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Landmarks

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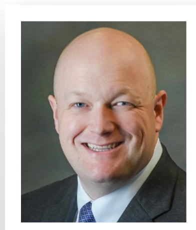
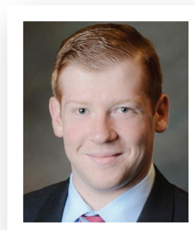
Zombie or Phoenix? Retail Redevelopment in 2018



Jared E. Oakes



Barry J. Guttman

Don't believe everything you read about retail commercial real estate (Retail CRE). If you just looked at the headlines, then you would see that, since reaching a peak of 146.51 on July 25, 2016, the Dow Jones U.S. Retail REIT Index has fallen to 91.62 as of April 25, 2018.[1] You would see that there's been increased talk of consolidation and elevated M&A activity in the retail REIT world[2] and, as indicated by Brookfield Property Partners L.P.'s recent agreement to purchase of GGP Inc.,[3] REITs are being taken private. You would see articles about dozens of retailers declaring or about to declare bankruptcy[4] and predictions that Retail CRE is dead or dying.[5]

But is that actually an accurate picture of the Retail CRE world in 2018, or is the headline risk overblown? In Q4 2017, according to data from the U.S. Department of Commerce, approximately 9.12% of the $1.304 trillion in retail sales during the same period occurred online.[6] While this represents a 16.8% increase in the amount of online sales as compared with Q4 2016, it also means that over 90% of retail sales are still occurring in brick-and-mortar stores. And there are still retailers opening up stores across the country.[7]

Instead, a more accurate description would be that Retail CRE is rapidly evolving,[8] perhaps in its most volatile period of change ever. Fierce competition from Amazon and other online retailers is causing traditional retailers to look more toward omnichannel sales.[9] Nordstrom recently announced a radically different store concept that's been described as "like shopping online—only in real life."[10] Once exclusively online retailers like Warby Parker and Bonobos are themselves pursuing brick-and-mortar stores to grow and meet consumer demands for a physical shopping experience.[11] Private equity is simultaneously driving the profitability of some retailers by effecting operational improvements, while distressing others under the burden of unsustainable debts.[12] The United States Supreme Court just heard oral arguments in *South Dakota v. Wayfair*, a case challenging the long-standing rule that a company needs a physical presence within a state in order for that state to impose sales tax on the company.[13] Depending on the outcome of that case, the Supreme Court could level the playing field between brick-and-mortar retailers and their online competitors with respect to sales tax.

In such a rapidly shifting landscape, developers and landlords are searching for ways to reinvigorate and add value to existing centers, while also working to stay relevant to

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modern consumers. Real opportunity exists for developers who are willing to put in the effort to find the right strategy to redevelop underperforming assets. For many, the holy grail is experiential retail—personalized, engaging activities for visitors. However, in order to pursue these redevelopment strategies to add experiential retail, developers need flexibility. Whether and to what extent developers have this flexibility can make or break a shopping center's financial profitability.

When looking to redevelop a shopping center asset, developers are often faced with a litany of issues stemming from the sometimes-competing interests of various third parties who may have an interest in the shopping center, including (1) tenants, (2) shadow anchors and REA parties, (3) lenders and investors, and (4) governmental authorities. A sampling of some considerations arising out of redevelopments is addressed below. For purposes of this article, the items below address a scenario in which a developer is looking to redevelop space that has been vacated by a major anchor tenant. While there are certainly other considerations to evaluate in the context of any redevelopment, the issues below are those often raised in the specific context of experiential retail redevelopment.

