National Association of REALTORS® Issue Brief

Commercial Real Estate

September 2016

1031 LIKE KIND EXCHANGES: Under both the House and Senate tax reform proposals released in the 113th Congress, Section 1031 is repealed, and further, the President's budget for Fiscal Year 2015 proposes limits on the deferral provisions of Section 1031. Although none of these proposals progressed in the 113th Congress, if tax reform plans are introduced in the 114th Congress it is likely that they will borrow heavily from the previous ones, so Section 1031 is still at risk. In June 2016, House Republicans released their "Blueprint on Tax Reform," a comprehensive document outlining principles for future tax reform plans. The Blueprint does not mention 1031 like-kind exchanges, but does allow for business expenses, including real property, to be written-off immediately – which some believe will make 1031s unnecessary.

NAR ACTION: *NAR participates in multiple coalitions to protect Section 1031 from repeal or limitation. As part of the "1031 Like-Kind Exchange Coalition," which includes non-real estate industry groups, NAR commissioned a study from Ernst & Young on the macroeconomic effects of repealing Section 1031, and participated in a press conference and a hill-visit day to meet with key Members of Congress to discuss the issue. As part of the "Real Estate 1031 Like-Kind Exchange Coalition," made up solely of real estate sector groups, NAR commissioned another economic study on Section 1031, this time focusing on its impact on real estate. Additionally, NAR surveyed its membership in early 2015 to better understand how REALTORS® use Section 1031, and how their businesses will be affected if it is repealed. NAR will continue to monitor this issue, and will oppose any plans to repeal or limit its use. Retaining Section 1031 was one of the talking points for the Spring 2015 and 2016 Hill visits, and NAR joined a letter to the Clinton and Trump presidential campaigns stressing the importance of retaining this provision in any future tax reform plans.*

BASEL III: The Basel Committee on Banking Supervision released a proposal addressing Revisions to the Standardized Approach for Credit Risk, which outlines the risk-weighting regime for credit exposures for those using the standard approach. The proposal, High Volatility Commercial Real Estate (HVCRE), would have a negative impact on credit availability for commercial real estate through its changes to risk weighting different factors within the loan, and increased lending standards that would be higher than what regulators already have in place.

NAR ACTION: *NAR signed onto a comment letter in March 2015 with several industry partners calling for the Committee to rethink its approach to the risk weighting standards and to scale back some of the changes that would be most limiting to commercial real estate lending. NAR submitted letters for the February 2016 House Financial Services Subcommittee on Capital Markets and Government Sponsored Enterprises hearing "The Impact of the Dodd-Frank Act and Basel III on the Fixed Income Market and Securitizations," and the June 2016 Small Business Committee Subcommittee on Economic Growth, Tax, and Capital Access hearing on the impact of regulatory burdens stressing the burden that overly-broad regulations for lending institutions have on commercial real estate.*

COMMERCIAL LEAD-BASED PAINT: The Environmental Protection Agency (EPA) continues to consider federal rules that would regulate the renovation and remodeling activities in public and commercial buildings to address possible lead-based paint hazards. The EPA is collecting data about the hazards presented by lead-based paint and how renovation and remodeling activities in commercial and public buildings would potentially increase the harm to building occupants. The EPA did not meet a court-imposed deadline of a proposed rule on lead paint RRP activities in commercial buildings on July 1, 2015. In addition, EPA has not, at this time provided a revised deadline for this proposal.

NAR ACTION: *NAR has been actively working with a coalition of real estate and contracting groups to inform the EPA's rulemaking process. The coalition has submitted several comment letters to the EPA and has met with the EPA and OIRA to discuss the rulemaking process. NAR also submitted its own comment letter in August 2014. NAR and the coalition continue to monitor the issue.*

CREDIT UNION LENDING: The National Credit Union Administration (NCUA) proposed a rule that would eliminate restrictions on credit unions making member business loans (MBL). The proposal would give credit unions more autonomy in creating commercial lending policies unique to each credit union. The proposal would also create a new treatment for construction and development loans. The rule was approved in March 2016, however a lawsuit filed by the Independent Community Bankers Association (ICBA) has caused some problems.

