactions—effectively raising taxes on sales that have already occurred.
- Moreover, the legislation would capture and apply to partnership agreements that were executed years— often decades—earlier. These negotiated agreements between the partners were based on well-established tax law as it existed at the time. By changing the tax results years later, the bill would undermine the predictability of the tax system and discourage the long-term, patient investment that moves our economy forward.
- In short, these proposals would make it more expensive to build or improve real estate and infrastructure, including workforce housing, assisted living communities, and industrial properties, to name just a few. Some development simply won't happen, especially in long-neglected neighborhoods or on land with potential environmental contamination.

Opportunity Zones

Issue

Created in the Tax Cuts and Jobs Act of 2017, Opportunity Zones (OZs) are designated, low-income census tracts where qualifying investments are eligible for reduced capital gains taxes. By channeling investment where it is most needed and prioritized by states and local communities, OZs help stimulate job creation and economic growth in low-income communities.

Capital gain from prior investments—proceeds from the sale of real estate, stocks, securities, etc.—can be rolled into an Opportunity Fund and the tax that would otherwise be owed on the gain from the prior investment is deferred and not taxed until the end of 2026. Second, capital gains tax on this deferred gain is reduced by 10% if the investment is held for five years or 15% if the investment is held for seven years (through a tax basis "step-up"). Third, capital gain generated from the investments made by the Opportunity Fund is exempt from capital gains tax altogether if the investment in the fund is held for at least 10 years.

Unfortunately, delays in the rulemaking process and the onset of the COVID-19 pandemic have short-circuited the full impact of OZs. The final OZ regulations were issued just four months (December 2019) before COVID-19 caused a national economic lockdown that severely affected taxpayers' ability to launch new real estate projects and other businesses.

In addition, the tax benefits associated with OZ investments are gradually phasing down and a significant OZ tax incentive expired at the end of 2021. Investors no longer qualify for the 15% basis step-up that applies to prior gain if the investment is maintained for at least seven years. Separately, the economic value of the temporary tax deferral that applies to gain rolled into an Opportunity Fund is gradually declining as 2026 draws near.

Bipartisan legislation (H.R. 5761) introduced in the House by Ways and Means Tax Policy Subcommittee Chairman Mike Kelly (R-PA), Rep. Dan Kildee (D-MI) and others would extend the OZ deadlines by two years, allow for helpful "fund of funds" OZ tax structures, and make other important OZ reforms. The changes include sunsetting the eligibility of certain high-income OZ census tracts for future investments, mandating new OZ information reporting rules, and creating a new fund for localities to support businesses and projects in OZs.

Similar legislation was introduced in the Senate in the last Congress by Senators Tim Scott (R-SC) and Cory Booker (D-NJ).

The Roundtable's Position

- In the short time since their enactment, OZs have created jobs and spurred billions of dollars in new investment in economically struggling communities across the country.

Opportunity Zones

- Opportunity Funds have financed affordable, workforce, and senior housing, grocery-anchored retail centers, and office buildings that allow new and growing businesses to gain a presence and create jobs in long-neglected neighborhoods.
- Other examples of productive activities in OZs include the rehabilitation of dilapidated buildings into new hotels that boost local tax revenue and serve as a magnet for jobs, visitors, and economic activity in the surrounding area.
- OZs have demonstrated extraordinary potential to improve communities. In 2020, the Council of Economic Advisors estimated that the Opportunity Funds had raised $75 billion in private capital in the first two years following the incentives' enactment, including $52 billion that otherwise would not have been raised. The council projected this capital could lift one million people out of poverty in OZs by 11%.
- The GAO estimated that 6,000 Opportunity Funds with more than 18,000 partners or shareholders invested $29 billion in OZs in 2019 alone.
- The decentralized design of OZs allows more investors and stakeholders to participate in the market and invest in qualifying projects that generate economic opportunity and improve the built environment in high-need communities.
- Congress should act quickly to extend expired OZ deadlines, as proposed in H.R. 5761. Extending the deadlines would ensure that OZs continue to act as a catalyst for economic development in struggling communities and allow the program to fulfill its original promise.
- Congress should also continue working on improvements to the OZ tax incentives, such as enhanced information reporting, data collection, and transparency, as well as lowering the substantial improvement threshold to cover a broad range of real estate rehabilitation and redevelopment projects.

Inflation Reduction Act Revenue Provisions: Fact Sheet

Issue

The *Inflation Reduction Act of 2022* (IRA) was signed into law by President Biden on August 16, 2022. The legislation was paid for through various provisions including adjustments to corporate taxes as well as a new stock buyback excise tax. The real estate industry encouraged lawmakers to drop proposed changes to carried interest rules that were part of the initial agreement between Senators Joe Manchin (D-WV) and Chuck Schumer (D-NY). The tax increases on carried interest were not included in the final legislation. The changes would have slowed housing production, discouraged the capital needed to reimagine buildings to meet post-pandemic business needs, and hampered job creation while creating an additional unknown in an already challenging economic environment.

The Roundtable will continue advocating for tax policies that facilitate capital formation, reward risk-taking, and bolster productive private investment. Below is our summary of key IRA revenue-raising provisions.

Corporate Book-Income Alternative Minimum Tax

The bill creates a new 15% corporate alternative minimum tax that applies when minimum tax liability exceeds regular tax liability, applicable for tax years beginning after December 31, 2022. The minimum tax has a lower rate—15% compared to the 21% corp. tax rate—but a broader base that reflects public accounting rules (GAAP or IFRS) rather than tax accounting rules. The base begins with financial statement income (book income) and includes certain adjustments. The tax applies to corporations with average annual book income, over a 3-year period, exceeding $1 billion.

REITs, S Corps, and RICs are exempt from the tax. For purposes of determining if a corporation is covered by the tax, a corporation's book income is aggregated with the income of all persons treated as a single employer under sections 52(a) or 52(b). However, a Senate floor amendment offered by Senators John Thune (R-ND) and Kyrsten Sinema (D-AZ) modified the aggregation rules to clarify that section 212 activities for the production or collection of income do not constitute a trade or business activity that requires aggregation under section 52. This amendment restricts the need to aggregate distinct portfolio companies that are owned under a private equity or other fund structure.

Inflation Reduction Act Revenue Provisions: Fact Sheet

Certain adjustments are made in measuring book income. Perhaps most importantly for real estate, tax depreciation deductions (e.g., accelerated depreciation and immediate expensing) are permitted for purposes of calculating book income. Book income is also reduced to reflect financial statement net operating loss carryovers.

The new minimum tax allows taxpayers to claim the low-income housing tax credit (LIHTC), new markets tax credit (NMTC), and other section 38 business credits to the same extent as allowed under the regular corporate income tax, ensuring no negative impact on the low-income housing incentive. This provision permits financial institutions and other large taxpayers to continue investing in affordable housing without generating new minimum tax liability.

Pass-Through Active Loss Limitation

The bill extends for two years a limitation on the deductibility of active pass-through business losses against other income. While the tax code has restricted the ability of taxpayers to deduct passive losses against other income since the 1980s, the Tax Cuts and Jobs Act of 2017, for the first time, included new general limits on a taxpayer's ability to deduct losses from an active business activity against other income, wage, and portfolio (investment) income. The limit applies to net, aggregate losses in excess of $250K for an individual and $500K for a married couple. The IRA extended the limitation (section 461(l)) for two years, through 2028. The extension of the active loss limitation was added on the Senate floor in an amendment offered by Sen. Mark Warner (D-VA) to replace another revenue provision that would have extended the limitation on the deductibility of state and local taxes by one year, through 2026.

Stock Buyback Excise Tax

The bill imposes a nondeductible 1% excise tax on the value of stock that is repurchased during the tax year by a publicly traded U.S. corporation or its affiliate. The excise tax does not apply to repurchases by a REIT or a RIC, or if the repurchase is part of a tax-free reorganization. The provision applies to repurchases of stock after December 31, 2022.

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Capital and Credit

Addressing the *Perfect Storm* of Pro-cyclical Regulatory Proposals and the Wave of Maturing CRE Debt

Issue

There is growing concern about the potential for a *perfect storm* of regulations that could stall credit markets and impair capital formation – particularly for the $5.5 trillion commercial and multifamily debt market. While well-intentioned, we are concerned that the proposals – particularly the *Basel III Endgame* – could increase the cost of credit, diminish lending capacity, and undermine the essential role banks play in lending and financial intermediation for real estate. These proposed regulations come at a significant economic cost without clear benefits to the resiliency of the financial system. In addition to the proposed capital increases for banks, the Securities and Exchange Commission (SEC) has a number of proposed rulemaking measures that could have a chilling effect on real estate capital markets that could further impair liquidity and be a "death by a thousand cuts" for commercial real estate capital markets. It is important for policymakers to be mindful of how all these regulations interact.

There are $1.5 trillion of commercial real estate loans maturing in the next three years. The bulk of these loans were financed when base rates were near zero. They now need to be refinanced in an environment where rates are much higher, values are much lower, and in illiquid markets. For over a decade, with interest rates close to or at zero, loans were conservatively underwritten, with strong debt service coverage and low loan values. As the Fed has increased rates to fight inflation, we are now in an entirely different environment. Liquidity has contracted, and values have declined. Many of these loans will require additional equity, and borrowers will need time to restructure this debt. Capital formation is vital when credit markets tighten to help restructure maturing debt and fill the equity gap.

The Roundtable's Position

- The $20.7 trillion commercial (CRE) and multifamily (MF) commercial real estate market is financed with $5.5 trillion of debt[1], 50.3% of which is provided by commercial banks. Of that outstanding debt, some $1.5 trillion of CRE and MF debt is maturing over the next

[1] Federal Reserve, Trepp.

Addressing the *Perfect Storm* of Pro-cyclical Regulatory Proposals and the Wave of Maturing CRE Debt

three years (2023, 2024, 2025). Smaller banks hold approximately $2.3 trillion in commercial real estate debt.[2]

- As requested in The Real Estate Roundtable's March 17, 2023[3] letter, the June 30, 2023 *Policy Statement on Prudent Commercial Real Estate Loan Accommodations and Workouts* *Policy Statement on Prudent Commercial Real Estate Loan Accommodations and Workouts* has reestablished a program similar to prior programs in 2009[4], 2010[5], 2020[6] that **calls for** "financial institutions to work prudently and constructively with creditworthy borrowers during times of financial stress."
- While this policy statement is helpful, additional steps are called for to help restructure and transition the ownership and financing of commercial real estate from a period of low rates and robust markets to a time of higher rates, declining credit capacity and uncertain economic growth. It also attempts to update the approach for the post-pandemic era, as increased remote working is shifting demand for commercial properties in ways that can adversely affect the financial condition and repayment capacity of borrowers.
- The 2023 *Policy Statement on Prudent Commercial Real Estate Loan Accommodations and Workouts* helps to renew the flexibility the regulators provided which allowed lenders to work with their borrowers more effectively during times of economic stress. It also attempts to update the approach for the post-pandemic era, as increased remote working is shifting demand for commercial properties in ways that can adversely affect the financial condition and repayment capacity of borrowers.
- The potential significant increase in capital requirements for large banks' capital market activities due to the *Basel III Endgame* could materially reduce the depth of banks' products and services

[2] Trepp data cited in the *Wall Street Journal*
[3] Roundtable Urges Federal Bank Regulators to Reestablish CRE Troubled Debt Restructuring Program, March 17, 2023, https://www.rer.org/policy-issues/policy-comment-letters/detail/roundtable-urges-federal-bank-regulators-to-reestablish-cre-troubled-debt-restructuring-program
[4] Policy Statement on Prudent Commercial Real Estate Loan Workouts, FIL-61-2009, October 30, 2009, https://www.fdic.gov/news/financial-institution-letters/2009/fil09061.html
[5] Meeting the Credit Needs of Creditworthy Small Business Borrowers, FIL-5-2010, February 12, 2010, https://www.fdic.gov/news/financial-institution-letters/2010/fil10005.html
[6] Interagency Statement on Loan Modifications and Reporting for Financial Institutions Working with Customers Affected by the Coronavirus, March 22, 2020, https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20200322a1.pdf

Addressing the *Perfect Storm* of Pro-cyclical Regulatory Proposals and the Wave of Maturing CRE Debt

offerings to the real estate sector, which will in turn lead to increased cost of raising capital and hedging risk for the industry. As a result, we anticipate that the industry could encounter difficulties in their access to liquidity and affordable funding to fuel growth and create jobs.

- While intended to "support financial stability" in the event of more bank failures, the August 29 Notice of Proposed Rulemaking from U.S. regulatory agencies would require large regional banks to increase their long-term debt (LTD) issuance by roughly 25 percent through the issuance of roughly $70 billion in fresh debt. They would also be required to reinforce their so-called living wills.
- The largest U.S. banks' capital and liquidity levels have grown dramatically since the original Basel III standards were implemented in 2013 in response to the 2008 Global Financial Crisis. Since 2009, Tier 1 capital has increased by 56 percent and Common Equity Tier 1 capital has tripled. Today, as the Federal Reserve recently observed, the U.S. "banking system is sound and resilient, with strong capital and liquidity."[7]
- While well-intentioned, we are concerned that the proposals could increase the cost of credit, diminish lending capacity and undermine the essential role banks play in lending and financial intermediation for real estate. The proposed increases in capital requirements come at a significant economic cost without clear benefits to the resiliency of the financial system.
- In addition to the proposed capital increases for banks, the Securities and Exchange Commission (SEC) has a number of proposed rulemaking measures that could have a chilling effect on real estate capital markets – e.g., the broadly drafted Conflicts of Interest in Securitization Rule; Rule 15c2-11; Private Fund; Custody Rule and others – that could further impair liquidity and be a "death by a thousand cuts" for commercial real estate. Capital formation is vital when credit markets tighten to restructure maturing debt.