Tenant Issues

- **Consent Rights Over REA Changes.** Many larger tenants' leases give those tenants consent rights over any changes to the underlying structural documents, such as REAs, that created and require keeping in place an existing shopping center or enclosed mall. Sometimes that consent can be withheld in the tenant's sole discretion, which means tenants can hold developers hostage, even if the tenants themselves might actually support the redevelopment. As a result, carefully reviewing the leases to determine any such consent rights is critical—or else developers risk being sued by the tenant and potentially suffering millions of dollars of damages, similar to what occurred in the well-known case *Lord & Taylor, LLC v. White Flint, LP,* 849 F. 3d 567 (4th Cir. 2017) (the *White Flint* case).[14]
- **Use Restrictions.** Particularly with older leases, many of the uses most central to successful experiential retail—such as restaurants, entertainment venues, gyms and the like—are prohibited or significantly restricted under tenants' leases. While the industry has recognized that the lists of prohibited uses that once made sense need to be modernized, very little actual progress has been made because tenants have been able to successfully leverage their consent rights. Accordingly, a thorough review of tenants' leases is necessary to determine any use or other restrictions that might apply to the proposed redevelopment.
- **Cotenancy.** Another reason to review tenants' leases is because many leases, especially those with larger or more sophisticated tenants, contain cotenancy clauses requiring specific named anchor tenants and/or a percentage of the gross leasable area (GLA) of the shopping center to remain open and occupied. With respect to the named anchor tenants, many leases will also provide certain replacement tenants that can suffice to satisfy the cotenancy requirement. While adding an experiential retailer would certainly help satisfy percentage GLA cotenancies (and may be more beneficial to the shopping center's health), when considering potential experiential retailers to backfill a named anchor cotenant's space, developers should consider whether the experiential retailers qualify as replacement tenants for purposes of satisfying existing tenants' cotenancy requirements.
- **Site Plan Controls; Physical Restrictions.** Leases will also frequently contain restrictions against modifying the common areas, protected areas or even building outside certain prescribed "permitted building" areas. Sometimes these will be a blanket prohibition against common-area modifications or modifications to the site plan, while other times the lease will only restrict landlords from modifying the common areas in such a manner as to materially adversely affect a tenant's access or visibility. Material redevelopment plans often change the site plan and common areas in ways that may not be contemplated in leases that contain site plan controls. Accordingly, common area and site control provisions that may otherwise seem boilerplate should be carefully reviewed as part of the redevelopment analysis. On a going forward basis, landlords should pause before granting these types of site plan controls to tenants or carefully limit the scope of these controls.

Shadow Anchor/REA Party Issues

- **Antiquated Language.** Many REAs, declarations and similar title documents will also contain restrictions on concentrations of uses (e.g., restaurants and entertainment uses), prohibitions against de-malling, limitations on developers' ability to change the interior of the mall or demolish existing stores, as well as use restrictions and common area restrictions similar to those described above. However, because these types of title documents often tend to survive far beyond the original parties who entered into them, the documents may use terms that seem innocuous today but meant something different at the time they were executed, which may give current REA parties grounds to contest the redevelopment. For example, older REAs restricting against "health clubs" were arguably intended to prohibit what we would now call a gym or fitness user, even though today there may be a difference between health clubs and gyms. As a result, thorough review of those title documents for these kinds of restrictions is crucial.
- **Parking Requirements.** Like leases, title documents will often contain provisions specifying certain parking requirements. These can include required minimum parking ratios for the shopping center (or parts of the shopping center) that may be based on certain uses, tenants or occupants that may exist within the shopping center, critical parking areas that must be maintained as parking, and critical access points to the parking areas that cannot be changed. In some instances, parking requirements that were

established decades ago are more restrictive than necessary to accommodate a modern shopping center's parking needs. Here too, determining whether a redevelopment would trigger a violation of these parking requirements is critical.

- **Identifying Consent Parties and Obtaining Consents.** Once it has been determined that a title document contains restrictions from which the developer needs relief, which is more likely in the context of experiential retail redevelopment than other redevelopment projects, another issue presents itself: Who are the current parties-in-interest with consent rights under the title documents? Particularly at older properties with several outparcels or ground leases, identifying these parties may not be as simple as obtaining title work for all the parcels affected by the applicable document, as consent rights may not always run with the land. Moreover, even after the appropriate consent parties have been identified, their consent must be obtained—which often comes at a cost to the developer and the redevelopment.

- **Ask for Permission or Beg for Forgiveness?** Historically, in the Retail CRE industry it was not uncommon to hear the mantra, "I'd rather beg for forgiveness than ask for permission." While there are likely many cases demonstrating the risks of that approach, none does so more vividly than the *White Flint* case. *White Flint* involved a developer who wanted to redevelop a failing mall in order to return it to profitability, but Lord & Taylor had consent rights and refused to grant such consent. The developer proceeded with the redevelopment anyway, and ultimately the developer was ordered to pay Lord & Taylor $31 million in damages, including potential lost profits.[15] The dangers of cases like *White Flint* speak to how careful developers should be when granting consent rights to third parties that may come to have competing interests with the developer.