NAR ACTION: *NAR wrote a letter in support of rule change, highlighting the important role of credit unions in commercial real estate lending and the success of small businesses.*

DODD-FRANK LAW: Implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") continues, with rulemaking on its remaining provisions progressing in the relevant Federal Agencies. While the rulemaking advances, many Republican Members of Congress hope to scale-back or repeal Dodd-Frank entirely, and we can expect to see bills introduced in the 114th Congress to accomplish that; in February 2016, Rep. Hill (R-AR) introduced H.R. 4620, the "Preserving Access to CRE Capital Act," which would widen the QCRE exemption to the Dodd-Frank commercial real estate retention rules (scheduled to go into effect on December 24, 2016). The bill was approved by the House Financial Services Committee on March 2.

NAR ACTION: *NAR is closely following all rule-making surrounding Dodd-Frank, and will submit comments to the relevant federal agencies on topics affecting commercial real estate whenever possible. NAR is also monitoring any bills from the 114th Congress that would roll back or otherwise amend the law, and will continue to advocate for common-sense financial regulations. NAR sent a letter of support and joined an industry coalition letter advocating for H.R. 4620, the "Preserving Access to CRE Capital Act" ahead of its March 2 full committee markup, and sent a letter of support for it to the Senate Banking Subcommittee on Securities, Insurance, and Investment for their hearing on the issue.*

EB-5 PROGRAM: The EB-5 Regional Center program was extended as part of the Omnibus Tax package signed into law in December 2015 through September 30, 2016. The extension did not make any reforms or changes to the program. Regional Centers help identify American business needs in the community and help direct foreign investor funds to those projects. In return for investing and creating American jobs, these foreign investors are eligible for visas that allow them to live in the United States. The Regional Centers began as a pilot program in 1992, but have been extended several times.

NAR ACTION: *NAR has sent several letters to the U.S. House and Senate as well as to the Director of the U.S. Citizenship and Immigration Services in support of the permanent authorization of the EB-5 Regional Center program. Two bipartisan bills have been introduced in the 114th Congress permanently reauthorizing this program which NAR supports – H.R. 616, cosponsored by Reps. Polis (D-CO) and Amodei (R-NV) in the House and S. 1501, cosponsored by Sens. Leahy (D-VT) and Grassley (R-IA) in the Senate. In addition, in September 2016 House Judiciary Committee Chair Rep. Goodlatte introduced a 5-year reauthorization measure, H.R. 5992, the American Job Creation and Investment Promotion Reform Act of 2016. NAR is part of a real estate industry coalition supporting the program, and has sent multiple coalition letters to lawmakers urging its reauthorization.*

ENERGY DEDUCTION 179D: The Section 179D deduction in the Internal Revenue Code encourages greater energy efficiency in our nation's commercial and larger multifamily buildings, by allowing for cost recovery of energy efficient windows, roofs, lighting, and heating and cooling systems meeting certain energy savings performance targets. Without section 179D, the same energy efficient property would be depreciated over 39 years (nonresidential) or 27.5 years (residential). This provision expired at the end of 2013, but in December 2014 Congress passed H.R. 5771, which retroactively reinstated the limit on it to $500,000 to cover the 2014 tax year. In the Omnibus Appropriation bill passed on December 18, 2015, Section 179-D was extended retroactively to include the 2015 tax year and through 2016.

NAR ACTION: *NAR supports the extension and enhancement of the 179D deduction by providing a sliding scale of incentives that correlate to actual and verifiable improvements in a retrofitted building's energy performance. NAR is part of the "179D Coalition," made up of supportive industry groups, and will continue to monitor this issue as the 114th Congress looks ahead to tax reform and tax extenders that have expired and will push for a long-term reauthorization for Section 179-D.*

ENERGY EFFICIENCY: The federal government is moving forward with voluntary energy efficiency policies and programs, as well as regulations to limit the U.S. atmospheric contribution of carbon dioxide (CO2) and other greenhouse gases. Some of these policies, programs and regulations may impact the built environment, including commercial properties. If energy efficiency were federally mandated, property owners' ability to sell their building would be at risk without first having to conduct energy audits and improve its heating and cooling system, windows, insulation and/or lighting.