[7] [1] https://www.federalreserve.gov/publications/files/svb-review-20230428.pdf

Commercial Insurance Coverage in an Evolving Threat Environment

Issue

The proliferation of natural catastrophe and pandemic threats has raised concerns about commercial insurance coverage for commercial real estate. As economic losses caused by disasters increase, changing exposures around the world must be addressed in order to effectively manage natural catastrophe risk. These concerns have highlighted the lack of—and need for—insurance capacity and various lines of commercial insurance. Expanding coverage gaps and increased costs present challenges for businesses across many industries, including real estate. A lack of adequate coverage will lead to economic uncertainty, harm stakeholders and undermine the growth of communities.

Pandemic-related coverage in various lines of commercial insurance has been withdrawn or restricted going forward. Additionally risks from natural disasters like floods, hurricanes, wildfires, hail, tornadoes, and drought cost the U.S. billions of dollars each year. If policyholders are able to find coverage for these various lines, the pricing has increased dramatically, raising economic concerns.

Without adequate coverage, the vast majority of these natural catastrophe and pandemic-related losses are likely to be absorbed by policyholders. These widening coverage gaps and price hikes, raise serious economic concerns about protection gaps, coverage capacity, and increased costs for natural catastrophe and some pandemic-related business interruption losses. The COVID-19 pandemic exposed and exacerbated a protection gap in what the business and non-profit sectors assumed to be a resilient financial protection system of commercial insurance. The budget debate in Congress has raised concerns about the future of the National Flood Insurance Program, which is subject to temporary funding extensions and now must be reauthorized by November 17, 2023.

It is important to find solutions to fill these commercial insurance gaps across changing threat pattern. Whether they be related to natural catastrophe or pandemic risk, it is important to find a solution—either market based or with the partnership of the federal government—that will provide the economy with the coverage it needs to address catastrophic events.

The Roundtable, along with its industry partners, continues to work constructively with policymakers and stakeholders to develop and **enact an effective pandemic risk program**. We also continue to work with our industry partner organizations to advocate for an **improved National Flood Insurance Program (NFIP)** that can be re-authorized for a lengthy time period.

Commercial Insurance Coverage in an Evolving Threat Environment

The Roundtable works with the Business Continuity Coalition (BCC), which represents a broad range of business insurance policyholders from across the American economy to develop an **effective pandemic insurance program** that protects jobs by ensuring business continuity from economic losses. The Roundtable works with the BCC and policymakers, the administration, and other U.S. stakeholders.

A long-term reauthorization of the **National Flood Insurance Program (NFIP**) is essential for residential markets, overall natural catastrophe insurance market capacity, and the broader economy. The NFIP's commercial property flood insurance limits are low—$500,000 per building and $500,000 for its contents – so it is important to exempt larger commercial loans from the mandatory NFIP purchase requirements.

The National Flood Insurance Program (NFIP) is currently operating under a continuing resolution. Since the end of FY 2017, over a dozen short-term NFIP reauthorizations have been enacted. As policymakers continue to debate potential changes and improvements to the program, their challenge is to find a balance between improving the financial solvency of the program, reducing taxpayer exposure, and addressing affordability concerns. Without congressional reauthorization, the program will sunset on September 30, 2023.

The Roundtable's Position

- Floods are the most common, costliest natural peril in the U.S. The NFIP was enacted in 1968 due to a lack of private insurance and increases in federal disaster aid. The Program is administered by the Federal Emergency Management Agency (FEMA) and is essential for homeowners, renters, and small businesses in affected areas.
- The level of flood damage from recent storms makes it clear that FEMA needs a holistic plan to prepare the nation for managing the cost of catastrophic flooding under the NFIP.
- The NFIP is important for residential markets, overall natural catastrophe insurance market capacity, and the broader economy. However, under the NFIP, commercial property flood insurance limits are low—$500,000 per building and $500,000 for its contents. NFIP has approximately five million total properties, only 6.7% are commercial. Nearly 70% of NFIP is devoted to single-family homes and 20% to condominiums. In the total program, 80% pay actuarial sound rates, however, in the commercial space, only 60% pay actuarial sound rates.

Commercial Insurance Coverage in an Evolving Threat Environment

- Congressional hearings have illuminated numerous acute problems surrounding the NFIP, such as insolvency, increased risk of flooding across the country, and insufficient and inaccurate flood mapping. The unintended negative outcomes generated by the NFIP continue to grow and are now spreading to GSEs (government-sponsored enterprises) Fannie Mae and Freddie Mac.
- Lenders typically require base NFIP coverage, and commercial owners must purchase Supplemental Excess Flood Insurance for coverage above the NFIP limits. The NFIP's low commercial limits make it problematic for most commercial owners. As a result, The Roundtable has been seeking a voluntary exemption for mandatory NFIP coverage if property owners have flood coverage from commercial insurers.
- By permitting certain private issue insurance policies to satisfy the NFIP's "mandatory purchase requirement" for properties in flood plains financed by loans from federally guaranteed institutions, commercial property owners would have the ability to "opt-out" of mandatory NFIP commercial coverage if they have adequate private coverage outside the NFIP program to cover financed assets.
- The Roundtable and its partner associations support a long-term reauthorization and improvements of the NFIP that help property owners and renters prepare for and recover from future flood losses. Given the low coverage amounts provided to commercial properties, it is important to permit larger commercial loans to be exempt from the mandatory NFIP purchase requirements.
- Going forward, it is important to protect American jobs and to ensure a sustainable and speedy economic recovery from future natural catastrophe events and government-ordered shutdowns. If not remedied, these insurance gaps could hinder economic growth.
- The Roundtable is working with industry partners, stakeholders, and policymakers through the Business Continuity Coalition (BCC) to develop and enact an effective, prospective federal public-private backstop program for pandemic risk insurance coverage across a variety of commercial insurance lines. Similar to the Terrorism Risk Insurance Act (TRIA) enacted the year following the 9/11 attacks, this program would provide the economy with the coverage it needs to provide businesses with pandemic-related coverages in the face of a future pandemic.
- Senate Subcommittee on Securities, Insurance, and Investment members, Kyrsten Sinema (D-AZ), and Thom Tillis (R-NC) are working along with other Banking Committee

members to develop bipartisan legislation pandemic risk insurance program in the Senate. The BCC is working with this bipartisan working group with the goal of introducing legislation in the Senate.

Beneficial Ownership & Corporate Transparency Act

Issue

Under the Corporate Transparency Act (CTA), many U.S. businesses will soon be required to disclose information on their "beneficial owners" under regulations issued (and to be issued) by the Treasury Department's Financial Crimes Enforcement Network (FinCEN). This disclosure obligation begins on January 1, 2024. The stated goal of the CTA is to prevent and combat money laundering, terrorist financing, corruption, tax fraud, and other illicit activity by requiring companies to disclose beneficial ownership information, or BOI, to FinCEN, a bureau of the U.S. Department of the Treasury.

The Rule imposes heavier compliance burdens on real estate businesses with numerous legal entities that own and operate real property across all asset classes. While the CTA and its implementing regulations are not specifically targeted to real estate businesses, it will have a direct impact on the industry. As discussed below, certain types of entities will be exempt from the reporting requirements; however, these exemptions will not apply to many typical real estate limited liability companies and partnerships formed to own and operate commercial properties.

The CTA requires reporting companies to supply three categories of information: information about the entity, BOI, and information about the company applicant. Each reporting company will have to provide information on its "beneficial owners" as well as the "company applicants" involved in forming the entity. A beneficial owner refers to an individual who owns at least 25% of an entity or indirectly exercises "substantial control" over it.

The Roundtable's Position

- The Roundtable and a broad coalition representing millions of businesses throughout the country wrote to House Financial Services Committee Chairman Patrick McHenry (R-NC), in strong support of his legislation—the *Protecting Small Business Information Act of 2023* (H.R. 4035). McHenry's bill would delay the date when the *Corporate Transparency Act's* (CTA) beneficial ownership reporting requirements go into effect, currently scheduled for Jan. 1, 2024.

Capital and Credit

Beneficial Ownership & Corporate Transparency Act

- There is significant concern about the CTA's far-reaching scope and its **impact on many commercial residential real estate businesses** that use the LLC structure for conducting business. The coalition's letter states that Chairman McHenry's bill "legislation offers a commonsense solution to this pending regulatory trainwreck."

- The CTA amended the *Bank Secrecy Act* to require corporations, limited liability companies, and similar entities to report **certain information about "beneficial owners**" who own at least 25% of an entity or indirectly exercise "substantial control" over it.
- The CTA authorizes the Treasury's Financial Crimes Enforcement Network (FinCEN) to collect and disclose beneficial ownership information to authorized government authorities and financial institutions, subject to effective safeguards and controls. The statute requires the submission of regular reports to the federal government that include **a litany of sensitive personal identifiers of the owners, senior employees, and/or advisors of covered entities.**
- Although the measure is intended to provide support for law enforcement investigations into shell companies engaged in money laundering, tax evasion, and terrorism financing, it places many costs and legal burdens on small businesses, especially those in the real estate industry.
- In 2021, The Roundtable and its coalition partners submitted detailed comments to FinCEN regarding the development, disclosure, and maintenance of a new federal registry that will contain beneficial ownership information.
- The real estate coalition's extensive comments emphasize the "scope of the CTA is far-reaching and will impact many commercial residential real estate businesses who are frequent users of the LLC structure for conducting business. If not implemented with a clear set of rules and regulations, the CTA could result in an outcome of confusion, missteps, and ultimately fines on law-abiding businesses."
- The Roundtable is also part of a broad coalition of business trade groups that supports a National Small Business Association legal challenge (*NSBA v. Janet Yellen*) on the constitutionality of the *Corporate Transparency Act (CTA)*, which became law in Jan. 2021.

Beneficial Ownership & Corporate Transparency Act

- The coalition's comments detail "concerns and recommendations for establishing regulations to implement reporting requirements—as well as provisions regarding FinCEN's maintenance and disclosure of reported information effectively and fairly."
- The coalition raised several specific implementation issues, including how small companies targeted by the CTA will face compliance burdens. The time-consuming and challenging process of gathering required information on all beneficial owners of a reporting company that may have been created years ago is also addressed.
- In 2022, The Roundtable and its coalition partners submitted comments to the U.S. Department of the Treasury (DOT) and FinCEN that support efforts to thwart illegal money laundering in real estate, while encouraging policymakers to find a balanced approach that does not unfairly burden law-abiding businesses.
- The Roundtable is part of a broad coalition of business trade groups that supports a legal challenge by the National Small Business Association (*NSBA v. Janet Yellen*), which challenges the constitutionality of the CTA. The coalition stated, "It is clear whatever marginal benefit the CTA affords law enforcement will be far outweighed by the costs borne by small businesses and their owners."
- The Roundtable continues to work with industry partners to address the implications of FinCEN's proposed rules and the impact it could have on capital formation and the commercial real estate industry.

SAFE Banking Act and CRBs

Issue

Legal cannabis-related businesses (CRBs) face the challenge of obtaining bank accounts, and commercial property owners face legal challenges of taking on CRB tenants without safe harbor protections.

The Roundtable's Position

- 47 states and DC currently legalize marijuana to varying degrees. Yet use, possession, and sale remains illegal under federal law.
- Real estate owners, lessors, brokers, and financiers need certainty when they transact with legitimate CRBs.
- The bipartisan *Secure and Fair Enforcement (SAFE) Banking Act*, (H.R. 1996) would eliminate the need for CRBs to operate on a cash basis, bring them into the banking system, and allow them to obtain accounts and credit cards. Commercial property owners would get a safe harbor if they lease space to a CRB, and their mortgages could not be subject to corrective action by a bank.
- To date, the *SAFE Banking Act* has passed the U.S. House numerous times, but it has yet to pass the Senate.

Restrictions on Foreign Investment in U.S. Real Estate

Issue

Foreign investment is a major source of capital for U.S. commercial real estate, leading to job creation and economic growth for communities throughout our nation. A number of policy measures at the national and state level seek to restrict foreign investment in U.S. real estate. A number are already in effect. Most of these measures are intended to protect the homeland and ensure that such investments may enable a nefarious state actor from adversely impacting the nation's economic, military or civil interests.

At the **state level,** the Florida legislature recently passed Senate Bill 264 (SB 264), which Governor Ron DeSantis signed into law on May 8, 2023. SB 264 aims to limit and regulate the sale and purchase of certain Florida real property by "Foreign Principals" from "Foreign Countries of Concern." Twenty states have enacted restrictions on foreign investors in real estate and agricultural land. Eight states are considering similar measures. More are looking at the issue. So, the state-level restrictions have national implications.

