

The Real Estate Roundtable

***THE NEW POLITICAL LANDSCAPE AND THE
IMPACT ON COMMERCIAL REAL ESTATE***

HOMER HOYT INSTITUTE

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Palm Beach, FL



The Real Estate Roundtable

Roundtable Mission

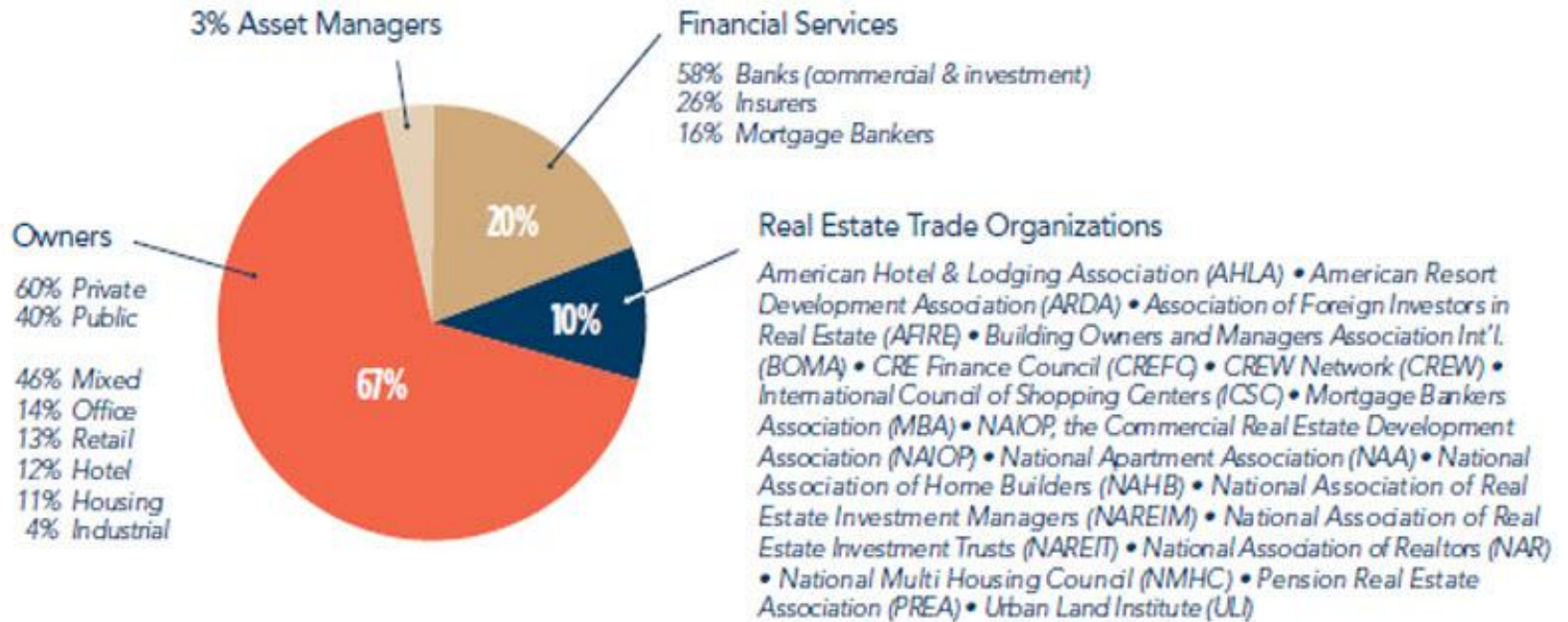
The Real Estate Roundtable brings together leaders of the nation's top publicly-held and privately-owned real estate ownership, development, lending and management firms with the leaders of the 17 national real estate trade associations to jointly address key national policy issues relating to real estate and the overall economy – with a focus on credit and capital, homeland security, sustainability and tax policy.

The Roundtable's key focus is to ensure that a cohesive industry voice is heard by government officials and the public about real estate and its important role in the American economy.