NAR ACTION: *NAR supports improving energy efficiency through voluntary incentives, commercially reasonable approaches and education in lieu of individual building mandates. The Department of Energy (DOE) is in the development phase of a voluntary Building Energy Performance Score program for commercial buildings, currently in the testing phase. NAR has communicated with Congress, the White House and various federal agencies to reinforce our strong concerns about the stigmatizing effects these kinds of energy use labels may have on commercial real estate. In the Spring of 2015 the Energy Efficiency Improvement Act of 2015 (S.535), sponsored by Senators Portman (R-OH) and Shaheen (D-NH), was passed by Congress and signed into law by the President. This legislation creates the "Tenant Star" program, a voluntary, market-driven approach which encourages building tenants and owners to reduce their energy consumption. NAR, in coalition with other real estate industry groups, supports this legislation and its flexible approach to improving energy efficiency in commercial buildings.*

FAA PROPOSED BUILDING HEIGHT RESTRICTIONS: The Federal Aviation Administration (FAA) has proposed new regulations that would limit building heights near airports to accommodate flight paths for airplanes operating under one-engine inoperative (OEI) procedures. While the FAA currently does regulate building heights near airports, the proposed regulation would create a single OEI path at each airport, inside which building heights may be severely limited. The FAA proposed regulations would not affect current buildings, but could affect new development and renovations on current buildings in the OEI paths. In January 2015 Rep. Steve Cohen (D-TN) introduced H.R. 365, which would require the FAA to conduct notice-and-comment rulemaking procedures before going forward with any such changes to its regulations.

NAR ACTION: *NAR is working with a coalition of real estate, construction and building management organizations to engage with the FAA about the proposed rulemaking and the impact it could have on businesses and properties. The coalition has been working actively to ensure that the FAA follows the formal notice-and-comment rulemaking procedures before making any such policy change, and will participate fully in that process when it occurs. The coalition sent a letter to the House Transportation Committee and its Subcommittee on Aviation in February expressing its support for H.R. 365 and urging the Committee to consider this issue when drafting the FAA Reauthorization language in the FY 2016 appropriations bills. The House FAA Reauthorization bill was introduced in February 2016, and NAR is working with the coalition to have the Cohen bill's language included as an amendment before final passage.*

FIRPTA REFORM: The Foreign Investment in Real Property Tax Act (FIRPTA) was enacted in 1980, as a response by Congress to concerns about increasing foreign ownership of farm land in the U.S. The purpose was to establish equity of tax treatment in U.S. real property between foreign and domestic investors. The Omnibus Appropriations bill passed in December 2015 included an amendment sponsored by Sens. Menendez (D-NJ) and Enzi (R-WY)that amends FIRPTA to allow more foreign ownership of Real Estate Investment Trusts (REITs), making it easier for foreign persons to invest in U.S. commercial Real Estate through REITs without having to pay tax under FIRPTA. Though a relatively modest provision, the legislation somewhat erodes the inequity of tax treatment that FIRPTA established; by doing this, it is expected that billions of dollars of additional investment in U.S. real estate from foreign investors will occur.

NAR ACTION: *NAR supports policies that encourage foreign direct investment in U.S. real estate through REITs that do not materially encroach upon the principle that all U.S. investors and foreign investors in U.S. real estate should be subject to similar rules under the U.S. tax system. In April 2015 Sen. Orrin Hatch (R-UT) reintroduced the Real Estate Investment and Jobs Act of 2015 (S.915), which would increase the amount that a foreign investor can invest in a REIT before being subject to FIRPTA from 5% to 10%. NAR strongly advocated for these reforms, and they were included in the Omnibus Appropriations package which passed on December 18, 2015.*

THE JUMPSTART OUR BUSINESS STARTUPS (JOBS) ACT OF 2012: The final elements of the JOBS Act are expected to be completed in 2015. The final rules implementing Title IV, which address Small Company Capital Formation, became effective in June 2015. The financing permitted through the enactment of Title IV is known as

crowdfunding. The new rules update and expand Regulation A, an existing exemption from registration for smaller issuers of securities. The updated exemption will enable smaller companies to offer and sell up to $50 million of securities in a 12-month period, subject to eligibility, disclosure and reporting requirements. The rules governing Title III went into effect in January 2016. Title III regulates how crowdfunding platforms and defines unaccredited investors, and how those investors can invest in crowdfunded projects.