While The Roundtable supports efforts to protect the nation's economic, military or civil security as well as the integrity of commercial real estate investments, we have concerns about rules that may hinder foreign investment in U.S. real estate by legitimate enterprises and capital formation by law-abiding entities.

The Roundtable's Position

The Roundtable's Sept. 5 encourages state regulators to ensure that Senate Bill 264 does not deter investment into real estate in the state or undermine the economic benefits of this important industry. It also raises concerns about the technical aspects of SB 264 that could have unintended and negative consequences for investment in Florida and therefore limit the freedom of Florida's future growth.

The letter also cites the importance of foreign investment in U.S. real estate markets. In particular, many investment funds that are controlled or advised by regulated U.S. asset managers—including those that actively invest in Florida real estate—source investment capital in global capital markets.

Restrictions on Foreign Investment in U.S. Real Estate

With approximately $1.5 trillion of U.S. commercial real estate debt coming due in the next three years, foreign equity investments in U.S. assets are often an important source of capital as commercial real estate owners seek to restructure, refinance or sell their properties.

Consistent with Roundtable requests, the Florida Department of Commerce recently proposed a positive clarification to SB 264 that responds to a Roundtable request urging the Florida Real Estate Commission to consider specific concerns before implementing the new state law, which could impair capital formation and hinder the important role that legitimate foreign investment plays in U.S. real estate, the broader economy and job growth.

The proposed rule published on Sept. 21 addresses the implementation of Florida Senate Bill 264 (SB 264), Section 203, signed into law on May 8. The new law aims to limit and regulate the sale and purchase of certain Florida real property by “foreign principals” from “foreign countries of concern.” The Florida Real Estate Commission will implement the new law. (SB 264 text).

Section 203 of the bill prohibits investment in real property near military installations and critical infrastructure. Importantly, the *de minimis* exemption has been re-drafted, which (1) fixes earlier drafting errors to the Registered Investment Advisor exemption, and (2) introduces a new category of *de minimis* interests that categorically exempts passive indirect investment. (See highlighted areas in the Notice of Proposed Rule)

The proposed rule clarification remains subject to change during a 21-day public comment period and may include a formal hearing.

EB-5 Reform and Integrity Act of 2022: Fact Sheet

Issue

Congress passed a major overhaul of the EB-5 "regional center" investment visa program in March 2022. The EB-5 Reform and Integrity Act is found at "Division BB" of the Consolidated Appropriations Act of 2022. It represents the first major reforms to the EB-5 program since it was enacted in the early 1990s. Reforms include:

Reauthorized EB-5 "Regional Center" Program

- 5-year extension through September 30, 2027.
- Reduces litigation risk from ~ 90,000 EB-5 investors who have seen no action by DHS on their petition since the regional center program expired on June 30, 2021.

Expanded Targeted Employment Area (TEA Designations)

- TEA projects qualify for both lower investment levels and visa set-asides (see below):

Prioritizing Rural Projects

- In areas outside a Metropolitan Statistical Area, or within the outer boundary of any city or town with a population of 20,000 or more. (No change from prior law).
- U.S. Citizenship and Immigration Services (USCIS) must prioritize processing visas for investors in rural areas.

New Criteria for Distressed Urban Area Projects ("High Unemployment Areas")

- Codified the 2019 USCIS regulation ("donut" approach in which a project must be within a census tract—or any "contiguous" census tracts that "touch" the project's tract—where the average unemployment rate is 150% of the national average.
- DHS Secretary has the discretion to include a "directly adjacent" tract (to either the "anchor" tract or a "contiguous" tract) to satisfy the requisite 150% high unemployment criteria.

EB-5 Reform and Integrity Act of 2022: Fact Sheet

- Distressed Urban TEA designations last for two years. These can be reviewed if the qualifying census tract(s) continue to meet "high employment" criteria.
- If a project was in an Urban TEA but falls out of high unemployment status, an "original" investor does not have to increase investment amounts to the non-TEA upper level.
- Only DHS can approve an Urban TEA "high unemployment" designation—unless the Secretary designates such authority to another federal official. No state or local official can approve.

Defining "Infrastructure Projects"

- A "capital investment project" administered by a "government entity"—that serves as the "job-creating entity" funded by EB-5 investors, and that contracts with a regional center—qualifies as an "Infrastructure Project."
- Must be a "public works project." No particular type of infrastructure "asset class" is specified.
- Only DHS can designate an Infrastructure Project—unless the Secretary designates such authority to another federal official. No state or local official can approve the designation.

Qualified Investment Amounts & Adjustments

- 800,000 in TEAs
- $1,050,000 in non-TEAs
- On January 1, 2027, and every five years thereafter, investment amounts adjust for inflation.
    - Non-TEA level "adjusts up" for inflation.
    - TEA level "adjusts up" to 75% of the non-TEA level (with the goal of keeping the $250K delta between investment levels intact).

EB-5 Reform and Integrity Act of 2022: Fact Sheet

Clarifying Visa Set-Asides

- Set-asides are a percentage of the roughly 10,000 EB-5 visas available every year.
- 20% for Rural projects
- 10% for Distressed Urban/High Unemployment Area projects
- 2% for Infrastructure Projects
- Unused visas “carry over” in the same category in the following year.
- Unused visas in any “set aside” category made generally available for any project, in the year immediately following the “carry over” year.

“Aging Out” Criteria

- An investor’s “child” who is admitted to the U.S. on a “conditional” basis and who turns 21 shall continue to be considered a “child” if:
  - she/he remains unmarried and;
  - the principal investor is approved as a permanent resident and;
  - the principal investor files a petition for the child to remain in the U.S. no later than one year after the child’s conditional status has terminated.
- The principal investor can only file one “aging out” petition after the child turns 21.

Allowing the Broad Deployment of Capital

- DHS to enact regulations that allow the new commercial enterprise to deploy capital anywhere in the U.S. to keep the investment “at risk.”

Sovereign Wealth Funds

- Capital from a “bona fide” SWF may be stacked with EB-5 capital to finance a project.
- The SWF can be involved with the equity “ownership”—but not the administration—of the job-creating entity.

EB-5 Reform and Integrity Act of 2022: Fact Sheet

- DHS to implement regulation for SWF funding in an EB-5 project.

Job Creation Criteria

- 10 jobs must be created per investment (same as prior law).
- One job must be a "direct" job. It can be "modeled," and it is not necessary to produce a W-2 for a particular employee.
- The other nine jobs can be "indirect," modeled, and estimated (same approach under prior law).
- Construction jobs that last less than two years can satisfy 75% of the estimated "indirect" jobs.

Allowing the Concurrent Filing of I-526 and I-485

- Investors can concurrently file their I-526 petitions (showing EB-5 compliance and investment) and their I-485 petitions (application for a "conditional" green card, which adjusts status from a "non-immigrant" to a conditional permanent resident). This can only be done if there is already a visa number available and current.
- Concurrent filing can reduce the time to adjust status once an I-526 is approved.

"Grandfathering" Existing Investors

- If Congress fails to reauthorize regional centers after the Act's expiration on September 30, 2027, DHS will continue to process petitions filed on or before September 30, 2026.
- Applies to I-526 petitions and I-829 petitions (to remove conditional status and allow permanent residency without conditions).
- DHS may not deny an I-526 or I-829 simply because the regional program might expire in the future.
- An investor is eligible to file the I-829 two years after filing the I-526.

EB-5 Reform and Integrity Act of 2022: Fact Sheet

New "Integrity Measures" to Deter Fraud and Safeguard National Security

- USCIS to conduct an audit of each regional center at least once every five years.
- Explicit authority granted to USCIS to deny regional center "business plans" where an applicant has engaged in fraud, criminal conduct, or where plan approval would threaten national security.
- Confirms the application of U.S. securities laws over regional center offerings and investment advice.
- Regional center must submit annual statements of investment activities to USCIS. Failure to submit or falsify an annual statement results in sanctions that can include fines, temporary suspension, and a permanent "de-bar" of individual and regional centers that fail to comply with new oversight requirements.
- No person convicted of a crime (in the last 10 years) or fraud-related civil offense (that resulted in liability greater than $1M USD) can participate in EB-5 activities.
- With a limited exception for bona fide sovereign wealth funds, no foreign government representative may provide EB-5 capital or be involved in the administration or ownership of a regional center, new commercial enterprise, or job-creating entity.
- Requires fingerprints and other biometrics of persons involved in EB-5 activities to be submitted to USCIS.
- Strict new "source of funds" requirements to ensure that an investor's funds are derived from legitimate and lawful sources.
- Establishment of a new "EB-5 Integrity Fund," capitalized by regional center program feeds, to support amplified USCIS oversight and site visits.

The Real Estate Roundtable (RER) does not intend this communication to be a solicitation related to any particular company, nor does it intend to provide investment, legal, or tax advice. Nothing herein should be construed to be an endorsement by RER of any specific company or products as an offer to sell or a solicitation to buy any security or other financial instrument or to participate in any trading strategy. RER expressly disclaims any liability for the accuracy, timeliness, or completeness of data in this publication.

SEC Proposed Rules: Private Fund Advisers, Form PF

Issue

In 2022, the Securities and Exchange Commission (SEC) proposed two rules that would significantly overhaul the regulation of the private fund industry—a key capital source for income-producing real estate. The first proposed rulemaking would amend the Form PF reporting requirements for certain private fund managers and the second proposed rule would impose new investor reporting requirements on certain Private Fund Advisers under the Investment Advisers Act of 1940.

The Roundtable's Position

- The SEC approved the two proposals despite strong dissents issued by Commissioner Hester Peirce, who voted no on each proposal and raised concerns that the rules would take away the SEC's resources for protecting retail investors. Chairman Gary Gensler, however, indicated that he views the rules as protecting retail investors whose retirement plans invest in private funds.
- With the stated goal of enhancing the Financial Stability Oversight Council's (FSOC's) monitoring and assessment of systemic risk and protecting investors, the SEC proposal would transform Form PF into a current reporting form for large hedge fund advisers and advisers to private equity funds, while maintaining the existing quarterly or annual reporting obligations applicable to private fund advisers regardless of size. The SEC's proposal also (1) expands Section 4 of Form PF by reducing the reporting threshold applicable to large private equity advisers from $2 billion to $1.5 billion in private equity fund assets under management, and (2) introduces a new large liquidity fund adviser reporting requirement that essentially requires such advisers to report the same information that money market funds report on Form N-MFP (as proposed to be amended in December 2021).

SEC Proposed Rules: Private Fund Advisers, Form PF

- As stated in our March 21, 2022, Form PF comment letter, the proposed addition of new reporting requirements presents significant compliance and operational challenges for private real estate fund sponsors with no added benefit to investors and no relation to the intent of Form PF in monitoring systemic risk. As a result, the proposed amendments are not required and should not be adopted. At the very least, the SEC must provide adequate evidence that the proposed amendments bear some reasonable resemblance to systemic risk and provide meaningful cost-benefit analyses to support the increased burdens inherent in adopting the compliance infrastructure necessary for such reporting.
- The "Private Fund NPRM" would add new and amended rules under the Investment Advisers Act that the SEC believes would increase transparency and avoid adviser conflicts of interest. If adopted as proposed, a private fund adviser would need to adopt policies and procedures to comply with these requirements and evaluate whether its governing documents, offering memoranda, and side letters should be updated to reflect the new regulatory requirements and prohibitions. The proposed rules apply to exempt reporting advisers in some instances, but the SEC has posed questions for comment asking whether other parts of the proposed rules should apply to such advisers. The proposed rules have the potential to significantly increase regulatory burdens across registered and exempt private fund advisers.
- While we support efforts taken by the Commission to protect investors and monitor risk, our April 25, 2022 comment letter raises concerns that, if finalized, the private fund proposal could hinder real estate capital formation, the development and improvement of real properties, essential economic activity, and jobs.

SEC Proposed Rules: Safeguarding Advisory Client Assets

Issue

On February 15, 2023, the Securities and Exchange Commission (SEC) proposed changes to require SEC-registered investment advisers to put all their clients' assets, including all digital assets like Bitcoin, with "qualified custodians".

The proposal would also require a written agreement between custodians and advisers, expand the "surprise examination" requirements, and enhance recordkeeping rules. These rules were originally designed for digital assets. "Reasonable" safeguarding requirements is ambiguous as applied to real estate. The SEC's release indicates that deeds evidencing ownership of real estate can be held at a qualified custodian—this is not accurate. Deeds are recorded with a government authority. Land and buildings cannot be physically absconded. Lenders and other interested parties have an interest in ensuring no misappropriation of real estate.

The Roundtable's Position

The Roundtable sees no policy reason to impose the proposed rule on real estate – real estate cannot readily be stolen. Lenders and others have an interest in ensuring no misappropriation of real estate. Title insurance protects real estate investors against covered title defects, such as a previous owner's debt, liens, and other claims of ownership. It's an insurance policy that protects against past problems, whereas other insurances usually deal with future risks. Titles are recorded in the name of the acquiring entity by a government entity.