WHO WE ARE

The Membership of The Real Estate Roundtable





The Real Estate Roundtable

Leadership - FY2017 Board of Directors

William C. Rudin, *CEO & Vice Chairman*, Rudin Management Company, Inc. , *Chairman*, The Real Estate Roundtable

Jeffrey D. DeBoer, *President and CEO*, The Real Estate Roundtable

Thomas M. Flexner, *Global Head of Real Estate* , Citigroup *Treasurer*, The Real Estate Roundtable

Debra A. Cafaro, *Chairman and Chief Executive Officer*, Ventas, Inc., *Secretary*, The Real Estate Roundtable

Thomas R. Arnold, *Head of Americas - Real Estate*, Abu Dhabi Investment Authority , *Chairman*, Pension Real Estate Association

Jeff T. Blau, *CEO* , Related Companies

Steve Brown, *2014 President*, National Association of REALTORS®

Tim Byrne, *President and Chief Executive Officer*, Lincoln Property Company, *Member*, National Multifamily Housing Council

Richard (Ric) Clark, *Chairman*, Brookfield Property Group

Brian Harnetiaux

Senior Vice President of Asset Management, McCarthy Cook & Co., *Chair and Chief Elected Officer*, Building Owners and Managers Association (BOMA) International

Elizabeth I. Holland, *CEO/General Counsel*, Abbell Associates, *Chairman*, International Council of Shopping Centers

David J. LaRue, *President and Chief Executive Officer*, Forest City Enterprises, Inc.

Anthony E. Malkin, *Chairman and CEO*, Empire State Realty Trust

Jodie W. McLean, *Chief Executive Officer*, EDENS

Roy Hilton March, *Chief Executive Officer*, Eastdil Secured

Robert R. Merck , *Senior Managing Director and Head of Real Estate Investments* , MetLife

David Neithercut, *President & Chief Executive Officer*, Equity Residential, *Immediate Past Chairman*, National Association of Real Estate Investment Trusts

Ross Perot, Jr. , *Chairman*, Hillwood

Robert J. Speyer, *President and Co-CEO*, Tishman Speyer

Barry Sternlicht, *Chairman & CEO*, Starwood Capital Group

Robert S. Taubman, *Chairman, President and CEO*, Taubman Centers, Inc., *Immediate Past Chairman*, The Real Estate Roundtable

W. Edward Walter, *President & CEO*, Host Hotels & Resorts, Inc.

Stephen P. Weisz, *President & CEO*, Marriott Vacations Worldwide Corporation , *Chairman of the Board*, American Resort Development Association



Roundtable Policy Committees

- The Real Estate Roundtable focuses on four principal areas of national policy: tax, credit and capital, sustainability and homeland security
- As such, we maintain policy committees and working groups for each key issue area:
 - Tax Policy Advisory Committee
 - Real Estate Capital Policy Advisory Committee
 - Sustainability Policy Advisory Committee
 - Homeland Security Task Force



Roundtable Policy Priorities

- Support pro-growth tax reform that does not discriminate against real estate investment
- Ensure adequate availability of credit, capital, insurance, and workforce resources – from domestic and foreign sources – for real estate markets to thrive
- Enable building owners and occupants to optimize their roles in reducing energy consumption; innovate through the design, operation, and planning of high performance built environments, infrastructure, and communities
- Establish policies and enhance communication platforms to help secure the homeland, and our members' buildings, from cyber and terrorism threats



New Political Alignment

- Republicans now control White House, both chambers of Congress, 32 state legislatures, and 33 governor's offices
- Alignment provides business community with a unique opportunity for pro-growth reform
- Potential financial services actions:
 - Freeze on new regulations
 - Repeal or selective reform of Dodd-Frank
 - Push back or diminution of new Basel rules
 - Slow or reverse Department of Labor's *Fiduciary Rule*
 - Reform and restructure GSEs (Fannie and Freddie)