Lender/Investor Issues

- Even before a redevelopment scenario arises, it is critical to structure the debt and equity for a project in a manner that not only gives developers flexibility to use their expertise in redeveloping an otherwise struggling shopping center, but also provides lenders and investors sufficient comfort that their capital is being deployed in an acceptable manner relative to their respective risk tolerances. In that vein, discussions between developers and their capital providers may center on particular risk profile of the experiential use(s) involved with the redevelopment, which would not be the case if a developer sought to backfill an anchor tenant's space with another traditional anchor retailer.

- Depending on how a particular project was originally financed, loan agreements, joint venture agreements or other financing documents very often give these third parties approval rights over any redevelopment of a shopping center. In particular, existing lenders' consent will almost always need to be obtained in order to get new financing for the redevelopment, and equity investors' consent may also be needed or they may be asked to make an additional capital raise. Once a developer is considering redevelopment, the debt and equity documents should be carefully reviewed to ensure that all necessary consents are obtained.

Governmental Issues

- Restrictions in applicable zoning codes might be implicated by the proposed redevelopment of a shopping center. In particular, the permitted uses, parking ratios and setback requirements specified in zoning codes may require getting a variance or conditional use permit in order to allow an experiential retailer to operate.

- If the developer intends to finance the redevelopment with TIF or other public financing, then developers should carefully consult with counsel to determine whether and to what extent an experiential retailer's use and any modifications to the shopping center necessitated by the redevelopment qualify for such financing under applicable laws.

Given the complexity of these issues and their interplay, it is critical to have creative legal, financial and tax advice, as well as a deep network of contacts who can help navigate these issues with the appropriate parties.

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1 https://www.marketwatch.com/investing/index/djusrl?countrycode=xx
2 https://www.reit.com/news/reit-magazine/march-april-2018/are-malls-ready-deal
3 https://bpy.brookfield.com/en/press-releases/2018/03-26-2018-230530913
4 http://www.businessinsider.com/retail-bankruptcies-expected-this-year-2018-3
5 https://www.zerohedge.com/news/2018-04-17/death-retail-real-estate-continues-77mm-sqft-shopping-space-closed-2018-already
6 https://www.census.gov/retail/mrts/www/data/pdf/ec_current.pdf
7 https://www.fool.com/slideshow/these-9-retailers-are-actually-opening-stores/
8 https://www.bloomberg.com/news/articles/2018-04-17/as-toys-r-us-fails-the-retail-real-estate-glut-is-getting-worse
9 E.g., https://www.prnewswire.com/news-releases/tailored-brands-innovates-with-new-omnichannel-customer-experience-300631622.html
10 https://www.gq.com/story/nordstrom-new-york-mens-store
11 http://www.adweek.com/digital/why-these-2-niche-ecommerce-brands-are-opening-up-more-brick-and-mortar-stores/
12 http://fortune.com/2018/04/24/retail-private-equity-investors-mall-shopping/
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15 http://www.bethesdamagazine.com/Bethesda-Beat/2017/White-Flint-Mall-Property-Owners-To-Pay-Lord-Taylor-after-Lengthy-Legal-Battle/

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Blockchain and Brick and Mortar: Flash in the Pan or Financing of the Future?

Barry J. Guttman

Samuel A. Mintzer

Bitcoin's meteoric rise over the course of 2017 spiked the commercial real estate (CRE) industry's interest in blockchain, the technology underpinning Bitcoin. After a failed attempt to use cryptocurrency to pay off the debt needed to acquire the Plaza Hotel in New York City, headlines once again shone a spotlight on blockchain's potential CRE applications. However, despite widespread media attention, blockchain and the opportunities and risks it presents remain poorly understood by most. This article will briefly attempt to explain blockchain, its current uses, its possible applications in CRE, and potential legal issues with that application.

Explaining Blockchain

Perhaps the easiest way to understand the concept of blockchain is to think about it as a different way of thinking about verifying information. Traditionally, we require a trusted third-party to verify information—for example, when the prospective buyer of a property wants to verify that the seller currently owns the property, the buyer will look to a title company's expertise in searching public records to comb those records and verify that the seller does, in fact, own the property.