The SEC's release indicates that deeds evidencing ownership of real estate can be held at a qualified custodian—this is not accurate. Deeds are recorded by a government authority. Conditions to the exemption for real assets are problematic. Auditor verification of transactions is costly and not negotiated for by fund investors.

"Reasonable" safeguarding requirements is ambiguous as applied to real estate. Different jurisdictions present even more challenges. Different laws for title exist between not only states but also countries. The rule applies to registered investment advisors regardless of where the asset is located.

For these reasons, we believe that the SEC's policy reasons for imposing the rule on real estate seem irrelevant.

NASAA's Proposed Revisions to its Statement of Policy Regarding REITs

Issue

On July 12, 2022, the North American Securities Administrators Association, Inc. (NASAA) announced it is seeking public comment on proposed revisions to the NASAA Statement of Policy Regarding Real Estate Investment Trusts (the "REIT Guidelines"). The Roundtable has serious concerns about the Proposal and urges NASAA to withdraw the Proposal.

The Roundtable's Position

- The Proposal could have a profound impact on the $20.7 trillion U.S. commercial and multifamily real estate market, approximately 9.4% of which is comprised of real estate investment trusts (REITs).
- It could have the unintended and unnecessary impact of impeding real estate capital formation, undercutting economic growth, and weakening the strength and stability of U.S. real estate capital markets. Investing in real estate supports economic growth; helps to grow the much-needed supply of housing, particularly in the multi-family, workforce, and affordable housing sector; enhances the infrastructure of industrial space, and supports state and local communities across the country.
- Since 1996, the Securities Act of 1933, as amended, has provided a preemption of the substantive state securities law requirements for several types of securities and offerings. However, certain securities offerings, including publicly offered REITs that do not list their securities on a stock exchange ("non-traded REITs"), remain subject to state securities law registration requirements. In addition, they remain subject to review by state securities regulators and the Securities and Exchange Commission (SEC). The REIT Guidelines have been adopted by several state securities regulators or used by their staff in reviewing such offerings.
- The REIT Guidelines were last amended in 2007 and set out requirements for REIT sponsors, advisers, and persons selling REITs, including provisions dealing with the suitability of investors, conflicts of interest, investment restrictions, and rights of shareholders as well as disclosure and marketing.
- NASAA has proposed revisions to the REIT Guidelines in four areas:

NASAA's Proposed Revisions to its Statement of Policy Regarding REITs

- The proposed revisions would update the conduct standards for brokers selling non-traded REITs by supplementing the suitability section with references to the SEC's best interest conduct standard.
- The proposal includes an update to the individual net income and net worth requirements—up to (a) $95,000 minimum annual gross income and $95,00 minimum net worth, or (b) a minimum net worth of $340,000—in the suitability section through adjusting upward to account for inflation occurring since the last adjustment in 2007.
- The proposal would add a uniform concentration limitation prohibiting an aggregate investment in the issuer, its affiliates, and other non-traded direct participation programs that exceeds 10% of the purchaser's liquid net worth. Liquid net worth would be defined as that component of an investor's net worth that consists of cash, cash equivalents, and marketable securities. [NOTE: There is no carveout for accredited or other sophisticated investors.]
- The proposed revisions also include, in multiple sections, a new prohibition against using gross offering proceeds to fund distributions, "a controversial product feature used by some non-traded REIT sponsors . . . having the potential to confuse and mislead retail investors."

- In the request for comment, NASAA points out that if adopted, the revisions to the REIT Guidelines have the potential to influence updates to other Guidelines, including those for Asset-Backed Securities, Commodity Pools, Equipment Leasing, Mortgage Programs, and Real Estate Programs (other than REITs) and the Omnibus Guidelines.
- We are concerned that the Proposal appears to be substantially based on a flawed and outdated impression of the PNLR sector and PNLR products. Many of the issues that NASAA highlights to justify the Proposal—such as liquidity concerns, fee transparency, and sources of distributions—are largely, if not completely, ameliorated with respect to the NAV PNLRs[8] that are now being offered to investors.
- We are working on this issue with a number of other groups and submitted a comment letter raising concerns about the proposal.

[8] REITs that are registered with the SEC but whose shares intentionally do not trade on a national securities exchange. NAV PNLRs, which comprise the majority of PNLRs marketed today, are permanent entities that provide shareholders with regular ability to sell shares back to the REIT at the current Net Asset Value (NAV).

Return to the Workplace

Issue

During the public health emergency created by the rapid spread of the COVID-19 virus, governmental authorities ordered widespread closures of places where people gather, including office buildings.

These shutdowns were appropriate at the time, and the commercial real estate industry worked diligently to create safe work environments that would accelerate the reopening of economic activity.

In his State of the Union speech in February 2022, President Biden stated:

- It's time for Americans to get back to work and fill our great downtowns again with people. People working from home can feel safe and begin to return to their offices. We're doing that here in the federal government. The vast majority of federal workers will once again work in person.

Unfortunately, agency actions did not immediately live up to the President's words. Federal agencies continued to promote remote working arrangements as a recruitment, retention, and cost-saving tool.

In February 2023, the House of Representatives passed the SHOW Up Act (H.R. 139) directing federal agencies to reinstate their pre-pandemic telework policies and ensuring that any future remote working plans receive careful and deliberate consideration.

In April 2023, the White House Office of Management and Budget informed federal agencies that they have 30 days to develop plans to "substantially increase" their employees' in-person work at headquarters. In the same month, the White House Office of Personnel Management announced in a government-wide memo that it was ending its "maximum telework" directive for federal agencies, which it adopted during the pandemic.

The new guidance is an important step forward supported by The Real Estate Roundtable. Federal agencies must follow through, in good faith, on the White House directive.

The Roundtable's Position

- The federal government employs over 1.3 million civilians in 2,200 communities across the country and is a market leader that influences leasing costs and property values. Actions it takes as a tenant have profound impacts on local markets and associated property tax revenue, surrounding small businesses and their workers, and more.

Return to the Workplace

- Federal agencies' actions to promote permanent remote working are out of step with the direction of private sector employers, who are increasingly recognizing the importance of bringing employees back to the workplace.
- Instead of aggressively promoting work-from-home arrangements for federal workers, the federal government should help facilitate a smooth, market-based transition to the new era.
- The work-from-home trend is increasing the negative pressure on commercial real estate property values and therefore reducing local tax revenues. For example, between 2021 and 2022, the decline in office building property assessments reduced property tax revenue in Washington DC by $140 million. The City of San Francisco forecasts that remote work could reduce office-related property tax revenue by more than $100 million in 2023.
- Restaurants, small businesses, and their employees are another casualty of policies that discourage a return to the workplace. Workers are spending less time and money in central business districts, with devastating consequences for the businesses—coffee shops, gyms, barber shops, restaurants, etc.—that rely on their patronage.
- Leading academic research has identified a dozen cities where the reduction in local spending as a result of remote work exceeds $2,000 annually per teleworking employee.
- Research released by the Labor Department found that "the increase in remote work had significant effects on local employment…[s]pecifically, a 10% decrease in foot traffic in a Census tract led to a 2.8% decline in employment for accommodation and food services and a 2 percent decline in retail trade employment."
- Remote working threatens the viability of public transit systems. Nationwide, according to the American Public Transportation Association, ridership on commuter rail is still only 58% of pre-pandemic levels.

Property Conversions and Housing Tax Incentives

Issue

The United States is facing a severe shortage of affordable housing. At the same time, certain other commercial real estate assets like office buildings are under significant stress due to pandemic-related issues, including employers' greater reliance on remote work arrangements. The Roundtable is encouraging lawmakers to help revitalize cities, boost local tax bases, and address housing challenges by enacting a tax incentive for converting older, under-utilized buildings to housing. The Roundtable also supports a meaningful expansion of the low-income housing tax credit.

Property conversions: In the 117th Congress, Senator Debbie Stabenow (D-MI) and Representative Jimmy Gomez (D-CA) introduced legislation, the *Revitalizing Downtowns Act* (S.2511, H.R.4759), which would create a new tax credit to reduce the costs associated with converting older office buildings to housing or other uses. In October 2022, a Roundtable-led coalition of 16 national real estate organizations endorsed the legislation while suggesting a number of improvements to further strengthen the bill.

Low-income housing tax credit: Since its inception in 1986, the low-income housing tax credit (LIHTC) has financed the development of nearly 3.5 million affordable rental homes that house over eight million low-income households. President Biden's *Build Back Better* agenda originally proposed dedicating $32 billion to the expansion of LIHTC. The president's desired investment in additional LIHTC allocations represents a 30% increase over the current federal subsidy. The *Build Back Better Act* approved by the House Ways and Means Committee would have provided $29 billion over 10 years to expand LIHTC, including a 50% increase in the allocation of credits to states.

In May 2022, the administration released its Housing Supply Action Plan, which calls on Congress to enact new tax credits for the development and rehabilitation of affordable housing sold directly to low- and moderate-income owner-occupants. It also proposes an expanded LIHTC subsidy for projects that otherwise would not be financially viable.

The Roundtable's Position

Congress should help expand and grow the supply of affordable and workforce housing by investing greater resources in time-tested tax incentives like the low-income housing tax credit and adopting creative new approaches that support the conversion of underutilized, existing buildings to housing.

Property Conversions and Housing Tax Incentives

- A quarter of American renter households spend more than 50% of their income on housing expenses. More than 10 million low-income households spend more than half of their monthly income on rent, according to Harvard's Joint Center for Housing Studies.
- 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.
- Conversion 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 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.
- LIHTC is an efficient, market-based housing solution that relies on the private sector to finance, build, and operate affordable housing by creating a federal incentive for new construction and redevelopment.
- Under the successful LIHTC program, states can award housing credits based on their own affordable housing priorities. They can target credits to housing units dedicated to certain populations such as seniors or veterans, or to specific regions most in need of affordable housing.
- The Tax Cuts and Jobs Act of 2017 indirectly diminished the value of low-income housing credits because the corporate tax cut reduced the underlying tax liability of many tax credit purchasers, thereby decreasing demand for the credits in the marketplace.
- Congress should significantly expand LIHTC, along the lines of the *Affordable Housing Credit Improvements Act* (S.1136, H.R. 2573), which would create and preserve more than two million affordable homes, support three million jobs, and generate $119 billion in sustainable tax revenue.

Bridging the Housing Gap and GSE Reform

Issue

There is a chronic shortage of housing in the U.S. that is driving up housing prices and making it more difficult for lower-income individuals to find safe, affordable housing. Housing production in the U.S. is not keeping pace with expanding housing needs. The underbuilding gap in the U.S. now totals more than 5.5 million housing units. The impact of this growing problem of an under-supply of affordable housing is far-reaching and undermines economic growth—particularly in urban areas. In addition, the government-sponsored enterprises (GSEs) Fannie Mae and Freddie Mac—one of the primary funding sources for housing in the U.S.—have been in conservatorship for over a dozen years. Debate over reforms continues.

The Roundtable's Position

- Safe, decent, and affordable housing is critical to the well-being of America's families, communities, and businesses. The COVID-19 pandemic has intensified the nation's persistent housing crisis, prompting The Roundtable to mobilize with our national real estate organization partners and jointly advocate for policies that will help to increase housing supplies, grow jobs, and modernize our nation's critical infrastructure.
- Having a robust housing finance system is critical to expanding America's housing infrastructure to help meet the nation's longstanding goal of ensuring decent and affordable housing for all. Current efforts have failed to keep pace with the growing need for affordable housing.
- GSE reform must appropriately balance taxpayer protections and establish an efficient marketplace with a strong, efficient, and sustained financing environment for homeownership, rental housing, and sustained mortgage liquidity.
- As the gap between the number of lower-income renters and the supply of affordable units continues to grow, it is critical for the GSEs to provide support for mortgages to aid low- and moderate-income families—for homeownership and rental housing—as well as underserved areas.
- As American households increasingly turn to the rental market for their housing, a strong housing finance system should support not only homeowners but also aid the expansion of affordable rental housing.

The Bipartisan "Physical" Infrastructure Law

Issue

In November 2021, President Biden signed into law the Infrastructure Investment and Jobs Act (IIJA). In a rare show of bipartisan consensus, the House and Senate cleared the measure with Democratic and Republican support.

The IIJA is a historic, $1 trillion+ bill that allocates $550 billion in new spending to improve the nation's "physical" infrastructure (transportation, water, sewer, electric grid, and broadband systems). The Roundtable strongly backed the IIJA as it moved through the legislative process. The Biden administration estimates it would create about two million jobs per year over the next decade. The law is a down payment on the long-term investments our country must make to productively move people, goods, power, and information from home to work, business to business, community to community, and building to building.

Throughout 2022, the administration has been focused on getting the IIJA money "out the door." It has developed a guidebook focused on spending for transportation, energy, and broadband infrastructure for states and local governments to apply for federal grants, loans, and public-private partnership resources under more than 375 programs across federal agencies.

The administration has also provided a web-based interactive map showing where IIJA funds have been disbursed in communities across the nation.