New Economic Leadership

- Senate Banking Committee – Mike Crapo (R-ID)
- House Financial Services Committee – Jeb Hensarling (R-TX)
- National Economic Council – Gary Cohn
- Treasury Secretary – Steven Mnuchin
- Commerce Secretary – Wilbur Ross
- Federal Reserve – Randy Quarles, Vice Chair (pending); 2 vacant Board positions; Chair Yellen remains until 2018
- SEC – Jay Clayton – 2 vacancies
- Reform-minded appointments to leadership positions in the FDIC, OCC



First 100 Days

- Trump Administration economic priorities:
 - Repeal/Replace ObamaCare
 - Comprehensive Tax Reform
 - Infrastructure Program
- First 100 days dominated by needless controversies and stalled initiatives
- Confirmations of key leadership posts stalled
 - 557 key positions requiring Senate confirmation
 - 460 have no nominee; 19 awaiting nomination
 - 49 formally nominated; 29 confirmed



Tax Reform

- Key Republican economic priority
- Tax reform themes:
 - Promote growth and investment, create jobs
 - Improve US competitiveness
 - Reduce government intervention in economy
 - tax relief for middle class Americans (Trump)
- Two key revenue raisers for House Blueprint:
 - Border Adjustment Tax (BAT)
 - Elimination of Business Interest Deductions (BID)
- Trump Administration seeking convergence with House Republican Blueprint, and Senate



Market Optimism

Budget Realities

- Market expecting pro-growth agenda, infrastructure bill, tax reform, job creation
- Rally has added value to U.S. equity market
- Market fundamentals remain strong:
 - Economy has shown signs of accelerating
 - Corporate earnings expected to improve
- Budget concerns
 - FY 2017 CR expired April 28; extended to May 5
 - Debt ceiling breached in March; Treasury now using *extraordinary measures* to fund government



Tax Reform – House Blueprint

- **Marginal rate reductions:**
 - 20% corporate – down from 35%
 - 25% active pass-through trade or business
 - 33% individual
- **50% exclusion for investment income:**
 - Applies to capital gains, dividends, and interest
- **Cost recovery:** replace depreciation of capital assets with immediate expensing
 - Expensing applies to structures but not land
- **Interest:** Eliminate deductibility of BID



Tax Reform – House Blueprint

- **Partnerships/Pass-Through Entities:** “reasonable compensation” of owner-operators of pass-through businesses taxed at ordinary income rate
- **AMT and Estate tax:** repealed
- **Border Adjustability Tax (BAT):** taxes cross-border activity based on where consumption (rather than production) occurs: imports effectively taxed, exports exempt



Tax Reform – House Blueprint

- **Section 1031:** likely repeals deferral of capital gain through like-kind exchanges (possible exception for land)
- **Losses:** indefinite carry forward of losses, adjusted for inflation and a real return on capital; no carry back; carry forward loss utilization limited to 90% of taxable income
- **Itemized deductions:** Repeal all except mortgage interest and charitable donations
- Repeal AMT and estate tax
- **Border adjustability:** Tax cross-border activity based on where consumption (rather than production) occurs: imports taxed, exports exempt



Tax Reform – Trump Proposal

- **Business rate reductions:**
 - 15% corporate – down from 35%
 - Territorial tax system to level playing field for US firms
 - One time tax on overseas business funds
 - Eliminate ‘special interest’ tax breaks
- **Individual rate reductions:**
 - 3 individual tax brackets: 10%, 25%, 35%
 - Double standard deduction
 - Repeal AMT, ‘death tax’, 3.8% ACA tax
 - Preserve home mortgage interest, gift tax deduction
 - Eliminate targeted tax breaks for ‘wealthy’
- Details not yet clear



Tax Reform – Differences

- Differences between House Blueprint and Trump Administration could include:
 - Top marginal corporate rate
 - Carried interest
 - Interest deductibility/expensing
 - Like-kind exchanges
 - Repeal vs. cap on itemized deductions
 - Border adjustability
 - Worldwide (Trump) vs. territorial (House) tax system
 - Use of repatriation revenue for infrastructure investment



