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ALERT MEMORANDUM

Impact of COVID-19 on US REITs

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We can see many areas where the COVID-19 pandemic could adversely affect Real Estate Investment Trusts ("REITs") in terms of the various tax requirements REITs must meet in order to maintain their REIT status or avoid punitive taxes. It remains to be seen how much of these issues will benefit from regulatory or statutory guidance.

First, REITs generally are required to pay dividend distributions each year in an amount equal to not less than 90% of their taxable income in order to maintain their status as a REIT. However, as interest on loans or rental payments due to a REIT are delayed, REITs may find themselves in the position of accruing income without actually receiving the related cash in time to fund a cash distribution to shareholders. This specific concern, along with the need to preserve liquidity as a more general matter, has caused REIT advocates to seek a rule that would allow public REITs to satisfy a larger portion of their dividend requirement through stock dividends, as opposed to cash distributions. Specifically, in connection with the 2008 financial crisis, the U.S. Treasury allowed public REITs to satisfy 90% of their distribution requirements in the form of stock dividends, with only 10% being required to be paid in cash. The rules were later changed so that at least 20% of the dividends had to be paid in cash, and on March 18 the National Association of REITs (NAREIT) submitted a letter to Treasury requesting a temporary return to the 90/10 rules for 2020 and 2021.

Second, due to market dislocations, it is possible that REITs will have difficulty proving that they meet their quarterly asset tests, since (i) in some cases, the value of "good" assets, such as real estate mortgages, could decline relative to the value of "bad" assets, such as stock in taxable REIT subsidiaries, and (ii) market dislocations may make it difficult for some assets to be reliably valued.

Third, to the degree that REITs are planning to assist tenants through capital injections or equitizing debt, they may run into limits as to the amount of stock they can hold in a tenant under the "related party rent" rules, as well as the prohibition against stock in "taxable REIT subsidiaries" accounting for more than 20% of the REIT's assets.

Finally, to the degree that REITs end up renegotiating debt obligations that they have issued, they will need to consider whether they are deemed to have retired debt at a discount under the relevant tax rules, which could give rise to cancellation-of-debt ("COD") income. Generally, COD income is excluded from the 90% distribution requirement discussed above to the extent that it (along with certain other types of income) exceeds 5% of the

REIT's taxable income and thus constitutes "excess noncash income." Such income must nonetheless be distributed in order not to be taxed at the REIT level.

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