NAR ACTION: *NAR supports regulation easing restrictions on businesses' ability to raise capital, and increasing liquidity in the commercial real estate market. NAR has sent letters to the House Small Business Committee and the House Financial Services Committee expressing support for the potential that crowdfunding has to bring capital into the commercial real estate markets, and has met with Congressional offices to discuss legislation furthering that goal. NAR has participated in and will continue to participate in meetings with the SEC and its committees.*

LEASE ACCOUNTING: As part of a larger effort to converge accounting standards, the Financial Accounting Standards Board (FASB) and International Accounting Standards Board (IASB) have been working since 2005 to develop a standardized approach to lease accounting. The initial proposal included new accounting rules that would force many companies to capitalize commercial leases onto their balance sheets using a "right-of-use" accounting model. Efforts to fully converge the two standards have stalled. The latest reports from FASB indicate it will replace the current dual model approach with a new one: though leases currently categorized as "operating leases" will be brought onto balance sheets under the new rule, "Type A" leases are treated as capital leases and "Type B" leases continue to be recorded as straight-line rent expenses. Most real estate leases will fall into the "Type B" category. The updated standards were released in February 2016 and will go into effect for public companies in 2019 and private companies in 2020.

NAR ACTION: *Throughout the standards convergence project, NAR has been active on its own and in coalitions to express concern the new lease accounting proposal would be detrimental to the economy by reducing the overall borrowing capacity of many commercial real estate lessees and lessors. NAR will continue to monitor the FASB and IASB negotiations as they approach finalization of their standards, and will provide education to its members about the new standard and the impact it may have on commercial real estate.*

LEASEHOLD IMPROVEMENTS: The 15-year straight-line cost recovery for qualified leasehold improvements on commercial properties provision expired at the end of 2013; in December 2015, Congress passed and the President signed into law an Omnibus Appropriations bill which makes the provision permanent. Thus, it is now available for all improvements to property placed in service.

NAR ACTION: *NAR has always urged Congress to ensure that depreciation tax rules match the economic life of assets by taking into account natural wear and tear and technological obsolescence. In the 114th Congress, NAR met with key Members of Congress and sent letters in support of this, urging that the leasehold improvements provision be extended as quickly as possible and on a retroactive basis. It was permanently extended as part of the Omnibus Appropriations bill signed into law on December 18, 2015, putting an end to years of short-term and retroactive extensions of the provision.*

MARKETPLACE FAIRNESS: On March 10, 2015, Senators Enzi (R-WY) and Durbin (D-IL) introduced S. 698, the "Marketplace Fairness Act of 2015," which would create authority for state governments to collect sales taxes on Internet sales for goods that are delivered to their states, which would level the playing field between brick-and-mortar and e-commerce retail businesses while assisting the states in collecting billions of uncollected state sales taxes. On June 15, 2015, Representatives Chaffetz (R-UT) and Womack (R-AR) introduced H.R. 2775, the Remote Transactions Parity Act of 2015. The House bill also gives states authority to collect sales taxes on remote sales, but does so in a way that gradually phases-in which remote sellers are required to comply. In May 2016 Rep. Bob Goodlatte (R-VA), Chairman of the House Judiciary Committee, circulated a draft of compromise legislation which would institute a federal clearinghouse system for collection and remittance of state sales taxes on online purchases.

NAR ACTION: *NAR participates in the Marketplace Fairness Coalition, and will continue to support S.698 and urge Congress to pass this legislation. In June 2015 NAR sent a letter of support to Representatives Chaffetz (R-UT) and Womack (R-AR) thanking them for introducing H.R. 2775, the Remote Transactions Parity Act of 2015, and also joined a coalition letter with other real estate industry groups*

in support of it. NAR is having ongoing conversations with the House Judiciary Committee and Leadership offices on this issue and participates in Hill visits in support of resolving it as part of the Marketplace Fairness Coalition.

MARKETPLACE LENDING: In May 2016, the Department of Treasury released a white paper, Opportunities and Challenges in Online Marketplace Lending. The white paper was written in response to a request for information that came out last summer, to which NAR responded. There is particular highlight of the opportunities available to small businesses for capital raising, and the availability of credit to traditionally non-credit-worthy borrowers.