Tax Reform in 2017: timing, process, politics

- **Optimistic scenario:**
 - President Trump's tax reform outline released in April, full plan scored and released in June
 - Passage of health care legislation in 2Q
 - Ways & Means Committee tax reform mark-up, House consideration in spring/summer (prior to August recess)
 - Senate consideration of tax reform in fall/winter
 - Tax reform sent to the President in 4Q 2017 or 1Q 2018



Tax Reform – Roundtable Principles

Tax reform should:

- Encourage capital formation and appropriate risk-taking, while providing predictable and permanent rules;
- Ensure rules closely reflect the economics of the underlying transaction;
- Recognize that, in limited and narrow situations, tax incentives are needed to address market failures; and
- Provide a reasonable, well-designed transition regime.



Positioning the Real Estate Industry for the Tax Reform Debate

Roundtable activities:

- Educating policymakers about real estate industry's vast economic contributions
- Developing well-reasoned, fact-based arguments through outside academic and economic research on depreciation (MIT), like-kind exchanges (Syracuse/Univ. Fla.), carried interest (Douglas Holtz-Eakin), and the House Blueprint (PwC)
- Building strong real estate stakeholder and cross-industry coalitions on specific issues, such as interest deductibility



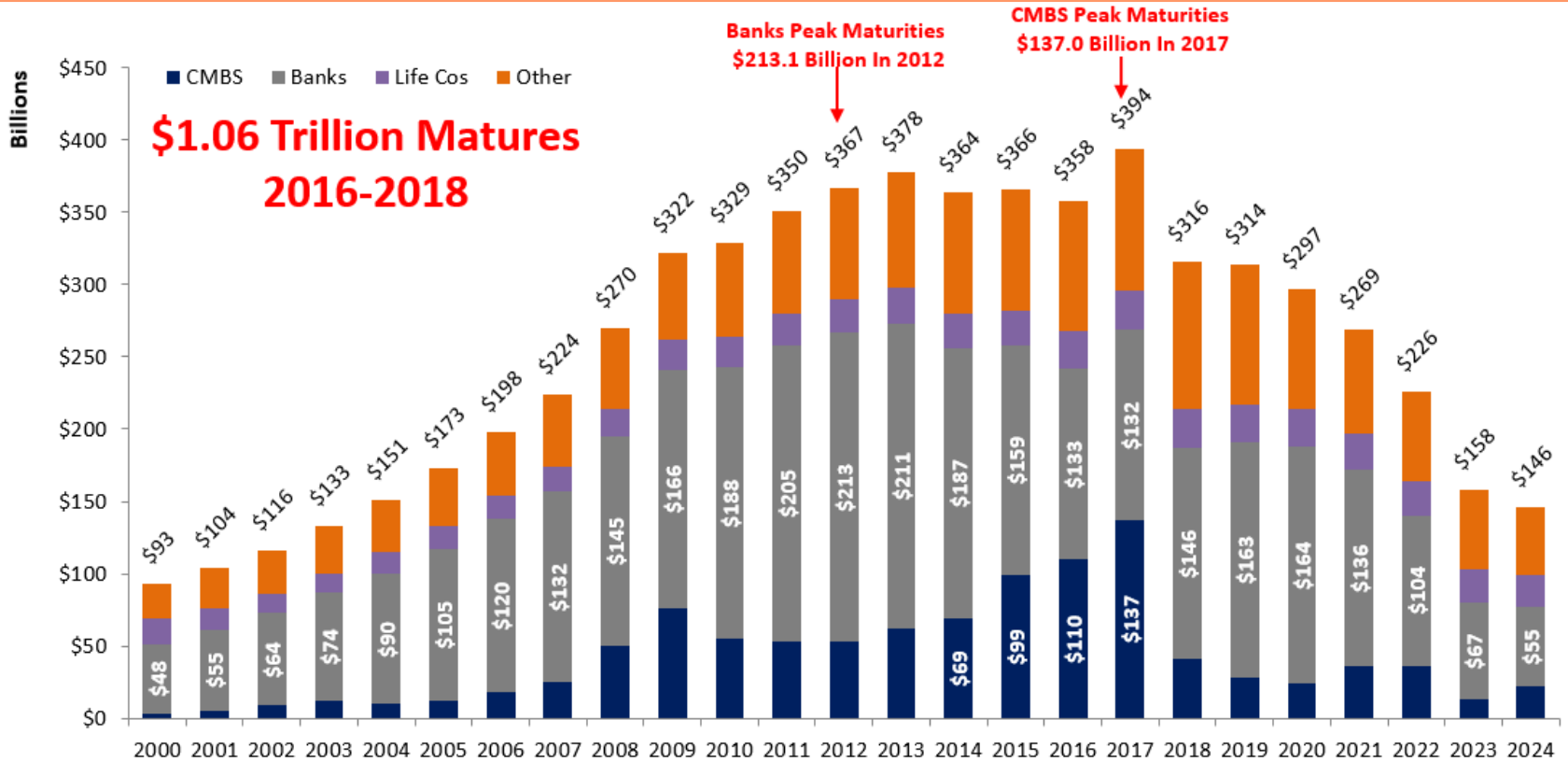
Real Estate Liquidity Challenges

- Over the next 3 years, over \$1 trillion – or approximately \$1 billion a day – in CRE debt is maturing – mostly banks, CMBS
- Maintaining adequate credit capacity, capital formation vital for commercial real estate
- Overlapping regulatory changes under Dodd-Frank/Basel III contributing to slowdown in bank CRE lending and fall off in CMBS issuance – two largest sources of credit for CRE sector



Wall of Maturities

\$1 Billion Maturing Daily In 2016-2018



Source: Trepp, LLC



Credit and Capital: Relieving Restrictive Capital Requirements, Regulatory Burden