The Roundtable's Position

- **Investments in infrastructure make our local communities safe, productive, and support healthy real estate markets.** Investments in infrastructure and the strength of real estate markets have a synergistic, two-way relationship. Our tenants and employees depend on safe and efficient roads, bridges, and mass transit to commute. Our buildings depend on reliable supplies of water, power, and broadband to function. In turn, infrastructure depends on healthy real estate markets. Property taxes are the main revenue source for local investments in roads, schools, etc. Higher property values mean more tax revenues to help pay for more infrastructure.
- **The IIJA helps the U.S. play "catch-up" on infrastructure investments.** The U.S. ranks 13th in the world when it comes to the quality of our infrastructure. Public investments in infrastructure as a share of the economy have fallen more than 40% since the 1960s—when the Interstate Highway System was built. If we want to stay globally competitive, increase GDP, create jobs, and out-compete China the U.S. has to continue to invest in infrastructure in a serious, significant way.

The Bipartisan "Physical" Infrastructure Law

- **The IIJA will boost Public-Private Partnerships (P3s).** Private sector capital must be tapped to help finance public infrastructure. There are simply not enough taxpayer resources to foot the entire bill for all of our nation's infrastructure needs. The IIJA supports programs that deploy taxpayer "seed money" to leverage far greater amounts of private sector investments in a variety of infrastructure asset classes. Its provisions are geared to boost P3 investments in road, transit, rail, broadband, electric grid, and carbon sequestration projects.
- **The IIJA will make our roads and bridges safer.** The largest category of IIJA expenditures is $110 billion to modernize roads and bridges. It represents the single largest dedicated bridge investment since the construction of the interstate highway system.
- **The IIJA helps build the high-speed rail network of tomorrow.** The new law makes the largest investment in intercity passenger rail since the creation of Amtrak. It devotes funds specifically to improve the Northeast Corridor route between D.C. and Boston.
- **The IIJA makes a massive investment in broadband.** It would devote $65 billion with the goal to ensure that every American has access to reliable high-speed internet.
- **The IIJA makes the largest single investment in the electric grid in history.** $65 billion goes to new transmission lines that facilitate widespread adoption of solar, wind, etc., so that clean energy can be transported over long distances.
- **The IIJA makes investments to replace the nation's lead pipes.** $55 billion is designated to provide clean drinking water for all Americans and eradicate the nation's remaining lead pipes. Every $5K investment to replace lead pipes results in $22K in avoided health care costs, as per the White House.
- **The IIJA invests in public transit.** The new law's mass transit investments total over $39 billion to help modernize bus, commuter rail, and subway networks. Most of the money would go directly to support local transit agencies.
- **The IIJA jump-starts federal investments in EV charging stations.** $7.5 billion is for construction of a national network of electric vehicle refueling properties. The goal is to make EV chargers as common as gas stations to minimize travelers' "range anxiety" and provide greater surety that "clean cars" can be easily re-charged and travel over long distances.
- **The IIJA helps streamline the cumbersome federal review process to approve projects.** The new law codifies a 2-year federal permitting goal and establishes a "One Federal Decision" document to coordinate the environmental reviews of multiple agencies.

The Bipartisan "Physical" Infrastructure Law

Additional Information

- White House Fact Sheet, "The Bipartisan Infrastructure Deal (Nov. 6, 2021)
- The Biden administration's bipartisan infrastructure law "spending guidebook" from the Biden administration (released Jan. 31, 2022)
- Interactive map "dashboard" showing IIJA project funding across the U.S.

SEC's Proposed Rule on Climate-Related Disclosures for Investors: Fact Sheet

Issue

On March 21, 2022, the U.S. Securities and Exchange Commission (SEC) released its proposed rule, "The Enhancement and Standardization of Climate-Related Disclosures for Investors." The SEC's proposal is one of the Biden administration's key policies to combat the climate crisis.

The proposed rule has no immediate effect. It kicked off a public comment period that generated the most stakeholder responses ever to an SEC-proposed regulation.

When finalized, the rule will impose the first-ever federal requirements on companies, funds, and lenders registered with the SEC to report, measure, and quantify for investors "material" risks related to climate change in Form 10-K and other filings.

California, however, has somewhat beat the SEC to the punch. In September 2023, Governor Newsom signed into law corporate emissions and climate-risk disclosure requirements without waiting for the SEC to act. (See The Roundtable's separate fact sheet, "California's Climate Disclosure Package.") While more companies will be affected by the SEC's eventual requirements, California is now the first jurisdiction in the U.S. to impose climate-related public disclosures on businesses as a matter of law.

The final SEC rule has been delayed for months. The delay is reportedly due to concerns that the proposal was too aggressive in its approach requiring disclosures of indirect Scope 3 emissions in a company's "value chain." Litigation against the SEC has also been widely reported as highly probable whenever the Commission releases a final rule. When—or even if— companies must comply with any SEC climate reporting rule thus remains unclear.

The Roundtable will update this fact sheet whenever the SEC releases a final rule. Below is a summary of the 2022 proposed rule.

Scope 1 & 2 GHG Emissions Disclosures

SEC registrants would be required to report and quantify Scope 1 and Scope 2 GHG emissions each year. Scope 1 and 2 reporting would require registrants to define and disclose how they determine their "organizational" and "operational" boundaries.

- Scope 1 and 2 emissions would need to be "disaggregated" and reported separately.
- "Organizational boundaries" for GHG emissions disclosure would track the same "scope of entities...and other holdings" based on the accounting principles that the registrant uses

for its "consolidated financial statements."

- "Operational boundaries" would require "identifying emissions sources within [the registrant's] plants, offices, and other facilities that fall within organizational boundaries;" and then "categorizing the emissions as either direct or indirect emissions." A registrant should explain its approach and describe its methodology for determining "operational boundaries."
- **The SEC does not specifically address how to bucket Scope 1 and 2 emissions in the building owner-tenant context. General principles on setting "organizational" and "operational" boundaries would need to be consulted in this regard.**
- A registrant would have the discretion to explain and disclose its emissions calculation approach. Examples: emissions per building floor area, kilowatt-hour (kWh) of electricity used, etc.

Scope 3 Reporting

SEC registrants would report Scope 3 emissions if the company has announced a Scope 3 reduction goal—or if investors would find the registrant's Scope 3 emissions "material."

- Scope 3 "indirect" emissions definitions follow the World Resources Institute's Greenhouse Gas Protocol "Scope 3" standard. The GHG Protocol is referenced heavily as a non-binding standard throughout the SEC's proposal. The SEC also repeatedly refers to the Task
- Force on Climate-Related Disclosures (TCFD) as another basis for its proposed emissions reporting framework.
- While the SEC does not propose a quantitative threshold for determining materiality, it "notes that some companies rely on a quantitative threshold, such as 40 percent, when assessing the materiality of Scope 3 emissions."
- If a registrant determines that its Scope 3 emissions are not "material," "it may be useful to investors" to explain why the registrant came to that conclusion.
- Under the GHG Protocol as cited in the SEC proposal, a building owner's "downstream" Scope 3 emissions would include tenant-based emissions – as well as "upstream" emissions that are "embodied" in construction materials and other purchased goods/services.

SEC's Proposed Rule on Climate-Related Disclosures for Investors: Fact Sheet

- Likewise, if the tenant is a registrant subject to SEC rules, then their "upstream" emissions would include the owner's building-related Scope 1 and 2 emissions.
- "As more companies make their Scope 1 and 2 emissions publicly available, these data can serve as the input for other companies' Scope 3 calculations."
- Review the 15 categories of Scope 3 emissions (including employee commuting, business travel, purchased goods, etc.) discussed in the GHG Protocol's Scope 3 guidance.

Scope 3 "Safe Harbor"

With regard to Scope 3 disclosures only, the SEC proposes a "safe harbor" for certain liability under federal securities laws.

- Under the proposed rule, "safe harbor" indicates that "disclosure of Scope 3 emissions [by a] registrant would be deemed not to be fraudulent statement" unless it was made "without a reasonable basis or was disclosed other than in good faith."
- The "safe harbor" extends to "any statement regarding Scope 3 emissions" in a document filed with the SEC under Reg S-K.
- The SEC recognizes the data collection, verification, and other difficulties in estimating emissions up and down a registrant's supply chain. It thus proposes a "targeted safe harbor for Scope 3 emissions data in light of the unique challenges associated with this information."

Third-Party Assurances

Scopes 1 and 2 disclosures would require independent third-party assurances.

- As part of the proposed requirements, registrants need to file an "attestation report" for Scopes 1 and 2 disclosures.
- "Limited assurance" is required in the first two years of compliance and scales up to "reasonable assurance" thereafter.
- "Reasonable assurance" is equivalent to the level of assurance provided in an audit of the financial statements included in a 10-K.

SEC's Proposed Rule on Climate-Related Disclosures for Investors: Fact Sheet

- Scope 3 assurances would be optional.
- Assurances would only be required from "large accelerated filers" and "accelerated filers" (See "compliance" summary below).
- "Attestation report" would need to be prepared and signed by a third-party "attestation provider" who has "significant experience" in GHG measurement and reporting. The provision is modeled after the SEC's existing rules to ensure that auditors reviewing financial statements are independent from their clients.

Reporting on "Transition Risks"

Registrants would need to report on "transition risks" such as regulatory compliance costs with federal, state, and local climate laws.

- While not specifically mentioned by the SEC, "transition risks" would likely encompass the costs and burdens of real estate stakeholders to comply with so-called energy"benchmarking," "building performance standards," and similar laws imposed by state and local governments.
- Other similar risks associated with the potential transition to a cleaner economy would include reduced market demand for carbon-intensive "products," devaluation or abandonment of assets, climate-related litigation risks and fines, and changes in "consumer behavior."
- Transition risk disclosure can also include optional reporting on "climate-related opportunities" such as capital expenditures, costs savings, and "new markets" that arise from energy- and water-efficiency investments; increased uses of renewable energy; claiming *IRA* clean energy tax incentives; and purchase of renewable energy certificates ("RECs").

Reporting on "Physical Risks"

In addition to GHG emissions, registrants would also need to report on material "physical risks" to buildings and other assets posed by climate change. Examples of material "physical risks" mentioned in the SEC's proposal include:

- Percentage of buildings located in flood hazard areas
- Potential diminution in value of coastal properties subject to rising sea levels

SEC's Proposed Rule on Climate-Related Disclosures for Investors: Fact Sheet

- Amount of assets (e.g., book value and as a percentage of total assets) in regions of "high" or "extremely high" water stress and scarcity
- Ability of construction laborers to work safely outdoors during heat waves which could delay operations and reduce earnings

Compliance Timeline

NOTE: In all likelihood, the proposed rule's deadlines will change when a final rule is announced.

Compliance would start in 2024 for the biggest registrants and phase-in for other companies.

- Registrants with a global value of $700 million or more—"large accelerated filers"—would need to comply first.
    - Compliance for Scope 1 and 2 disclosures for filings in 2024 (covering FY 2023 emissions)
    - Compliance for Scope 3 disclosures for filings in 2025 (covering FY 2024 emissions)
- Registrants with a global value of $75 million or more up to $750 million—"accelerated filers"—would need to comply next.
    - Compliance for Scope 1 and 2 disclosures for filings in 2025 (covering FY 2024 emissions)
    - Compliance for Scope 3 disclosures for filings in 2026 (covering FY 2025 emissions)
- Smaller reporting companies have the most time to comply.
    - Compliance with Scope 1 and 2 disclosures for filings in 2026 (covering FY 2025 emissions)
    - Exempt from Scope 3 reporting

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California's Climate Disclosure Package: Summary of SB 253 and SB 261

Issue

In September 2023, the California Legislature passed two bills that will require certain businesses to disclose and report their greenhouse gas (GHG) emissions and climate-related financial impacts:

- SB 253: The Climate Corporate Accountability Act requires certain businesses to quantify, report, and disclose Scopes 1, 2, and 3 emissions.
- SB 261: Requires certain businesses to more generally report and disclose climate-related financial risks.

Governor Gavin Newsom will sign these measures into law. Upon their enactment, SB 253 and SB 261 will become the first laws in the U.S. to require companies to report, disclose, and publicly file specific reports regarding GHG emissions and climate risks. California's climate reporting package precedes a long-anticipated final rule on climate disclosures anticipated by the U.S. Securities and Exchange Commission. The new laws could also compel other states to adopt similar measures.

Below is The Real Estate Roundtable's topline summary of SB 253 and SB 261.

California SB 253, "Climate Corporate Data Accountability Act"

WHAT: CORPORATE EMISSIONS DISCLOURES

- Requires annual corporate disclosures of Scopes 1, 2, and 3 emissions.
- Reporting in conformance with Greenhouse Gas (GHG) Protocol's standards, guidance, and "scopes" definitions.
- Scope 1: direct GHG emissions from sources a reporting entity owns or "directly controls," including but not limited to "fuel combustion activities."
- Scope 2: indirect GHG emissions from "consumed" electricity, steam, heating or cooling "purchased or acquired by a reporting entity."
- NOTE: There is no reference in the law regarding reporting of power purchase agreements (PPAs), renewable energy certificates (RECs), offsets, or other instruments regarding off-site purchases of clean energy.

