

## Are You Ready To Head To The Hill?

MARK YOUR CALENDAR! ON MAY 5, 2010, IREM MEMBERS, JOINED BY MEMBERS OF THE CCIM INSTITUTE, WILL BRING ISSUES THAT AFFECT COMMERCIAL REAL ESTATE TO CAPITOL HILL. The IREM & CCIM Institute Orientation and Capitol Hill Visit Day event are held in conjunction with the IREM Leadership and Legislative Summit. Last year, over 275 IREM and CCIM Institute Members participated in over 225 meetings with their legislators, educating them on commercial real estate management and investment issues.

An orientation will be held at the JW Marriott Hotel in Washington, D.C., on Tuesday, May 4. At the orienta-



tion, legislative staff will explain the issues affecting the industry and what to expect when meeting with members of Congress. Participants will receive essential materials to take with them to the Hill. Time is also provided for members to meet with their delegation and role play.

» More information on the 2010 Capitol Hill Visit Day event is available at [www.irem.org/capitolhill](http://www.irem.org/capitolhill).

## ACCOUNTING RULES CONTINUE TO IMPACT COMMERCIAL REAL ESTATE

THE CREDIT CRISIS HAS PUT IMMENSE PRESSURE ON THE COMMERCIAL REAL ESTATE INDUSTRY. Liquidity in the commercial real estate market has been considerably hampered by one of its key lending vehicles—the nearly frozen \$900 billion commercial mortgage-backed securities (CMBS) market.

Currently, banks and the CMBS market represent most of all outstanding commercial real estate loans. In addition to banks tightening their loan volumes, the CMBS market has ceased to function with respect to new issuance until more recently. Even with the recent new issuance of CMBS, this market continues to be plagued by systemic dysfunction. Without a functional CMBS market, many property owners across the country will face a growing challenge to refinance an estimated \$1.4 trillion worth of commercial real estate loans which are set to mature over the next few years.

The liquidity crisis has been exacerbated by certain Fair Value Accounting (FVA) standards, known as mark-to-market. In particular, the interpretation and application of FAS 157 led banks to mark down their mortgage-backed securities as they declined in value, forcing them to report hundreds of billions of dollars in losses over the last year. However, in early April 2009, the Financial Accounting

Standards Board (FASB) voted to change these rules to allow assets to be valued at what they would go for in an “ordinary” sale, as opposed to a forced distressed sale.

While this rule change is encouraging, other FASB accounting rules such as FAS 166 and FAS 167 (formerly FAS 140 and FIN 46(R)) threaten the recovery of the securitized markets. These two new rules eliminate the Qualifying Special Purpose Entity (QSPE), which makes commercial real estate securitization possible. The QSPE enables banks and companies to treat transfers of financial assets as a sale rather than a financing for accounting purposes. This allows firms to keep these transferred assets off balance sheets. However, the new accounting rules would essentially force banks “to bring hundreds of billions of dollars in assets back onto their balance sheets, forcing them to set aside more capital.” These new rules also require a company to perform a qualitative analysis when determining whether it must consolidate.

Representative Scott Garrett (R-N.J.) introduced an amendment to conduct a study of the impact of FAS 166 and 167 on the securitization markets during the Financial Services Committee “markup” (analysis) of the Financial Stability Improvement Act of 2009. IREM will continue to encourage accounting policy makers to fully examine FAS 166 and 167.

# NEW BILL MAY TAX INCOME FROM CARRIED INTEREST

ON DECEMBER 10, 2009, THE HOUSE PASSED A "TAX EXTENDERS" BILL (H.R. 4123), WHICH INCLUDES EXTENSIONS ON A VARIETY OF TAX BREAKS SCHEDULED TO EXPIRE AT THE END OF 2010. This piece of legislation has several provisions beneficial to the commercial real estate industry, such as a 15 year leasehold improvement depreciation extension, as well as an extension to the current 50 percent bonus depreciation, allowing property owners to deduct 50 percent of the cost of qualifying property in addition to the regular depreciation allowance normally available. Moreover, the bill extends the current \$1.80 per square foot energy tax credit for commercial property owners who achieve 50 percent energy savings through energy retrofits. The bill also provides an extension to Brownfields expensing provisions, allowing real estate owners to recover environmental cleanup costs in the year they are incurred. While all of these elements of the bill are beneficial to the commercial real estate industry, the House bill also included tax increases that could adversely affect many real estate partnerships in order to help pay for these and other extensions.

Under the House bill, income generated from carried interest could be taxed at a rate of ordinary income (at 35 percent or more), as opposed to the current capital gains rate (15 percent). Most general partners with existing carried interests will be penalized under the passed legislation. Extensive rules for carried interests in real estate partnerships are provided so that some real estate general partners will continue to receive capital gains treatment, while many will face ordinary income treatment.

The loss of capital gains treatment for real estate investment partnerships would turn long-established taxation rules upside down. Real estate partnerships,



from the smallest venture to the largest investment fund, have a carried interest component. Approximately \$1 trillion of commercial and residential properties are held by partnerships. Changing the tax rates on carried interest from capital gains rates to ordinary income rates would be devastating to these businesses.

Such a tax increase clearly discriminates against real estate compared to other assets and puts it at a greater competitive disadvantage for investment dollars. Additionally, it puts more pressure on a fragile commercial real estate industry already facing a rapid rise in delinquencies and foreclosures, as well as a growing challenge to access credit.

Currently Senate Finance Chairman Max Baucus (D-MT) opposes an increase to the treatment of carried interests, making it unlikely that such a provision will be passed by the Senate. Nonetheless, a tax increase could be slipped into any one of the bills that are currently before the Senate. To prevent this from happening, IREM submitted a joint letter with NAR and CCIM Institute urging all 100 Senators to not change the current capital gains treatment of carried interests for real estate partnerships.



WOULD YOU LIKE TO KNOW WHAT THE IREM LEADERSHIP AND LEGISLATIVE SUMMIT AND CAPITOL HILL VISIT DAY IS LIKE? VISIT [WWW.IREM.ORG/CAPITOLINVESTMENT](http://WWW.IREM.ORG/CAPITOLINVESTMENT) TO READ ABOUT THE HILL VISIT EXPERIENCES OF IINDA JACKSON, CPM®.