- Cumulative impacts of post-crisis legislative and regulatory changes made to financial system from measures such as Basel III and Dodd-Frank are beginning to be felt in CRE markets
- Important for policymakers to enact measures that will encourage capital formation, balanced lending and investments in the US economy—support job creation and economic growth



Dodd-Frank, Basel Concerns

- Dodd-Frank *Risk-Retention Rules*
- Dodd-Frank *Volcker Rule*
- Basel III *High Volatility Commercial Real Estate (HVCRE)*
- Basel III *Liquidity Coverage Ratio* rule (*Reg AB*)
- Basel Committee on Banking Supervision (BCBS) *Fundamental Review of the Trading Book (FRTB)*
- BCBS *Step-In Risk*



Basel III – HVCRE

- July 2015 comment letter to regulators:
 - HVCRE rule has slowed ADC lending
 - Bank confusion on interpretation of the rules
 - Recognition of appreciated land value
 - Using “as completed” appraisal values for initial equity determination focuses solely on completion, not lease-up risk of ADC loans
 - Prohibition of withdrawal of internally generated capital
 - Bipartisan legislative “fix” introduced April 26



HVCRE Legislation

- HR 2148 focuses on the following issues:
 - Allows borrowers to use internally generated cash outside project once construction risk has passed, and the project is cash flowing
 - Clarifies that loans made for general upgrades and other improvements on existing properties with rental income do not trigger the capital penalty
 - Allows banks to establish borrower land value as equity into projects as established by compliant appraisals and bank review
 - Excludes from application and compliance any loans made before January 1, 2015



Credit Risk Retention Rule

Uncertainty About Liquidity and Issuance

- Risk Retention Rule took effect Dec. 24, 2016
 - CMBS issuance for 2016 down from prior year
 - A number of issuers have now successfully done conduit deals structured to follow the new risk retention rules
 - Concerns about liquidity and meeting credit demand
 - particularly in secondary markets
 - Is it a non-event or a threat to CMBS issuance?
 - Will *shadow market* fill the gap?