Blockchain proposes an alternative to this model. Instead of seeking one expert, blockchain suggests having the public records maintained on a publicly available, decentralized ledger that contains pieces of information called blocks—for instance, using the example above, everyone who has ever bought and sold the property—that are chained together and secured using advanced cryptography (hence, the blocks that are chained together are called the "blockchain"). Everyone using the publicly available ledger in turn verifies the blocks and the then-existing chain every time they seek to use it, which maintains the blockchain ledger's integrity and enables the information contained in the blockchain to be relied upon. This would, in theory, enable a prospective buyer to verify the property's owner without relying on the title company's expertise.

Blockchain's Uses Today

Blockchain's uses are growing by the day. This article will focus on only two. Blockchain's best-publicized use is as a cryptocurrency, of which Bitcoin is the most well-known example. In its classic form, a cryptocurrency essentially seeks to reward those who verify the blockchain by granting the first person to do so a digital token (in Bitcoin's case, a bitcoin). This race to verify and ultimately reward is commonly called "mining." The digital token for a cryptocurrency can then, at least in theory, be used as an alternative to fiat money.

A second common use case is so-called "smart contracts." Smart contracts are digitally encoded agreements whose terms are verified using blockchain technology. Often, smart contracts are to some extent self-executing. For example, instead of a typical purchase agreement between a buyer and seller that exists only on paper or as a PDF and relies exclusively on the buyer and seller to each perform, a smart contract could digitally encode the agreement between the buyer and seller. Then, at the transaction's closing, the self-executing contract could automatically transfer the buyer's funds to the seller (particularly if those funds were deposited using a cryptocurrency) and automatically transfer title to the property to the buyer (particularly if such title is recorded on a blockchain), which would eliminate the need for escrow and the associated fees.

Possible Applications of Blockchain in CRE

In addition to the examples listed above for verifying title to a property and utilizing a smart contract purchase agreement, there are myriad other possible uses for blockchain in CRE. A few of these uses include:

1. Substituting a cryptocurrency for currency in a sale, lease or financing. While some landlords accept bitcoin as rent and are exploring cryptocurrency otherwise, using cryptocurrency could greatly modernize investment and payment by cutting down on transaction costs (e.g., removing the need for escrow fees) and speeding up the transaction (e.g., removing the need for wire transfers and bank confirmations for international wire transfers).
2. Substituting smart contracts for leases, loan agreements, and other transactional documents. For example, an office building or shopping center using exclusively smart contract leases could vastly reduce the headache and disputes that often accompany annual common area expense reconciliations and significantly streamline rent collection, calculations of percentage rent, and/or security deposit management. Likewise, a smart mortgage and smart promissory note could automatically discharge the lien of the mortgage once the note has been paid in full (which could automatically be reflected on the title blockchain if one is being used). A smart loan agreement could facilitate loan servicing by providing automatic notifications to borrower, lender, servicer, administrative agent and others of any issues in connection with the property or the loan. Smart joint venture agreements could automatically disburse funds in accordance with the agreed-upon waterfall or make additional capital calls.

Potential Legal Issues with Blockchain Applications in CRE

Although blockchain is an exciting technology that may revolutionize CRE in time, there remain many issues with blockchain that require careful, knowledgeable counsel, such as:

1. The tax consequences of transacting in cryptocurrencies are still unsettled.

2. From a risk management standpoint, parties need to consider their tolerance for allowing automated transactions over which they have no control once smart contracts are put in place, how to address errors in the contract (especially for such self-executing transactions), and how to resolve disputes over such transactions.
3. The difficulty of tracing some cryptocurrencies, especially internationally, may complicate a developer's or lender's ability to conduct proper diligence on potential investors or borrowers.
4. Blockchain relies to a large degree on transparency, and parties may want to keep certain matters confidential for either legal or business reasons (such as a confidentiality agreement or concern over competitors obtaining proprietary information).
5. The parties to a smart contract need not only legal counsel to assist in negotiation but also potentially programmers to assist with ensuring that the smart contract reflects agreed-upon terms.

Although key hurdles in its implementation exist, blockchain technology presents an opportunity to radically change a traditionally conservative CRE industry. Time will tell whether and to what extent these blockchain-based technologies will be introduced throughout all aspects of CRE, but no matter what happens, we at Benesch will keep you up to speed on the ever-shifting CRE landscape.