NAR ACTION: *NAR submitted a letter highlighting the growing role that these lenders play in real estate, and the need for balancing innovation and regulation. The letter also referenced NAR's commitment to innovation and data privacy.*

NATIONAL FLOOD INSURANCE PROGRAM (NFIP): The National Flood Insurance Program (NFIP) was extended for five years in 2012 by the Biggert-Waters Act, but Congress must reauthorize it again to continue providing flood insurance after 2017. Biggert-Waters also phased out subsidized flood insurance rates for many commercial properties but severe implementation problems threatened to undermine real estate transactions where flood insurance is required to obtain a mortgage. In March 2014 Congress responded to these issues by amending Biggert-Waters with the "Homeowner Flood Insurance Affordability Act." The new law, among other things, restores the grandfathering of properties under lower risk rates upon remapping, reduces the increased rates of non-grandfathered properties, and repeals rate premium increases at the sale of properties (including refunding increases to those who have already paid them). For more information on the law, see NAR's "National Flood Insurance Program" issue page here. In December 2014 FEMA launched the Office of the Flood Insurance Advocate, to assist property owners with questions and concerns over flood insurance rates and maps. In June 2015 Reps. Dennis Ross (R-FL) and Patrick Murphy (D-FL) introduced H.R. 2901, the "Flood Insurance Market Parity and Modernization Act," which clarifies that property owners may satisfy federal flood insurance requirements with *either* NFIP or private coverage. The bill was approved by the House Financial Services Committee on March 2, 2016.

NAR ACTION: *NAR continues to work closely with Congress and FEMA to implement the rest of the law, consistent with the statutory deadlines and congressional intent. NAR has met with the Office of the Flood Insurance Advocate, and will continue to monitor this issue and work toward the timely and long-term reauthorization of NFIP before it expires in 2017. NAR sent a letter of support for H.R. 2901 to the House Financial Services Committee for its markup of the legislation on March 2, 2016.*

TERRORISM INSURANCE: Following the 9/11 attacks private insurers backed out of the terrorism insurance marketplace prompting Congress to enact the "Terrorism Risk Insurance Act of 2002" (TRIA), a federal insurance backstop that allows the federal government and private insurance companies to share losses in the event of a major terrorist attack. TRIA helped stabilize commercial real estate markets by making terrorism coverage available and more affordable over time. The program was allowed to briefly expire at the beginning of 2015 when Congress did not reauthorize it before it expired on Dec. 31, 2014. In its first act of legislative business in the 114th Congress, the House passed H.R. 26, the Terrorism Risk Insurance Program Reauthorization Act of 2015, on January 7th, 2015; the following day the Senate passed it as well. The act reauthorized the program for six years, through 2020, and made some changes to the program to decrease the government's exposure to risk in the event of a catastrophic terrorist event.

NAR ACTION: *NAR participated in the Coalition to Insure Against Terrorism (CIAT), and as part of its steering committee met with many key offices in the House and Senate regarding TRIA reauthorization. NAR also communicated with both the House Financial Services Committee and the Senate Banking Committee in advance of their hearings on the issue, and sent letters to the committees and the full Congress stressing the importance of the Terrorism Risk Insurance Program to commercial real estate and the economy. Reauthorization of TRIA was one of NAR's August 2014 talking points, and was the focus of multiple "Calls for Action."*

TRANSPORTATION: Since 2008 the Highway Trust Fund (HTF) has become insolvent, resulting in the federal government transferring funds from the general fund to the HTF to maintain the existing levels of funding at the state and local levels. The current surface transportation funding and reauthorization of "MAP-21" expires in 2020.

NAR ACTION: *NAR believes that more needs to be done to level the playing field with respect to funding highways versus transit and other modes. Transportation plans should reflect a broad community vision, considering the needs of all transportation users, and should*

emphasize repair and maintenance over development of new capacity. NAR sent a letter to the House Transportation and Infrastructure Committee in September 2015, providing information on programs that help create liveable communities- Transportation Alternatives Program (TAP) and Safe Streets, while asking them to oppose any transportation package that includes using GSE g-fees as a pay-for of federal transportation funding. NAR supported a long-term solution to transportation funding, and was pleased when Congress passed H.R. 22, "Fixing America's Surface Transportation Act" (FAST Act) in December, which reauthorizes the surface transportation funding for five years, through 2020, without using GSE g-fees as a pay-for.