Dodd Frank Reform Financial CHOICE Act

- *Creating Hope and Opportunity for Investors, Consumers and Entrepreneurs*
- Would provide banks with alternative to Dodd Frank
- Banks would have the option to trade regulatory burden relief for increased capital requirements, 10% leverage ratio
- SIFI banks would need to raise more capital; most community banks already meet threshold
- Seen as a starting point for House reform efforts in 2017; Senate looking at alternative reforms



GSE Reform

- Fannie and Freddie were placed under conservatorship in Sept. 2008 and provided the U.S. Treasury with \$5.3 billion in dividends last year
- New Senate Banking Chair Mike Crapo (R-ID) expected to make new bipartisan effort on GSE reform, building on *Johnson-Crapo/Corker-Warner*
- Chmn. Hensarling's *Protecting American Taxpayers and Homeowners (PATH)* Act never garnered broad bipartisan support but is seen as starting point in House
- Trump Administration is expected to make this a priority, but their plans are not yet clear



FIRPTA Reform

- FIRPTA reform enacted in 2015:
 - Lifts barriers to foreign investment in US CRE
 - Increases ownership stake for foreign investors in publicly traded REITs; extends provision to certain collective investment vehicles
 - Foreign investors may own up to 10% of a publicly traded REIT without being subject to FIRPTA; prior ownership cap is 5%
 - Exempts "***qualified foreign pension funds***" from FIRPTA taxation, putting foreign funds on even footing with US pension funds
 - Could generate \$20-\$30 billion in US CRE investment



EB-5 “Immigrant Investor”

- Visa program to attract foreign investment to US
- EB-5 regional centers pool foreign investment funds, channel them to job-creating real estate, infrastructure, and other development projects
- EB-5 funds have been a significant source of development capital since the recession
- Omnibus extends program until September 30
- Sets foundation for continued negotiations to reform and improve *Regional Center* program



Real Estate and Homeland Security

- Roundtable *Homeland Security Task Force* includes lead security officers from member firms – work with FBI, DHS, state and local law enforcement
 - Industry, government working together to mitigate risk, protect buildings, their occupants, and the economy from an ever-changing range of threats
 - Focus on detection, prevention, and mitigation of physical, cyber threats to CF sector critical infrastructure



Risk Management

- *Terrorism Risk Insurance Program Reauthorization Act* enacted in Jan. 2015
 - Extends federal terrorism insurance program to 2020
- Terrorism risk insurance program originally enacted in 2002, after reinsurers left the market
- Extended in '05, '07 and expired in 2014
- Perennial threat of renewing this program creates an unacceptable level of economic risk for the economy and real estate
- Roundtable work to find long-term solution



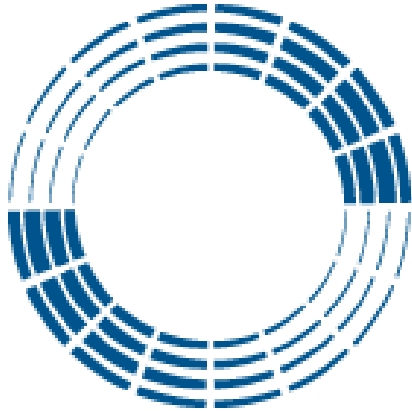
Risk Management

- *National Flood Insurance Program (NFIP) Reauthorization* will sunset Sept. 30, 2017
- Floods are most common and costliest natural peril in the US
- NFIP enacted in 1968 due to lack of private insurance, increases in federal disaster aid
- Essential for homeowners, small businesses
- Commercial limits too low for many CRE owners
- Roundtable working to exempt large commercial loan transactions from mandatory purchase requirement

Real Estate Information Sharing and Analysis Center

- Public-private partnership between U.S. commercial facilities sector and federal homeland security officials organized by the Roundtable in February 2003
- Designated conduit of physical, cyber threats – terrorism, criminal and natural hazard – warning and response information between the government and real estate
- The RE-ISAC issues a *Daily Report* and timely bulletins on potential threats to the sector
- Supported by ten organizations and overseen by the Roundtable's Homeland Security Task Force leadership
- Facilitates the sharing of actionable intelligence from the federal government to members

www.reisac.org



The Real Estate Roundtable

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