For more information, please contact **BARRY J. GUTTMAN** at bguttman@beneschlaw.com or (216) 363-4547, or **SAMUEL A. MINTZER** at smintzer@beneschlaw.com or (216) 363-6284.

Get to Know **Jared Oakes**

Jared E. Oakes

Who: Jared Oakes is a partner and Vice Chair of Benesch's Real Estate & Environmental Practice Group. He regularly represents Real Estate Investment Trusts (REITs), institutional investors, lenders, private equity funds, family offices and other public and private investors, developers and owners of commercial real estate, with a particular focus on large-scale development projects, capital transactions and corporate real estate. This work includes counseling clients in the acquisition and sale of commercial properties, joint ventures, commercial lending, leasing, development, corporate facilities management, asset management and debt restructuring.

What Jared wants you to know about the current real estate market (or industry): Transactional activity in most assets classes remains strong, as does the supply of debt and equity for strong sponsors. Capitalization rates in multifamily, industrial and self-storage remain relatively compressed, and headline risk has made retail a disfavored asset class (likely with too broad of a brush). Several of our clients with specific expertise in retail and mixed-use development are taking advantage of the retail headline risk (and the resulting price opportunity) by buying retail assets with the intention of undertaking significant redevelopment. We have also seen large private equity buyers take advantage of depressed pricing of retail REITs by taking public companies private. While not a "new" trend anymore, we continue to see significant activity in the real estate sector from family office investors as well as international institutional buyers. Our experience is that it isn't possible to say whether one asset class is overpriced because real estate is so unique, both in terms of geography and asset quality. For now, we see opportunities for buyers looking to acquire new assets, as well as investors looking to have a profitable exit due to strong pricing and seller-favorable terms.

When Jared isn't practicing law he is: Either helping to manage and grow one of the largest real estate practice groups in the Midwest, or helping my clients identify new deals and connecting capital to deals. Much of my professional time is spent as a "connector," rather than simply practicing law. As a result of our broad client base and national practice at Benesch, we often have access to "off market" deals, and we spend a significant amount of time connecting potential buyers and sellers. Likewise, we do the same thing in the capital stack. We have many clients that are equity or debt sources for real estate deals, and we have other clients and contacts that are looking to raise capital. One of the most attractive value-added services we provide to our clients is making strong connections in the capital stack. Personally, when not practicing law or otherwise working, I am most likely spending time with my wife (Jill) and our three kids (Braden, Olivia and Avery).

Jared's favorite hobby is: Traveling with my family.

The best thing about being a real estate attorney is: Transactional real estate law is a very fulfilling practice for many reasons. I often refer to it as "happy law" because at the end of a deal, as difficult as the negotiation may have been, both sides are typically satisfied with the result (whether they bought, sold, financed or leased a property, they have hopefully accomplished their goal). This is very different from litigation, where there is often a winner and a loser, or a settlement with which neither party is really satisfied. The nature of transactional real estate practice allows me to be a strong advocate to protect my clients' objectives (business and legal) and also to facilitate the deal getting done. Being known as pragmatic, deal-making attorneys is one of the attributes that differentiates the Benesch real estate practice group from our peers. The other great thing about real estate law is that it is tangible. Especially in the context of a significant development or redevelopment project, our work can facilitate positive change in the physical and economic fabric of a community. It is a very gratifying feeling to visit a successful development project that we helped create that has served as a catalyst for growth or revitalization within a community.

Tax Reform: Highlights and Reflections for the Real Estate Industry

Leah Beitner

At the end of last year, Congress enacted the most comprehensive reform of U.S. tax law in more than three decades. The Tax Cuts and Jobs Act (the "Act" or "Tax Reform") contains major changes to the taxation of individuals and business entities, and many provisions have a particular effect on the real estate industry. Although the full scope of Tax Reform's impact remains to be seen, this article highlights and reflects on some of the more significant changes for the real estate industry (including real estate investors, operators, managers, developers, REITs and funds).

Changes to Tax Rates

For individuals, almost every tax bracket has been widened and lowered, with the top bracket going from 39.6% to 37% through December 31, 2025. The corporate tax rate under the Act has been permanently reduced to 21%, as compared to 35% under prior law.

