

CRE's Future is Uncertain From a Legislative Standpoint

Tax reform and energy standards are two things for brokers to keep their eyes on

By Robert M. Brierley

This year seemed to hold potential to be a fruitful one on the legislative front for the U.S. commercial real estate (CRE) industry, with proposals on big issues like infrastructure and tax reform looking likely to advance. Despite the Republicans' single-party control in Washington, D.C., however, legislative wins have proven elusive.

Still, dramatic policy changes affecting commercial real estate have the potential to take hold and ripple through all aspects of the industry, from development and operations to investments and transactions. Ownership structures and lease agreements also could be affected, and the brokerage community needs to remain vigilant — and vocal — about the potential implications of a number of proposed legislative actions.

Historically, when a political party gains control of both the legislative and executive branches, the first 100 days of office are the ideal time to implement a legislative agenda. The real estate community was cautiously

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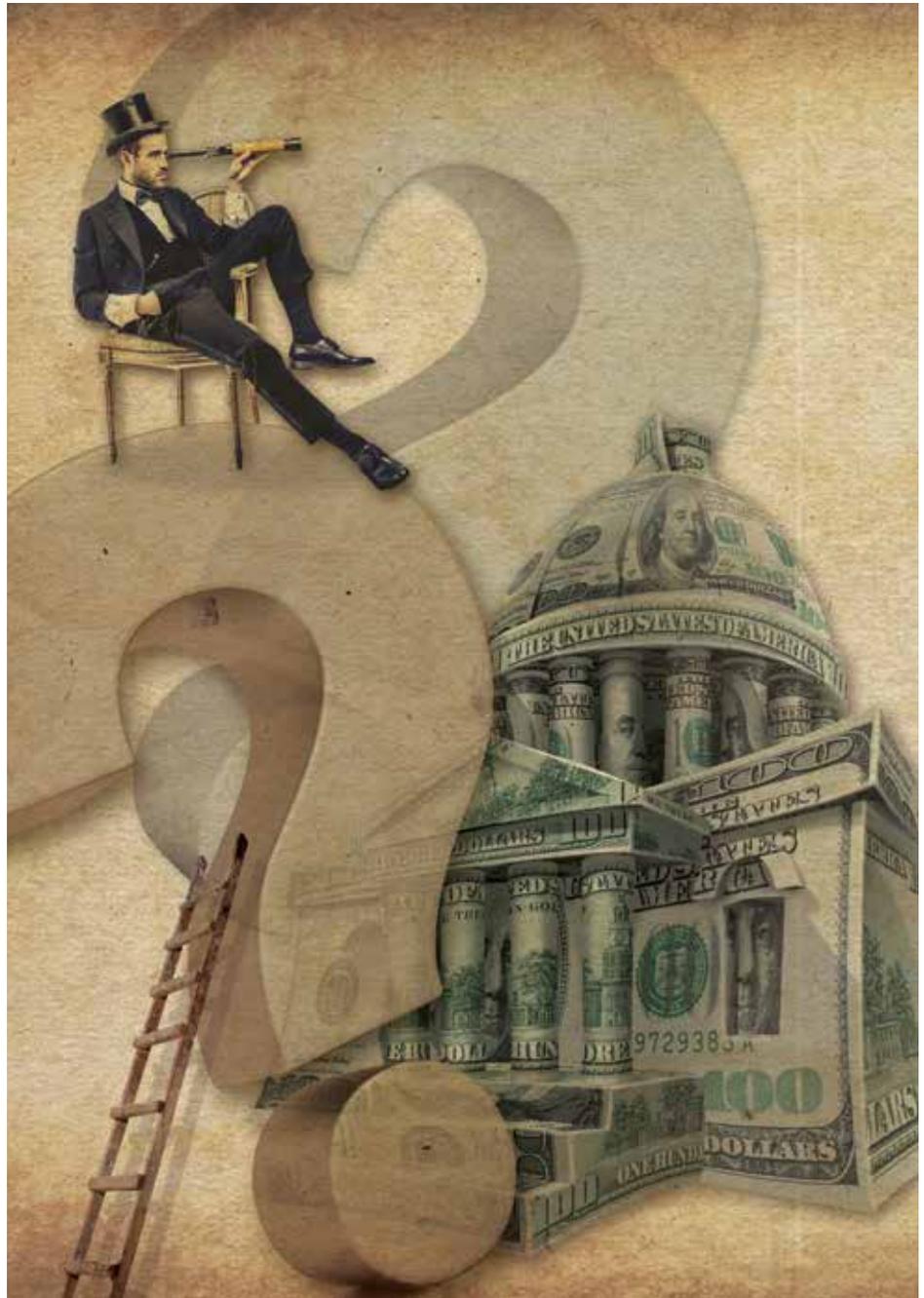


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hopeful that momentum from the 2016 election would translate into Congress passing several issues important to the industry. Organizations such as the Building Owners and Managers Association (BOMA) International went to work preparing their advocacy wish lists to pitch to lawmakers.