California's Climate Disclosure Package: Summary of SB 253 and SB 261

- Scope 3: indirect upstream and downstream GHG emissions from sources that the reporting entity does not own or directly control, that "**may** include … purchased goods and services, business travel, employee commutes, and processing and use of sold products."
- Thus, embodied emissions in construction materials, and tenant-based leased space emissions, **may** be included in required disclosures
- **NOTES:**
  - The statutory text explicitly requires that that **"all"** of a reporting entity's Scope 1 and Scope 2 emissions must be disclosed.
    - Thus, the extent of Scope 1 and Scope 2 reporting appears to be regulated company's national and global emissions.
    - There is not a limitation to emissions from assets only located in California.
  - In contrast: The "all" qualifier is **not** included in the statutory text regarding Scope 3 emissions.
    - Because of the plain textual difference in the bill's language for Scope 3 reports compared to Scopes 1 and 2, there is arguably an interpretation that the California Legislature did not intend to mandate disclosures for all Scope 3 emissions (either in terms of all GHG Protocol Scope 3 categories or in terms of geographic reach).
    - The extent of Scope 3 reporting will likely be a controversial issue during the agency rulemaking stage that will develop regulations to implement the law.

WHO: "REPORTING ENTITIES"

- Any partnership, corporation, LLC or other business entity.
- Formed under any state law, or federal law.
- Does business in California.
- "Total annual revenues" greater than $1 billion dollars.
  - Not "profits."
  - "Total" revenue (i.e., global).

California's Climate Disclosure Package: Summary of SB 253 and SB 261

    - Based on reporting entity's revenue for the prior fiscal year

TO WHOM: "EMISSIONS REPORTING ORGANIZATION"

- Annual disclosures submitted to a non-profit Emissions Reporting Organization to be contracted by the California Air Resources Board ("Board").
- Board to establish a "digital platform" where public disclosures are made available.

HOW: THIRD-PARTY ASSURANCE

- Reporting entity must retain a "third-party assurance provider" regarding all reported emissions.
    - Provider "shall have significant experience in measuring, analyzing, reporting, or attesting to" GHG emissions.
- A "complete assurance provider's report" must accompany the emissions disclosures.
- Scope 1 and Scope 2 engagement:
    - Performed at a "limited assurance level" starting in 2026.
    - "Reasonable assurance level" starting in 2030.
- Scope 3 engagement:
    - Law does not specify an assurance level through 2029, but the Board may establish one by regulation.
    - Starting in 2030, law specifies a "limited assurance level" for Scope 3 reports

HOW MUCH: FEES AND FINES

- Board to establish a "filing fee" at a level to cover its administration costs. To be deposited in a State Treasury climate disclosure fund.
- Board to establish "administrative penalties" for nonfiling, late filing, or "other failure to meet requirements."
    - Any penalties imposed on a non-compliant entity shall not exceed $500K in a reporting year.

California's Climate Disclosure Package: Summary of SB 253 and SB 261

WHEN: RULEMAKING AND COMPLIANCE DEADLINES

- By January 1, 2025: Board to adopt implementing regulations.
- Starting in 2026: Scope 1 and Scope 2 disclosures required.
- Starting in 2027: Scope 3 disclosures required.
    - Scope 3 disclosures filed no later than 6 months after Scope 1 and Scope 2 disclosures.
- During 2029 and by January 1, 2030: Board "shall update as necessary" disclosure deadlines.
- After 2033: Board can stick with the GHG Protocol, or adopt an alternative standard following a stakeholder input process.

California SB 261, Disclosures of Climate-Related Financial Risks

- Companies with annual "total" revenues > $500 million, d/b/i California, must biannually report and disclose:
    - climate-related financial risks; and
    - mitigation measures to reduced and adapt to such risks.
    - Entities regulated by the California Department of Insurance, or in the "business of insurance in any other state," are exempt and have no reporting responsibilities under this law.
    - There is no requirement that only "public companies" must file California law disclosures.
- Disclosures as aligned with the Task Force on Climate-Related Financial Disclosures (TCFD) standard satisfy the law.
- Publicly accessible reports satisfy the law where such reports are required by "any regulated exchange national government, or other government entity."
    - E.g.: Functionally equivalent reports for purposes of California law would be those submitted and filed pursuant to:

    - Any rule ultimately finalized by the US-SEC regarding disclosures for climate-related financial risks; or
    - International Financial Reporting Standards Sustainability Disclosure Standards, as issued by the International Sustainability Standards Board.
- The climate-related financial risk report does not need to include Scopes 1, 2, or 3 disclosures. But if they are included, they should be third-party verified.
- SB 261 reports must be filed by January 1, 2026 – and posted on the company's own website.
- Fees will be imposed on companies for the CA government to administer the program. Penalties may be imposed for non-filings or insufficient reports.

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Energy and Climate

IRA Clean Energy Tax Incentives Relevant to U.S. Real Estate: Fact Sheet

Issue

President Biden signed the *Inflation Reduction Act of 2022* (IRA) into law on August 16, 2022. The legislation will invest almost $370 billion over 10 years to tackle the climate crisis.

A number of the IRA's changes to the federal tax code may help the U.S. real estate sector reduce its carbon footprint, particularly:

- A deduction to help make commercial and multifamily buildings more energy efficient (Section 179D);
- A credit to encourage investments in renewable energy generation, storage, and other "clean energy" technologies sited at buildings and other facilities (Section 48);
- A credit to incentivize the installation of EV charging stations (Section 30C); and
- A credit to incentivize energy-efficient new residential construction, including multifamily (Section 45L).

The Real Estate Roundtable (RER) has encouraged Congress for a number of years to make clean energy tax incentives more usable for building owners, managers, and financiers—and more impactful to help meet national GHG reduction goals. Below is our summary of key IRA provisions.

179D Tax Deduction for Energy Efficient Buildings[9]

Amount of Deduction

- The 179D deduction amount is on a "sliding scale."
  - Amount increases with higher levels of building efficiency.
  - Minimum efficiency gain eligible for the deduction: 25%, pegged to a minimum deduction amount of 50 cents per building ft^2.
  - Each percentage point increase in building efficiency correlates to a 2-cent increase in the deduction amount.

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IRA Clean Energy Tax Incentives Relevant to U.S. Real Estate: Fact Sheet

Efficiency Gain Over Baseline	Deduction Amount Base Rate	Labor Standards "Bonus Rate"
25% (minimum)	**50 cents per ft^2**	**\$2.50 per ft^2**
30%	**60 cents per ft^2**	**\$3.00 per ft^2**
35%	**70 cents per ft^2**	**\$3.50 per ft^2**
40%	**80 cents per ft^2**	**\$4.00 per ft^2**
50% (maximum)	**\$1.00 per ft^2**	**\$5.00 per ft^2**

- 179D deduction amount increases five times if the building project meets labor standards that: (1) pay "prevailing wages" to laborers that "install" equipment; and (2) satisfy "apprenticeship" hiring requirements.
  - IRA's general approach: Projects meeting labor standards are eligible for "Bonus" incentives that are five times more than "Base" incentives.
  - See prevailing wage and apprenticeship guidance (published by the IRS on Nov. 30, 2022)

179D is a "deduction" – not a "credit."

- 179D effectively works as a form of "accelerated depreciation" for energy efficient building "property"—as long as the property achieves the "efficiency gain" performance standard along the sliding scale in the table above.
- 179D is **<u>not</u>** a tax "credit" and does not reduce a company's tax liability dollar-for-dollar.

IRA Clean Energy Tax Incentives Relevant to U.S. Real Estate: Fact Sheet

Eligible Energy Efficient "Property"

- Projects to achieve whole-building efficiency gains through installations of any combination of:
    - Interior lighting (not "exterior")
    - HVAC and hot water systems
    - Envelope (roof, windows, insulation)

Timing

- IRA sliding scale amounts apply to energy efficient property "placed in service" after December 31, 2022.
- No sunset for this deduction. 179D became a permanent part of the tax code in December 2020.

Eligible Building Types

- Any building within the scope of the ASHRAE 90.1 energy standard—which covers commercial buildings and larger multifamily buildings with four floors or more (not "low-rise" multifamily).

General 179D Baseline for New Construction

- New construction must model at least 25% more efficient over the ASHRAE 90.1 baseline to qualify for an incentive on the sliding scale.
- The 2007 version of ASHRAE 90.1 provides 179D's general baseline for equipment "placed in service" up to Dec. 31, 2026 (see IRS guidance published on Dec. 23, 2020).
- The 2019 version of ASHRAE 90.1 will provide 179D's general baseline for equipment "placed in service" on or after Jan. 1, 2027.

Retrofits—Section 179D(f) "Alternative Deduction"

- Retrofit baseline: The building's own specific level of pre-retrofit site energy usage intensity (EUI).
    - Post-retrofit site EUI reductions of at least 25% are measured against the pre-retrofit baseline to determine the "sliding scale" incentive amount.
- A building must be five years or older to qualify for 179D(f)'s retrofit path.

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- Project must be set forth in a "qualified retrofit plan" certified by a professional engineer or registered architect.
  - No requirement that the government review or approve the qualified retrofit plan.
- Taxpayer must wait to claim the retrofit deduction at least one year after the equipment is in service **and** the project results in anticipated site EUI reductions of at least 25%.
  - Taxpayer cannot claim the retrofit deduction in the year it buys or installs equipment.
  - Architect/engineer must make a "final certification" of site EUI at least one year after the retrofit plan is implemented to show the requisite level of efficiency gain.
- 179D(f) retrofit deduction amount and cap
  - Uses the same sliding scale in the table on page 1.
  - The deduction amount increases with greater efficiency gains proved-out in the retrofit plan's "final certification."
  - The deduction amount is capped at the retrofit plan's cost (i.e., "aggregate adjusted basis...of energy efficient building retrofit property placed in service").

Deduction Reset

- The 179D deduction can apply to a specific building every 3 years (or every 4 years in the case of a building owned by a governmental or tribal body, or a non-profit organization).

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REITs

- Includes earnings and profits (E&P) "conformity" accounting fix.
  - 179D deduction amount fully reduces E&P in the year that the energy efficiency components are installed or, in the case of a retrofit, in the year that site EUI reductions are proven and "certified" (not ratably over a five-year period, as prior law required).
  - REITs and their shareholders may thus receive a fuller and more immediate financial benefit by claiming the 179D deduction.

Relationship to Low-Income Housing Tax Credits (LIHTCs)

- 179D Deduction amounts **do** reduce basis in LIHTC properties.
  - Note different treatment for Section 48 tax credit that **does not** reduce LIHTC basis.
  - Bipartisan LIHTC reform legislation pending in Congress **would not** reduce LIHTC basis under 179D (section 309 of S. 1557/H.R. 3238).

Section 48 Investment Tax Credit

Types of Projects

- "Energy Property" covered by prior law: solar to generate electricity for heating or cooling; fiber-optic solar to illuminate the inside of a structure; "small wind" and microturbines; geothermal used to produce electricity; geothermal heat pumps to heat or cool a structure; fuel cells; waste recovery; and combined heat and power.
- IRA adds: energy storage (including thermal energy storage); dynamic glass; microgrid controllers; biogas property; linear generators; and "interconnection property" to the electric grid.

Base and Bonus Rate ITC Credit Amount (see also separate RER chart on "Base and Bonus Rate Amounts")

- 6% of the cost of the Energy Property ("Base Rate").

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- Can scale up to 30% of cost ("Bonus Rate") if project pays prevailing wages and meets apprenticeship requirements for the duration of the project's "construction."
  - Except for microturbines: 2% "Base Rate" and 10% "Bonus Rate."
- "Small solar" and other projects that generate less than one MW of electricity can qualify at the 30% "Bonus Rate" even if they do not meet wage and apprenticeship standards.
- Credit amount increased by 2% if project meets "domestic content requirements" (i.e., iron, steel, manufactured products are made in the USA). See also IRS Notice 2023-38 (May 12, 2023)
  - Boost to 10% if prevailing wage/apprenticeship standards are met.
- Credit amount increased by 2% if project is located in an "energy community" (i.e., Brownfield site, census tract [or immediately adjacent tract] where a coal mine closed after Dec. 31, 1999, or coal-fired electric plant was retired after Dec. 31, 2009). See also IRS Notice 2023-29
  - Boost to 10% if prevailing wage/apprenticeship standards are met.

Low-Income Housing and Communities– See also IRS Notice 2023-17 (Feb. 13, 2023)

- Any credit amounts under Sections 48, 48E, or 45Y do **not** reduce the basis of buildings supported by Section 42 LIHTCs.
- 20% credit boost for solar and wind projects, generating less than 5 MW, installed "on" low-income housing buildings (such as those supported by LIHTCs).
- 10% credit boost for solar and wind projects, generating less than 5 MW, located in census tracts eligible for New Markets Tax Credits (NMTCs).
- Section 48 credit increases for low-income housing and communities are competitive. They are capped at annual capacity limits, require an application to US-DOE, and approval by Treasury/IRS.

Timing and Switch to "Technology Neutral" Tax Credits

- Generally: Section 48 project construction must commence in 2023 or 2024.
  - Except for geothermal heat pumps: Construction must commence through 2034.