As an attempt to provide parity between the 21% tax rate for corporations and income earned through pass-through entities, Tax Reform provides noncorporate owners (i.e., individuals, trusts and estates) with a new 20% deduction for "qualified business income" with respect to a qualified trade or business from certain partnerships, sole proprietorships and S corporations. The deduction has the effect of reducing the marginal tax rate applied to individuals, estates and trusts on such income from 37% to 29.6%.

However, there are several limitations that are likely to materially limit the benefit of the pass-through deduction for many taxpayers. Specifically, the availability and amount of the pass-through deduction will depend on the individual's taxable income and the amount of "qualified business income," and is also subject to a wage and property limitation.

To begin with, "qualified business income" does not include:

- Compensation or wage income paid to a taxpayer for services rendered to the trade or business (including Section 707(c) guaranteed payments).
- Income received for the performance of specified services, including (1) in the fields of, among others, health, law, accounting, consulting, financial services, brokerage services or any trade or business where the principal asset is the reputation or skill of one or more of its employees or owners, or (2) consisting of investing or investment management, trading, or dealing in securities, partnership interests or commodities.

Under the wage and property limitation, the 20% pass-through deduction generally may not exceed the greater of two amounts, one based on "wages" and the second based on a hybrid of "wages" and "tangible property" of each qualified business, as follows: (1) 50% of W-2 wages paid to employees with respect to a qualified trade or business or (2) 25% of W-2 wages paid to employees with respect to a qualified trade or business, plus 2.5% of the acquisition cost basis (unadjusted) of tangible, depreciable assets including personal and real property used in the qualified trade or business and which are not fully depreciated.

For taxpayers whose taxable income does not exceed $157,500 for individuals (and $315,000 in the case of a joint return), the exclusion for specified services trades and the wage and property limitation do not apply. Likewise, dividends of ordinary income from REITs, as well as publicly traded partnerships (PTPs) taxed as pass-through entities, are not subject to the wage and property limitation. In other words, REIT and PTP ordinary income automatically receives the full 20% deduction and is taxed at the optimum rate of 29.6%.

For real estate ventures that do not have their own employees, but instead rely on services performed by employees of general partners, managing members or affiliated management companies, the wage limitation may be a significant concern. Real estate companies that have a relatively low amount of W-2 wages may look to rely on the alternative 2.5% cost basis prong of the wage and property limitation, rather than solely the W-2 wage cap.

Like the reduced rate for individuals, the 20% pass-through deduction is scheduled to expire after December 31, 2025.

Finally, the tax rates for capital gains and dividends are left unchanged. Also left unchanged is the 3.8% net investment income tax.

Immediate Expensing of Qualified Depreciable Personal Property

Tax Reform increased the first-year depreciation deduction from 50% to 100% for qualified depreciable personal property acquired and placed in service after September 27, 2017, and before January 1, 2023 (January 1, 2024, in certain cases). Bonus depreciation is no longer limited to new property, but also is now available for the purchase of used items from unrelated parties. The bonus depreciation percentage is phased-down to 80% in 2023, 60% in 2024, 40% in 2025 and 20% in 2026.

Although land and buildings are not eligible for bonus depreciation, certain improvements to the interior of nonresidential real property may be eligible for immediate expensing, provided the business has not made the election to opt out of the interest deduction limitation described below.

Limitation on Business Interest Deductibility & Modification of Other Deductions

To partially offset the costs of the lower tax rates and bonus depreciation, the Act modifies a number of deductions that were present in prior law. In particular, Tax Reform generally limits the annual deduction for business interest expense to an amount equal to 30% of "adjusted taxable income" (with a more expansive definition of "adjusted taxable income" through December 31, 2021, that narrows starting in 2022). To the extent a business is subject to the limitation on interest deductibility, the disallowed interest may be carried forward indefinitely.

There are several exceptions to the business interest expense limitation, including an exemption for taxpayers with average annual gross receipts of $25 million or less over the previous three years. There is also an exception for taxpayers engaged in a "real property trade or business," pursuant to which any such business may elect out of the interest deduction limitation. A "real property trade or business" is defined broadly for this purpose, encompassing any real property development, redevelopment, construction, reconstruction, acquisition, conversion, rental, operation, management, leasing, brokerage trade or business, and also includes the operation or management of lodging and health care facilities. An election to opt out of the interest deduction limitation is irrevocable, and comes with a cost: Electing taxpayers are ineligible for immediate expensing and are required to use the longer depreciation recovery schedules proscribed by the alternative depreciation system for their nonresidential real property, residential rental property, and qualified improvement property.

Given that real estate businesses are often highly leveraged, the interest deduction limitation may have a significant effect on tax liability. As such, any real property business that is potentially subject to the interest expense limitation should undergo modeling to determine whether and when it should make the election to opt out of the interest deduction limitation.

Some of the Act's other changes to deductions relevant to the real estate industry include:

- Limits on the carryover of net operating losses to 80% of taxable income and elimination of the carryback (with special rules for certain insurance and farming businesses).
- With respect to noncorporate taxpayers, a $10,000 per year cap until 2025 for (1) state and local income taxes and (2) state and local property taxes that are not paid or accrued in carrying on a trade or business or an investment activity.
- Limits on the deduction available for mortgage interest expense by reducing the amount of debt that can be treated as acquisition indebtedness from $1 million to $750,000, and suspension of the deduction for interest on home equity indebtedness until 2025.

Like-Kind Exchanges

Tax Reform left "like-kind exchanges" relatively untouched, but did revise Section 1031 to limit its applicability to only "real property." Thus, real estate businesses can generally continue to be eligible for gain deferral under Section 1031, with the only change being that post-Tax Reform, there may be immediate gain to the extent that personal property is exchanged in such a transaction.

Carried Interests

The Act reclassifies long-term capital gain as short-term capital gain in situations where (1) a taxpayer holds a partnership interest in connection with the performance of services in an applicable trade or business and (2) either (a) the partnership sells a capital asset whose holding period was less than three years or (b) the taxpayer sells its partnership interest after less than three years. This provision applies to noncorporate taxpayers. For this purpose, the IRS has expressed the view that an S corporation is considered a noncorporate taxpayer.

The term "applicable trade or business" refers to an activity that is conducted on a regular, continuous, and substantial business and that consists (in whole or in part) of (1) raising or returning capital and (2) either (a) investing in or disposing of "specified assets" or (b) developing "specified assets." The term "specified assets" includes, among other things, real estate held for rental or investment.

As such, gains from the sale of carried interests, or gains allocated to a carried interest partner from the sale of rental real estate, would be subject to ordinary income rates if the partnership interest or underlying asset is held for less than three years. Although most carried interest holders typically hold their interests for more than three years, taxpayers in the real estate industry will need to be cognizant of holding periods in order to ensure long-term capital gains on the sale of partnership carried interests and assets.

Conclusion

While this summary highlights some of the Act's key provisions applicable to the real estate industry, the true breadth and depth of Tax Reform's reach is beyond the scope of this article. The impact of Tax Reform on each taxpayer will, of course, depend on the taxpayer's particular circumstances.

For further information or questions, you are encouraged to contact your Benesch tax team, including **LEAH BEITNER** at leah.beitner@beneschlaw.com, **RICHARD F. TRACANNA** at rtracanna@beneschlaw.com and **JESSICA N. ANGNEY** at jangney@beneschlaw.com.