This sentiment was echoed on Wall Street and shown by record gains in the major indexes early in the year. Yet, the accomplishments to date have not matched early expectations, and there is a concern the future might not hold the type of change that many banked on. What's more, commercial real estate has found itself defending other interests that were once seen as unassailable, because of broad bipartisan support and economic benefits.

Political engagement across the industry will be a determining factor in commercial real estate's future growth and success.

Tax reform

Despite challenges within Congress, BOMA International and its coalition partners throughout the commercial real estate industry are continuing to advocate for policies that encourage capital investment and provide long-term certainty and stability to the marketplace.

Foremost among these advocacy efforts are passage of comprehensive tax reform and protecting the Energy Star program. These issues have far-reaching implications for the commercial real estate industry, from sales and leasing transactions to property operations and management.

Some of the legislative foot-dragging around comprehensive tax reform is nothing new. Despite the ongoing discussions and general calls for simplifying the U.S. tax code, there has been little action in the tax-policy world for years, with the exception of reduced leasehold depreciation schedules, which were made permanent in 2015.

The current tax code needs to be updated because it relies on economic models that do not represent current economic realities. Despite this need for reform, there is appre-

hension that sweeping change could have unintended economic consequences on both real estate transactions and current holdings. Congress has not yet drafted legislation, reducing the discussion to talking points and general principles. Because of this, there are many questions about the effectiveness of the various tax-reform proposals and the effect they will have on commercial real estate.

BOMA International and its coalition partners are educating lawmakers on the importance of transition rules, data-proven depreciation schedules, as well as partnership and rent-taxing rules. Specifically, they are lobbying Congress to preserve Section 1031 "like-kind" exchanges and to continue carried-interest tax rates for general partners in real estate ventures. Both of these issues will directly affect multiple layers of business deals and, if eliminated, likely will reduce the number of real estate deals and ventures across the country.

Tax reform was slated for action before the year's end. President Donald Trump has signaled that this issue will be a top focus of his administration and failure to pass tax reform could hamper Republican efforts to explore other policy priorities.

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Energy Star

Established in 1992 under President George H.W. Bush's administration, Energy Star is a voluntary program of the Environmental Protection Agency (EPA) to encourage energy efficiency and to certify buildings and consumer products that meet certain energy-efficiency standards. Energy Star Portfolio Manager is the benchmarking tool used on more than 450,000 commercial buildings, representing more than 40 billion square feet of space, to measure a property's energy, water and waste consumption. The use of Portfolio Manager is ingrained in real estate business models and operational practices.

More than 40 percent of the commercial real estate industry currently uses Energy Star and there is no existing private-market replacement. In 2015 alone, American businesses cumulatively saved \$3.4 billion on utility bills through the program. Many real estate investors and businesses that lease space have Energy Star-certification requirements, and these buildings often prove to be the best investments.

Although Energy Star enjoys widespread bipartisan support, President Trump proposed eliminating the program in the 2018 federal budget. The demise of Energy Star could potentially cause widespread disruption to the commercial real estate industry, both in terms of operations and transactions.

The House Appropriations Committee passed the fiscal year 2018 Interior and Environment Appropriations bill this past July. The legislation, which includes funding for the EPA, contained language that expressed the committee's support for Energy Star, although funding will drop by 40 percent. This was the first step in a long process. BOMA International and its partners will continue to engage Congress and the Trump administration on the business case for safeguarding the Energy Star program.

Election implications

Polling from earlier in the fall had Congress' approval rating hovering around 16 percent, while President Trump's approval rating was

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at about 38 percent. It is hard to pinpoint that a lack of legislative victories is the cause for those historically low numbers, especially in the current hyperpartisan atmosphere. Regardless of the reasons, members of Congress and President Trump himself understand the relative lack of accomplishments could influence the outcome of the 2018 midterm elections.

Although the political maps of House and Senate seats favor Republicans, there is still cause for angst among those in power. The next political season starts in early 2018 and, absent further action, elected officials will be hard-pressed to show that they have achieved significant legislative victories.

Bipartisanship seems rare these days, but commercial real estate's top priorities offer clear economic wins for both Democrats and Republicans. BOMA International is aggressively lobbying both sides of the aisle to support these issues, and is making the case that policies that positively affect commercial real estate are not only good for the industry, but also good for the country. The exclusion of certain provisions in tax reform that currently encourage real estate investments, such as 1031 exchanges and carried interest, could curtail future commercial real estate growth. And the elimination of the Energy Star program would inhibit certain real estate transactions and disrupt the operations and management of commercial buildings.



If Congress and the Trump administration are going to show voters that they are looking after the interests of the economy, BOMA International has given them a road map that can help them achieve a stated goal: passing an agenda that supports commercial real estate. ■