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ALERT MEMORANDUM

The American Jobs Plan and Commercial Real Estate

May 5, 2021

On April 28, 2021, President Joe Biden addressed a joint session of Congress on his "American Jobs Plan" ("AJP"), a historic proposal that, if passed, promises to rebuild large swaths of aging infrastructure and create millions of jobs. The $2.3 trillion infrastructure proposal sets forth goals to repair bridges, highways, ports, airports and transit systems. While there is hope for bipartisan support in Congress, the proposal could pass with the support of Democratic lawmakers alone through the budget reconciliation process.

The American Jobs Plan Seeks to Invest in Affordable, Accessible and Resilient Real Estate

— The AJP would provide $213 billion of funding for the construction and renovation of 2,000,000 homes and commercial buildings in the next 10 years.

— Included in the AJP is the Neighborhood Homes Investment Act, which would provide $20 billion of tax credits over the next 5 years for investors and developers to build or rehabilitate 500,000 single-family homes specifically for low and middle income households.

— The spending budget is coupled with calls for Congress to provide grants to local jurisdictions contingent on those jurisdictions' elimination of exclusionary zoning laws that often limit development. Were Congress to do so, the revisions to local zoning laws could drive housing prices down. Further, developers might find new opportunities to build on previously restricted land.

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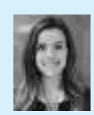

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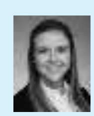

Funding for the American Jobs Plan is Found in a Variety of Proposed Tax Increases, Including Several That Would Directly Impact Real Estate Investors and Real Estate Businesses

— In order to finance this massive investment in American infrastructure (and the government spending proposed in Biden's "American Families Plan"), the Biden proposals would raise revenue through significant changes to the tax law. While aspects of the AJP may directly benefit commercial real estate, some of the tax changes may have a direct negative impact on real estate investors and real estate businesses.

— *Increase in Tax Rates- Corporations.* The proposals would increase the corporate tax rate from 21% to 28%; the proposals would also increase the taxes corporations pay on their foreign profits. Corporations with $2 billion or more in net income would also be subject to a new alternative minimum tax of 15% of the "book income" reported in their financial statements. This alternative tax could negatively impact corporations benefiting from tax depreciation on real estate investments that exceeds book depreciation and other book-tax differences. One consequence of these higher corporate rates is that the tax benefits conferred by REITs could become even more valuable.

— *Increase in Tax Rates – Individuals.* For individuals, the proposals would increase the rate on capital gains from 20% to 39.6% for households with over $1 million in income, and would impose the 3.8% Medicare tax on income streams that are currently exempt, such as certain income earned by S corporation shareholders and limited partners. The proposals would also modify the estate tax rules so that untaxed appreciation in property passed on to heirs would be taxed (either at the time of death or a subsequent sale, the details are not spelled out yet). The estate tax proposal would have exceptions for "family owned businesses and farms" that continue to be operated by the heirs, but would apply to investment real estate. The combination of the increase rate on capital gains and the estate tax proposal (together with the other changes described below) could mean a significant increase in the taxes paid on profits from real estate investments.

— *1031 "Like-Kind" Exchanges.* Biden's plan specifically targets 1031 "like-kind" exchanges that allow real estate investors to defer paying capital gains taxes on the sale of an investment property when the investor purchases another investment property within a specified time period after the sale of the original property. The AJP would eliminate the deferral of tax on gains of over $500,000. This change would impact not only real estate investors, but also the businesses that facilitate like-kind exchanges (by matching up willing buyers and sellers and acting as intermediaries).

— *Opportunity Zone Tax Incentive.* One potential consequence of Biden's proposals could be increased utilization of the "Opportunity Zone" tax incentive enacted in 2017. This incentive allows for deferral of tax on certain capital gains and permanent elimination of tax on certain gains from investments in "opportunity zones". If the capital gains rates are increased and there is no longer an ability to defer taxation of those gains through 1031 like-kind exchanges or eliminate those gains through inheritance, then the Opportunity Zone program may become an even more valuable tax planning technique. Biden has proposed to increase data collection regarding the program, while others have proposed to extend the program. One of the tax benefits of the program requires that investments be made before the end of 2021, accordingly we may see a particular increase in interest in the program over the next 6 months.

— *Carried Interest – This Time For Real?* The proposal would attempt to put a permanent end to the favorable treatment of "carried interest" by requiring that carried interest be taxed as ordinary income. The 2017 tax changes imposed a 3-year holding period for carried interest to be taxed as long-term capital gain. The Biden proposal is intended to be a more complete and permanent fix that would apply even if the capital gain rate increase is not enacted or is subsequently reversed. This would impact sponsors of real estate funds that derive carried interest.

— *Individuals' Ability to Use Excess Business Losses to Offset Ordinary Income.* Prior to the 2017 tax changes, individuals with net operating losses from their active businesses (including businesses conducted through pass-throughs) could use those losses to offset their ordinary income from other sources. Current law prohibits that for years 2021 through 2025. The Biden proposal would make this limitation permanent. This would impact individuals who have losses from their operating real estate businesses.

— *Significant Increases in Enforcement – Aimed at Wealthy Individuals and Large Corporations.* The Biden proposals call for a significant increase in IRS funding and audit and enforcement activity – aimed at wealthy individuals and large corporations. Improved enforcement activity is intended to raise revenue, but under current practices the expected increased revenue may not be able to be "counted" in scoring the impact of proposed legislation. This means that there need to be enough other revenue-raisers to pay for the spending proposals (including, ironically, the spending on increased enforcement).

Increased Investment in Clean Energy May Shift Development Norms

— The AJP includes tax credits for real estate developers and investors using sustainable development methods and newly-created green certifications in their projects. While details are still developing, some suggestions include offering incentives to private investors to invest in retrofitting residential, commercial and municipal buildings to meet clean energy goals.

— Biden's plan would also extend the 48C manufacturing tax credit, an incentive enacted in 2009 which provided for a credit of 30% of approved qualified investments in facilities that produce clean energy, electric vehicles or otherwise contribute to reducing greenhouse gas emissions. The 48C tax program was very popular and seen as having been very successful in encouraging clean energy manufacturing. Indeed, 590 applications were submitted and 183 domestic clean energy facilities were approved in the initial round. Biden's plan to extend these credits would answer a call from top unions, environmental groups and businesses who also want to benefit from this tax program.

The American Jobs Plan Seeks to Revitalize American Manufacturing

— $52 billion of the AJP would be allocated to domestic manufacturing. Biden has called for this investment's primary focus to be on manufacturing in rural areas and clean energy.

— This investment in manufacturing would be expected to increase demand for industrial real estate. Industrial real estate spaces expected to grow under such a plan would include not only manufacturing spaces themselves, but also distribution centers and warehouses. The demand for these spaces is compounded by an increase in online retail sales over the past year.

— If American manufacturing were to grow, so would industries serving the manufacturing economy. Investment into manufacturing could spur demand for housing developments and data centers near manufacturing centers.

The Infrastructure Plan Also Aims to Reach into Rural Areas and Smaller Cities, Potentially Incentivizing Development Outside of Major City Centers

— A modernized electric grid and increased access to a reliable internet connection, as set forth in the AJP, could lead to increased investment in residential and commercial development opportunities in rural areas of the United States.

— The AJP plans to expand public transit, create new transit systems which could lead to greater mobility in and around cities. In turn, demand for new multifamily and single family residential developments may rise in areas further from city centers.

— $5 billion would be invested in cleaning and redeveloping Brownfield and Superfund sites, with the goal of spurring development in disadvantaged communities.

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