RECENT TRANSACTIONS

- Ongoing representation of a developer in connection with the de-malling and complete transformation of recently acquired enclosed malls, including providing counsel with respect to the construction, development, public finance, leasing, REA and anchor tenant approval considerations and negotiations, and debt and equity financing.
- Representation of a private investor in connection with the redevelopment of a former Kmart into a multitenant shopping center, which includes junior anchor leases, modification of title documents, and acquisition of adjacent land.
- Represented one of the largest developers, owners and managers of multifamily residential property in the U.S. as seller of a $61 million multifamily residential property in North Carolina.
- Represented a seller/tenant in a $15.1 million sale leaseback of an office and warehouse facility in Nevada.
- Advised one of the largest private equity funds in the U.S. in connection with its acquisition of a senior living portfolio valued in excess of $400 million.
- Represented one of the largest developers, owners and managers of multifamily residential property in the U.S. as seller of a $57.5 million multifamily residential property in Texas.
- Represented a large real estate private equity fund in the U.S. as purchaser of a $52 million grocery-anchored shopping center in Pennsylvania and subsequently as borrower on a $32 million CMBS loan secured by such shopping center.
- Represented a multifamily developer in the acquisition of a large market-rate apartment complex in a suburb of Columbus, Ohio, which also included a $43 million loan for acquisition financing, a preferred equity component, and a complicated joint venture.
- Represented a developer in its capacity as the primary investor in a joint venture being formed for an approximately $91 million acquisition and redevelopment of a mixed-use (office and retail) property located in Brooklyn, New York.
- Represented a global mining company in connection with the real estate and environmental aspects of assembling various pieces of land owned or controlled by a number different parties though the negotiation of various ground leases, ground subleases, acquisitions and easements, all in connection with readying the real property for the eventual construction of a large manufacturing facility.
- Represented a real estate developer in the development and leasing of a three-phase, 550,000 square foot shopping center in Newark, Delaware.
- Represented a national dental group in the structuring and negotiation of a 14-property sale-leaseback formation with an institutional buyer and the negotiation of a master brokerage services agreement for all of its leasing, acquisition and disposition requirements.
- Representation of a developer in the acquisition and redevelopment of an abandoned warehouse building in Northeast Ohio that has been converted into a multifamily apartment building, as well as the sale of a portion of the property to a townhouse developer.
- Representation of a borrower in a $34 million CMBS loan to acquire a major regional power in Northeast Ohio.
- Acquisition of an 18-acre parcel in Copley, Ohio, that will be developed into a mixed-use community featuring an assisted living facility, residential development and retail center.
- Represented a private investment group in the acquisition and disposition of multiple apartment properties throughout the United States, totalling over $70 million.
- Represented the borrower in a deed-in-lieu of foreclosure transaction for a 334,000 square foot shopping center with no liability to the borrower and structured as a like-kind exchange to defer recognition of depreciation recapture in Flint, Michigan.
- Represented the purchaser in the acquisition and financing of a shadow-anchored shopping center located near Grand Rapids, Michigan, including a "reverse" 1031 exchange.
- Represented one of the world's largest real estate owners and managers in the disposition of multiple power centers in Alabama with a combined purchase price of over $110 million.
- Represented one of the world's largest real estate private equity funds as purchaser of a $45 million retail focused mixed-use property in California and subsequently as borrower on a $27 million CMBS loan secured by such property.
- Ongoing representation of a large publicly traded REIT in connection with multiple sales of grocery anchored shopping centers and power centers, as well as excess development land, on a national basis, with transaction values typically ranging from $10 million to in excess of $50 million. Recently closed transactions include sales of assets located in Arkansas, Idaho, Pennsylvania, California, Virginia, South Carolina, Mississippi, and Florida.
- Represented one of the world's largest private equity fund in connection with its sale of a joint venture-owned power center in Texas for over $80 million and assignment of the loan encumbering such shopping center.
- Ongoing representation of a large publicly traded REIT in the structuring and implementation of a nationwide disposition program for over 40 assets and the negotiation of listing agreements, letters of intent, purchase agreements and other transaction documents in connection with such disposition program.

Real Estate & Environmental Group

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Thank You!

2018 ICSC RECAP

MY BENESCH MY TEAM

Ten attorneys from Benesch's Real Estate and Environmental Practice Group recently attended the annual ICSC RECon shopping center convention that was held in Las Vegas from May 20-23. The RECon convention is the premier global gathering of shopping center industry professionals, and over 37,000 people attended the convention this year. We did note that attendance at RECon was materially impacted this year due to an unfortunate scheduling overlap with the Jewish holiday, Shavuot. During the convention, the Benesch team hosted approximately 150 clients, colleagues and friends at the firm's annual cocktail reception. Despite endless news headlines proclaiming the death of retail, and the headwinds the industry is facing due to e-commerce, many attendees expressed optimism and have shifted their focus toward the evolution of retail and the shopping experience. Leasing activity appeared to be mixed with certain retailers in high growth mode, while others are evaluating their models and are focused in improving their existing portfolio of stores. We noted particular strength in value oriented retailers as well as food, beverage and experiential retail. Redevelopment of existing assets is the strongest trend we are noticing in retail currently, with several large REITs and developers investing billions in the transformation of their properties. