THE PROPERTY REPORT

Industry Sees Friendlier Climate

Real-Estate Sector Likely to Benefit as GOP Gains in Force

By Robbie Whelan

The commercial real-estate industry stands to benefit from the shifting political power in Washington, as Republicans attempt to roll back some parts of financial regulation and stanch any efforts to raise taxes.

As of Tuesday, with eight races remaining undecided, Democrats had lost 60 seats in the House, with Republicans now in control of 239 seats, compared with the Democrats' 188. Democrats still retain a narrow lead in the Senate.

Real-estate executives said that with the GOP taking control of the House in the next term and stronger numbers in the Senate, the industry's profits will be safer from any attempts to raise taxes. Moreover, Republicans have said they plan to ease some provisions of the Dodd-Frank financial-overhaul bill.

Kevin Brady

"Most of my membership...on fiscal issues they are probably conservative Democrats. But I think most of them were pretty happy about the results of 2010," said Steven Spinola, president of the Real Estate Board of New York, a trade association that represents some of the largest developers in New York, including LeFrak Organization, Tishman Speyer Properties and the Fisher family. "The sense is that it will bring the Congress back to the middle a bit, about what needs to be done."

One issue for commercial real-estate professionals is the taxation of "carried interest," or the share of profits paid to the manager of a partnership, typically a hedge fund or private-equity fund.

Profits reaped by partnerships are taxed as long-term capital gains, at 15%, a much lower rate than corporate income taxes.

That tax law is set to expire in 2011 and revert to the pre-2003 level of 28%.

According to the Real Estate Roundtable, a Washington advocacy group, real estate accounts for 46% of the $13.6 trillion in assets held by partnerships in the U.S., and real-estate partnerships, unlike hedge funds, generally risk their own capital, over the course of several years, to build or improve property. If, as some Democrats have pushed for, these fees paid to managers of partnerships and dividends paid to real-estate investors are treated as corporate earnings, it could cut into developers' profits.

"Most of our members, where they get caught is, they have a great idea, they get an option to buy, they spend a number of years getting the right zoning, then they get investors, and in return for all that effort, they get a little piece of the action after the investors get paid," said Mr. Spinola. "We think [those profits] should continue to be taxed as capital gains."

U.S. Rep. Sander M. Levin (D., Mich.) had introduced legislation to raise taxes on carried-interest profits, but with last Tuesday's election and the Republican takeover of the House, he will lose his position as chairman of the House Ways and Means Committee to Dave Camp, a Republican, also from Michigan, who has been outspoken in his opposition to raising taxes of any kind.

Kevin Brady, a Texas Republican who also serves on the Ways and Means panel and is the ranking Republican of the Joint Economic Committee, said that "efforts to tax traditional real-estate partnerships and tie them in to giant hedge funds" are "dead on arrival in a Republican House."

He said in an interview Tuesday that he would use his position on the Joint Economic Committee to focus on commercial real estate by helping ease regulatory pressure on banks that are loath to make new loans or restructure existing loans with troubled borrowers.

A lack of clarity over the recently passed financial-overhaul bill related to capital-reserve requirements, derivatives trading and other issues could limit bank profits and further stunt lending, said several Republican lawmakers, including Mr. Brady.

Mr. Brady and other Republicans have vowed to scale back the financial overhaul by softening some of its more than 240 new rules.

"There are $1.4 trillion in commercial real-estate loans rolling over in the next three to four years," he said. "If banking regulators don't hit the right balance, you're going to be making the problem even greater."

Mr. Levin said through a spokeswoman: "As the new Congress inevitably considers tax reform, including corporate tax rates and other business taxation, I believe the issue of carried interest will be among the items under discussion."

Other issues facing the commercial real-estate industry include job growth, so businesses can expand and invest in capital assets like office and industrial buildings. Cutting taxes on businesses or encouraging other measures that stimulate commercial lending could help that, said some analysts.

Scott Garrett

Rep. Scott Garrett, a New Jersey Republican who hopes to become chairman of the House's capital-markets subcommittee, introduced a bill in March to allow the issue and sale of covered bonds, a high-yield debt security backed by residential and commercial mortgages that commonly is used in Europe to finance real-estate projects.

The bill passed the House this summer, but wasn't included in the Dodd-Frank financial-overhaul bill passed in July.

Mr. Garrett, who couldn't be reached to comment, has said the bonds would help provide banks with lending tools and give consumers more access to credit.