UNMANNED AERIAL VEHICLES (DRONES): Current Federal Aviation Administration (FAA) rules prohibit the use of Unmanned Aerial Systems (UAS), or drones, for commercial purposes. In 2012, Congress required the FAA to begin to integrate UAS into the National Air Space (NAS) by September 2015. The FAA released proposed regulations governing the use of "small" UAS (under 55 pounds) in February 2015. Congress has become concerned with this issue as well, and both the House and Senate have held hearings on the need for the FAA to get its rules finalized, while also considering concerns about the safety and privacy aspects of integrating drones into the NAS. In February 2016 Reps. Shuster (R-PA) and LoBiondo (R-NJ) introduced a FAA reauthorization bill, the AIRR Act, which includes sections dedicated to UAV test sites, the permitting process, and technological advancements. In March 2016, NAR participated in the FAA Micro UAS Aviation Rulemaking Committee (ARC) which will address micro UAS operations over non-participants. The Small UAS rule became effective on August 29, 2016.

NAR ACTION: *NAR is working directly with the FAA UAS Integration Office, and participated in several working groups addressing end-user concerns and safety issues with UAS technology. NAR sent letters to several House and Senate Committees holding hearings on this issue expressing support for clear regulations from the FAA which permit commercial use of drones in a way that is affordable for users and safe for communities. NAR submitted a comment letter on the FAA's proposed rule on integrating UAS into the National Air Space (NAS), and also submitted a comment letter in support of the National Telecommunications Information Administration (NTIA) privacy working group on commercial UAS. In September 2015 NAR President Chris Polychron testified before the House Judiciary Subcommittee on Courts, Intellectual Property, and the Internet at a hearing on commercial UAS applications and policy implications, where he highlighted NAR's commitment to protecting citizen safety and privacy in the context of widespread commercial UAS use. In August 2016, following the FAA's release of the final Small UAS rule, NAR participated in the White House Office of Science and Technology Policy Workshop on Commercial Drones, a "roll-out" event. NAR will continue to work with Congress and the FAA as they move on to address "micro UAS" and rules for their commercial use.*

WATERS OF THE U.S. DEFINITION: In April 2014 the EPA and the Army Corps of Engineers jointly proposed a rule to "clarify" which bodies of water are "waters of the U.S.," and thus able to be regulated under the Clean Water Act (CWA). In support of this, the agencies released a draft science report on "connectivity" of various bodies of water in the U.S. Depending on how the definition is finalized, compliance with the CWA under it may require expensive, time-consuming federal permits to develop private property near most water bodies, not just those which are navigable (as under the current regulatory scheme). The final definition was released in May 2015, and several states sued the government. In October 2015, an appellate court ruled to stay the implementation of the rule, effectively halting the rule from going forward.

NAR ACTION: *NAR strongly opposes the proposed rule and, working closely with industry partners and the Waters Advocacy Coalition, submitted extensive comments to express its concerns with it, refute the conclusions of the EPA's cost-benefit analysis and scientific study, and urge them to complete an economic analysis. It is the position of NAR that only Congress can fundamentally alter the CWA, and will continue to oppose any efforts, whether guidance or proposed regulation, to expand the Act's reach or otherwise infringe on property rights. NAR supports H.R. 1732, the Regulatory Integrity Protection Act, sponsored by Rep. Shuster (R-PA); this bill would require the EPA to withdraw their "Waters of the U.S." proposed rule and begin the rulemaking process again, making sure there is a comprehensive scientific process and a robust public review and comment period. In April, NAR sent a letter to the full house in support of this bill; NAR also joined an industry coalition letter urging its passage, and issued a "Call for Action" among its FPCs on the issue. In June 2016, the Supreme Court ruled on "Hawkes v. U.S. Army Corps of Engineers," determining that "jurisdictional determinations" made by the Corps as to whether or not an area is a wetland which can be regulated by them are subject to judicial review. In an amicus brief, written in cooperation with the National Association of Home Builders, NAR had supported this position, which the Court ultimately ruled in favor of.*