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  - Tax credit starts to scale down for geothermal heat pumps constructed in 2033 and 2034.
- For Section 48 projects constructed **after** Jan 1, 2025:
  - Transition to the technology-neutral "Clean Electricity Production Credit" (Section 45Y) or the "Clean Electricity Investment Credit" (Section 48E).
    - Taxpayer to opt for either the 45Y PTC or the 48E ITC.
    - Credits start to phase out by 2032 or when the electric power sector emits 75% less carbon than 2022 levels (whichever comes later).
  - Section 45Y PTC or Section 48E ITC is available for any "zero carbon" electricity facility or technology.
    - 45Y PTC = tax credit per kWh of "zero carbon" electricity produced and sold in the 10-year period after the facility is placed in service.
      - Base Rate of .5 cents per kWh.
      - Bonus Rate of 2.5 cents per kWh (if prevailing wage/apprenticeship standards are met).
    - 48E ITC = tax credit based on same Base Rate and Bonus Rate structure discussed above.
      - Base Rate: 6% of the cost investment in the "zero carbon" facility.
      - Bonus Rate: 30% of the cost of investment in the facility (if prevailing wage/apprenticeship standards are met).
    - 5-year depreciation for any qualifying "zero carbon" 45Y facility or 48E property.

30C Tax Credit for EV Charging Stations

- Extended through 2032.
- Same Base Rate (6%) and Bonus Rate (30%, if labor standards are met) structure discussed above.

- Credit capped at $100K for each charging station or refueling pump installed at a property.
- Third-party "transferability" applies.
- Geographic limitations—charging station must be located in either:
    - A low-income or high-poverty Census tract under New Markets Tax Credit (NMTC) criteria (see NMTC tracking tool); or
    - Not an "urban area" as defined by the U.S. Census Bureau. Guidance ideally forthcoming here.

Section 45L "New Energy Efficient Home" Tax Credit

Duration and Building Eligibility

- Extended through 2032.
- Pertains to new construction and "substantial rehabilitation".
- All residential buildings—single-family and multifamily—are eligible.
- Multifamily and apartment buildings that are 4 floors or more can also qualify for the Section 179D tax deduction discussed above (as they are in the scope of ASHRAE 90.1 standard).

Primary Use of Building

- Must be "residential."
- Mixed-use buildings: "Dwelling" units and common space (excluding parking garages) must exceed 50% of the building's square footage.

For Multifamily Homes

- Credit applies to "dwelling units" in a "building" eligible for EPA's ENERGY STAR "Multifamily New Construction Program."
- "Dwelling unit" must meet both:
    - EPA's most recent National Program Requirements; and
    - Any applicable EPA regional program requirements (e.g., California).

IRA Clean Energy Tax Incentives Relevant to U.S. Real Estate: Fact Sheet

Credit Amounts

- Credits are "per unit" in a qualifying multifamily building.
  - Increased amount if the unit meets U.S.-DOE's Zero Energy Ready Home Multifamily Program (in development).
  - For single family: Increased credit amount if the home is certified by U.S.-DOE as a "Zero Energy Ready Home."
- 5x "Bonus Rate" if prevailing wage requirements are met.
  - No apprenticeship hiring requirement for multifamily "Bonus Rate."
  - No prevailing wage "Bonus Rate" for single family.

	Base	Base Zero Energy	Bonus	Bonus Zero Energy
Multifamily	**$500**	**$1,000**	**$2,500**	**$5,000**
Single-Family	**$2,500**	**$5,000**	**n/a**	**n/a**

Low-Income Housing

- 45L credit amounts do ***not*** reduce the basis of buildings supported by Section 42 LIHTCs.
- However, 179D deductions ***do*** reduce the basis of LIHTC buildings.

Credit Transfers Allowed to Third Parties

- Companies with little or no tax liability that cannot typically benefit from tax credits—like REITs—have the option to "transfer" certain IRA credits to another taxpaying entity that can use them.

IRA Clean Energy Tax Incentives Relevant to U.S. Real Estate: Fact Sheet

- REITs, etc., can transfer the full or partial amount of a credit.
    - Transferability allowed for credits under Sections 30C, 45Y, 48, and 48E.
    - Transferability is ***not*** allowed for the Section 45L credit.
    - Transferability of 179D (called an "allocation") is only allowed by government, tribal, and non-profit building owners. They can allocate the deduction to architects and designers responsible for the building project. 179D transfer is ***not*** allowed by private sector, for-profit building owners.
- The recipient of the credit (the "transferee taxpayer") must pay for the credit "in cash."
    - Joint Committee on Taxation report (JCX-5-23) at p. 98): Transferee taxpayer bears "recapture risk."
    - That is, the buyer of tax credits is responsible to payback any credit amounts if the property ceases to be used to generate solar, wind, used for storage, EV charging, etc.
    - To create a robust market for IRA credits, transferee buyers will likely require contractual indemnities and other protections from building owner taxpayers upon the sale of credits.
- The "transferee taxpayer" must be unrelated to the company making the transfer.
- Transferred credit amounts are not "income" to the company making the transfer.
- Transferred credit amounts are not deductible by the "transferee taxpayer."
- REITs can transfer the full amount of the credit.

IRA Clean Energy Tax Incentives Relevant to U.S. Real Estate: Fact Sheet

Who Can Buy and Sell IRA Tax Credits -- Summary

IRA Tax Incentive	Direct Pay from U.S. Government	Optional Transfer of Incentive
• **179D Tax Deduction for Energy Efficient Commercial and Larger Multifamily Buildings**	Not allowed	***Who can transfer:*** • Only specified "tax-exempt entities" that own buildings can "allocate" 179D amounts. • This includes federal/state/local government, tribal, and non-profit building owners. • Private sector building owners ***cannot*** transfer 179D amounts. ***Who can receive:*** • Only the "person primarily responsible for designing" the energy-efficient property can receive allocated 179D amounts. • E.g., Architects, engineers, efficiency contractors/consultants ***NOTE:*** Earnings and Profits "conformity" for REITs—i.e., full amount of 179D deduction reduces E&P in the same year that the REIT claims the deduction.
• **Section 48 Investment Tax Credit (projects constructed in 2023 or 2024)**	Direct pay eligibility limited to state/local governments, tribes, rural electric coops., and non-profits.	***Who can transfer:*** • All business taxpayers that are not eligible for "direct pay."

• **Section 48E Clean Electricity Investment Tax Credit (projects constructed in 2025 or later)** • **Section 45Y Clean Electricity Production Tax Credit (projects constructed in 2025 or later)**		• E.g., REITs, partnerships, corporations ***Who can receive:*** • Any unrelated third-party that pays taxes (the “transferee taxpayer”), and that buys the credit amount “in cash.”
• **Section 30C EV Charging Station Tax Credit**	Same as immediately above for Section 48 ITC, etc.	Same as immediately above for Section 48 ITC, etc.
• **45L Tax Credit for New Energy Efficient Homes (Single- and Multifamily eligibility)**	Not allowed	Not allowed

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IRA Section 48 Investment Tax Credit— “Base” and “Bonus” Rate Amounts

	Section 48 Project Type	Base Credit Amount	Meets Wage, Apprenticeship	Bonus Credit Amount	Relevant Statutory Section/ Regulation/Guidance
	Various “energy property”[10]	6% of project costs	30% of project costs	See below for bonus re: solar, wind, associated storage < 5 MW; and “domestic content”; and Brownfields.	• 26 U.S.C. §§ 48(a)(2)(a)(i), (9), (10) • IRS Notice 2022-61 (87 Fed. Reg. 73,580 [Nov. 30, 2022]) for labor guidance
	Any “energy project” with max net output < 1 MW (measured in AC)	30% of project costs	N/A	See below for bonuses re: solar, wind, associated storage < 5 MW; “domestic content”; and Brownfields.	• 26 U.S.C. §§ 48(a) (9)(A), (B)(i) • Guidance expected to define “single” energy project
	Interconnection property for projects ≤ 5 MW (measured in AC)	6% of project costs	30% of project costs	See below, “domestic content”; and Brownfields.	• 26 U.S.C. § 48(a)(8) • IRS Notice 2022-61 (87 Fed. Reg. 73,580 [Nov. 30, 2022]) for labor guidance
	Microturbines[11]	2%	10%	See below, “domestic content”; and Brownfields.	• 26 U.S.C. §§ 48(a)(2)(a)(ii), 3(a)((iv)
Only solar, wind + storage projects with max net output < 5 MW (measured in AC).	**In an NMTC census tract (“low-income community”)**	N/A	N/A	Add 10%. Annual capacity limit.[12] Must apply to DOE/IRS for allocation.	• 26 U.S.C. §§ 48(e)(1)(A)(i), (2)(A)(iii)(I) • IRS Notice 2023-17 (Feb. 13, 2023)
	On low-income housing (e.g., supported by LIHTCs or Section 8 vouchers)	N/A	N/A	Add 20%. Annual capacity limit.[13] Must apply to DOE/IRS for an allocation.	• 26 U.S.C. §§ 48(e)(1)(A)(ii), (2)(A)(iii)(II), (2)(B) • IRS Notice 2023-17 (Feb. 13, 2023)
	“Low-income economic benefit” (high poverty, low income census tract)	N/A		Add 20%. Annual capacity limit.[14] Must apply to DOE/IRS for allocation.	• 26 U.S.C. §§ 48(e)(1)(A)(ii), (2)(A)(iii)(II), (2)(C) • IRS Notice 2023-17 (Feb. 13, 2023)
	Any “energy property” that meets domestic content requirements (“Buy American”)[15]	N/A	• Add 10% if project meets wage, apprenticeship	• Add 10% if project generates < 1MW (labor standards N/A) • Add 2% if project ≥1 MW and does not meet wage, apprenticeship.	• 26 U.S.C. §§ 45(b)(9)(B); 48(a)(12) • 49 C.F.R. § 661.5 (*IRA* incorporates “Buy America” regs from the Federal Transit Administration) • IRS Notice 2023-38 (May 12, 2023)

[10] Consult relevant definitions for each “energy property” type at 26 U.S.C. § 48(c): fuel cells; solar electricity for heating/cooling/hot water; fiber-optic solar for interior illumination; electrochromic (dynamic) glass; “small wind” property (turbine capacity ≤ 100 KW); waste energy recovery (capacity ≤ 50 MW); electricity and hydrogen storage (nameplate capacity ≥ 5 KWH); thermal energy storage; biogas; combined heat and power; geothermal heat pumps; microgrid controllers.
[11] Nameplate capacity < 2,000 KW and electricity-only generating efficiency ≥ 26%. 26 U.S.C. § 48(c)(2).
[12] 700 MW as per IRS Notice 2023-17 (Feb. 13, 2023). Cannot be combined with extra credits for low-income housing or “low-income economic benefit.”
[13] 200 MW. See *id.* Cannot be combined with extra credits for “low-income community” or “low-income economic benefit.”
[14] 700 MW. See *id.* Cannot be combined with extra credits for low-income housing or “low-income community.”
[15] Steel, iron, and certain percentages of “manufactured products” that are components of “energy property” and certified by taxpayer as produced in the U.S.A. Additive and *can* be combined with various low-income extra credits for “communities,” “housing” and “economic benefit.” No capacity limits or IRS/DOE application required

Brownfield site (or area economically dependent on fossil fuel industry)[16]	N/A	• Add 10% if project meets wage, apprenticeship	• Add 2% if project does not meet wage, apprenticeship.if project also meets labor standards.	• 26 U.S.C. §§ 45(b)(11)(B)(i); 48(a)(14) • IRS Notice 2023-29 (Apr. 4, 2023)

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[16] Additive and *can* be combined with various credits for low-income "communities," "housing" and "domestic content." No capacity limits or IRS/DOE application required

New Federal Definition for "Zero Emissions Buildings" ("ZEB")

Issue

The Biden Administration plans to propose a standardized definition for the term, "Zero Emissions Building" ("ZEB"). The U.S. Department of Energy (US-DOE) will take public comments on the definition. It is expected to release a final version as early as the end of this year.

Certainly, Congress has not granted any authority to ***mandate*** that private sector buildings must be "zero emissions." DOE's definition, however, can establish a guideline and aspiration. The Roundtable has long advocated for a uniform, realistic – and ***voluntary*** – federal definition to clarify how the U.S government defines real estate with low or no carbon footprint.

Key CRE audiences all have different and varying conceptions of what "net zero," "zero emissions," and "low carbon" mean. A unifying federal "ZEB" definition can potentially bring much-needed consistency to help owners, developers, and financiers navigate the diverse patchwork of climate-related programs such as:

- Building "labels" and financial incentives administered by various federal agencies;
- Consistent disclosures for the SEC's imminent climate reporting rule and similar reporting required at the state level [See RER's US-SEC and California law climate disclosures facts sheets];
- Compliance with state and local building performance mandates;
- Criteria for financial institutions, pensions, SWFs, insurance providers, and other institutional investors and asset managers of real estate;
- Federal leasing clauses for U.S. government tenants in private sector buildings;
- "Points" across myriad building certification programs; and
- NGO protocols and standards that have international reach for companies to establish emissions targets. [See RER's Science-Based Targets Initiative (SBTi) fact sheet.]

"ZEB" should best construed to mean, "zero over time." It is likely not a standard for an asset to reach immediately or in the short-term. However, with the right definition, an asset may strive for zero emissions by 2040 or later. For example, at or near the end of the useful life of a gas-fired building boiler, cap ex planning now may support replacement with a heat pump in 10-15 years.

New Federal Definition for "Zero Emissions Buildings" ("ZEB")

New construction might be able to reach "ZEB" even quicker, if planned at the start of development and construction compared to retrofitting a decades-old asset.

The U.S. Environmental Protection Agency (EPA) is pursuing complementary policy. Its ENERGY STAR program plans to issue final criteria for its "NextGen" label for low-carbon buildings by Q1-2024. NextGen should be viewed as a "point in transition" along the path to ultimately achieve zero emissions. Both DOE's definition of "ZEB" and EPA's NextGen "label" criteria can – and must – work together.

The Roundtable's Position

The Roundtable's comments to US-DOE will explain that a federal "ZEB" definition should – and should not – include the following:

- **Efficiency First:** Emissions must be reduced first and foremost by making the asset as cost-effectively efficient as possible.

- **Focus on "The Building":** The "zero" emissions aspiration should focus on emissions attributable to energy consumed within the asset's physical parameters. This means the eventual removal of Scope 1, Scope 2, and tenant-based Scope 3 emissions.

- **Not Embodied Carbon:** The real estate market, product manufacturers – and government guidance – are not ready now to get to "zero emissions" embodied in construction materials and other purchased goods and services.
  - EPA's holistic embodied emissions strategy may help real estate owners ***eventually*** make strides in tackling embodied carbon. But EPA's collaboration with manufacturers is nowhere near complete and needs time to gain traction.

- **Not Scope 3 Generally:** Similar to excluding embodied carbon, other Scope 3 categories (such as employee travel or commuting) should not be encompassed in a "ZEB" definition.
  - As noted above, from the perspective of "The **Building**," a "Zero Emissions **Building**" should strive over time to eliminate emissions from downstream tenant-based energy consumption.
  - Such leased space emissions should be ***the only*** Scope 3 category within the purview of a federal "ZE**B.**"

New Federal Definition for "Zero Emissions Buildings" ("ZEB")

- **100% Renewables – Either On-Site of Off-Site:**
  - "Zero emissions" should mean that all energy consumed on-site is renewably sourced.
  - However, not all buildings can deploy or install on-site solar panels, tap into geothermal heat, etc.
  - Thus, off-site renewable energy purchases (e.g., RECs) must be allowed.
    - We need a standardized system to track REC purchases to assure they are valid, independently verified, and to avoid double-counting.
    - ENERGY STAR Portfolio Manager should be enhanced to incorporate REC tracking functions.
  - Because climate change is an international problem, there should be no geographic restriction as to where RECs may be purchased. RECs should "count" as long as they are third-party verified and meet quality control criteria – regardless of where the corresponding zero-emissions energy is sourced.
    - For example: Don't limit REC purchases to the "grid region" where the building is located.
    - Electric utilities may not even make RECs available in U.S. markets where they operate as monopolies (e.g., non-ISO regions).
    - Even if RECs are made theoretically available in certain markets, utilities might purchase them all to meet their own "renewable portfolio standards" imposed by state law – leaving nothing left over for nearby building owners to purchase at scale.

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"NextGen" EPA Label for Low-Carbon Buildings

Issue

On January 31, 2023, the U.S. Environmental Protection Agency (EPA) proposed a low-carbon voluntary building recognition label called ENERGY STAR NextGen™. EPA designed the new program to reflect U.S. real estate's role to support the Biden administration's goal of economy-wide net-zero emissions by 2050.

The NextGen building label would expand upon the agency's successful ENERGY STAR program for assets that attain high levels of energy efficiency. The new label would allow companies to highlight buildings that further reduce Scopes 1 and 2 GHG emissions, deploy renewable energy technologies on-site, and encourage clean power purchases that increase off-site renewable energy supplies.

The Roundtable encouraged EPA to create a label for low-carbon buildings, along the lines of NextGen, to create uniform, voluntary, and easy-to-implement federal guidelines that help simplify the confusing patchwork of city and state climate-related building mandates.

EPA intends to make its NextGen label available in late 2023-early 2024. The Roundtable submitted comments on March 2, 2023. Our comments urge the agency to conduct a pilot program that tests the low-carbon label before any final NextGen criteria are released to the CRE marketplace. RER's comments also recommend that EPA refine its proposed NextGen criteria, as follows:

The Roundtable's Position

Efficiency

- Significant and **demonstrated reductions in a building's energy use** should be eligible for the NextGen label (as an alternate, additional criterion to EPA's proposal that only ENERGY STAR-certified buildings could qualify).
- Buildings that have the most room to improve performance (but are not yet "top of class") should be afforded NextGen label opportunities. These are exactly the kinds of real estate assets that need incentives to also increase renewable energy use and lower emissions.

"NextGen" EPA Label for Low-Carbon Buildings

Renewable Energy

- The NextGen proposal would require that 30% of a building's energy use must derive from renewables. This level should start at 20% and adjust over time **to reflect the changing status of the electric grid as it decarbonizes** through increased reliance on solar, wind, and other clean power sources.
- **Battery storage** should be included in the percent requirement for renewable energy use.
- The requisite percentage of renewable energy use should also encompass **geothermal and other technologies** that harness clean energy sources for heating, cooling, hot water, cooking, and other building functions.
- NextGen should move toward recognizing **"peak demand" mitigation measures.** EPA's federal standard energy benchmarking tool, Portfolio Manager, should evolve so a building owner can track progress to use less electricity at times of peak demand.

GHG Reductions

- The Roundtable commends the EPA's proposal to **normalize a GHG "intensity target"** that correlates to a building's asset type and unique weather conditions based on a metric known as Heating Degree Days (HDD).

Renewable Energy Certificates (RECs)

- Voluntary NextGen recognition can provide **much-needed guidance on corporate accounting for REC purchases** and enhance credible claims on the environmental benefits from offsite clean power procurement.
- For purposes of the proposed label, an organization should promote its renewable energy consumption through RECs by showing it:
  - Has exclusive, contractual rights to the environmental attributes of the RECs it purchases;
  - Retains those rights and does not sell them;
  - Limits claims to match the scope of its REC purchases (here, for the tailored purpose of mitigating emissions from electricity consumed by a specific building(s) seeking NextGen recognition);

"NextGen" EPA Label for Low-Carbon Buildings

  - Retires RECs associated with a green power purchase to prevent "double counting";
  - Certifies and verifies qualifying RECs by an independent third party; and
  - Maintains the paperwork needed to substantiate its ownership of the energy attributes of verified RECs.

Application Process

- EPA should optimize NextGen procedures by allowing owners to **apply concurrently for both ENERGY STAR and NextGen certifications with the same application**.
- The Roundtable recommends a **three-year cadence for NextGen certification renewals** because many companies with nationwide portfolios choose to pursue updates to their asset certifications in cycles and not annually due to the heavy compliance lift.

Cyber and Physical Threats

Issue

The rising incidence of violent crime, organized retail crime, civil unrest, cyber-attacks, and the renewed threat of terrorism have prompted increased vigilance, information sharing, and legislative efforts to improve our nation's resilience. The proliferation of these threats and the reduction of funding for many state and local law enforcement agencies have raised concerns in the commercial facilities sector about how to protect commercial properties and the people who occupy them from such threats. In addition to the remaining challenges posed by the pandemic, the Russian invasion of Ukraine has raised security concerns about the increased incidence of cyber-attacks from the Russian Federation and other state actors.

The Roundtable's Position

- Recent high-profile hacking attacks have brought to the fore the necessity of fortifying the nation's IT infrastructure against cyber-attacks.
- On March 15, 2022, President Biden signed into law the Cyber Incident Reporting for Critical Infrastructure Act, which was included in an omnibus appropriations bill. Against the backdrop of high-profile cyber-attacks on critical infrastructure providers and growing concerns of retaliatory cyber-attacks relating to Russia's invasion of Ukraine, the House approved the bipartisan legislation on March 9 and the Senate unanimously approved the legislation on March 11.
- The Act creates two new reporting obligations on owners and operators of critical infrastructure:
    - An obligation to report certain cyber incidents to the Cybersecurity and Infrastructure Security Agency (CISA) of the U.S. Department of Homeland Security (DHS) within 72 hours, and
    - An obligation to report ransomware payments within 24 hours.
- The new reporting obligations will not take effect until the Director of CISA promulgates implementing regulations, including "clear description[s] of the types of entities that constitute covered entities."
- In addition, the SEC has proposed regulations that would require public companies to make prescribed cybersecurity disclosures. The proposed rules would "strengthen investors' ability to evaluate public companies' cybersecurity practices and incident reporting" by requiring:

Cyber and Physical Threats

  - (i) mandatory, material cybersecurity incident reporting, including updates about previously reported incidents; and
  - (ii) mandatory, ongoing disclosures on companies' governance, risk management, and strategy with respect to cybersecurity risks, including board cybersecurity expertise and board oversight of cybersecurity risks.
- The Roundtable submitted comments on the proposed SEC rules for submission on May 9, 2022. In the letter, we cite our long history of support for effective information sharing and policies that promote industry reporting to the federal government on significant cybersecurity incidents. We also raise a number of concerns regarding the detailed, granular reporting that would be required by the Proposal, and the rigid incident reporting deadlines, which members fear may unintentionally exacerbate cybersecurity risks for issuers and impose burdens unjustified by obvious benefits.
- The Roundtable is working through a coalition of business organizations to ensure that any cyber incident reporting legislation creates a compliance regime that treats cyber-attack victims as victims, provides affected businesses with clarity in reporting, encourages cooperation between the public and private sectors, and limits legal liability.
- Through our Homeland Security Task Force and Real Estate Information Sharing and Analysis Center (RE-ISAC), The Roundtable remains focused on measures that businesses can take—such as creating resilient infrastructure that is resistant to physical damage and cyber breaches—through increased cross-agency information sharing and cooperation with key law enforcement and intelligence agencies.
- Through a Cybersecurity Information Sharing and Collaboration Agreement with DHS's Cybersecurity and Infrastructure Security Agency (CISA), the RE-ISAC engages in operational efforts to better coordinate activities supporting the detection, prevention, and mitigation of cybersecurity, communications reliability, and related data threats to critical infrastructure.
- In addition to civil unrest, organized retail crime, and violent attacks on properties across the U.S., real estate continues to face a variety of cyber and physical threats, such as:
  - disruptive and destructive cyber operations against strategic targets, including an increased interest in control systems and operational technology;
  - cyber-enabled espionage and intellectual property theft;

Cyber and Physical Threats

  - improvised explosive devices (IEDs);
  - attacks against U.S. citizens and interests abroad and similar attacks in the homeland;
  - tenant fraud;
  - pandemic risk; and
  - unmanned aircraft system (UAS) attacks against hardened and soft targets.
- As a critical part of the nation’s infrastructure, real estate continues to assess and strengthen its cyber and physical defenses to protect our industry from an array of threats—international and domestic terrorism, criminal activity, cyber-attacks, border security, and natural catastrophes.
- The Roundtable continues to promote security measures against both physical and cyber threats by facilitating increased information sharing and cooperation among its membership with key law enforcement and intelligence agencies.

Cyber and Physical Threats: Continuity of the Economy Plan (COTE)

Issue

Pursuant to Section 9603 of the 2021 National Defense Authorization Act (NDAA), Congress mandated that the President shall develop and maintain a Continuity of the Economy Plan (COTE) to maintain and restore the economy of the United States in response to a significant event. Despite having Continuity of Operations (COOP) and Continuity of Government (COG) plans to ensure the nation could function after a nuclear attack, no equivalent effort exists to ensure the rapid restart and recovery of the U.S. economy after a catastrophic or major disruption. Such disruptions could include a large-scale cyberattack or any other severe degradation that compromises the national conveyance of goods or services. Following such a catastrophic event, the government will have to prioritize its limited recovery resources, governed by a COTE Plan. A COTE will provide the U.S. with a robust and adaptable framework to restore the economy after a catastrophic attack.

The Roundtable's Position

- The Roundtable has been working with the Cybersecurity and Infrastructure Security Agency's (CISA) National Risk Management Center to aid their efforts to develop a Continuity of the Economy Plan (COTE) to maintain and restore the U.S. economy in response to a significant event. CISA works with government and industry to identify, analyze, prioritize, and manage the most significant strategic risks to the nation's critical infrastructure.
- The Roundtable's focus is on the Commercial Facilities (CF) Sector and the potential impacts on real estate from a wide-scale event. Among other things, the Plan requires an analysis of U.S. distribution and supply chains to identify the critical economic actors and functions that must be operational if the U.S. is to maintain its defense readiness, public health, and national security.
- Given the crucial role that the CF Sector plays in facilitating interaction and communication with critical infrastructure owners, operators, and relevant stakeholders, we are including key partners in our discussions with the COTE Project Team to provide insights and input on the COTE scoping effort from our community.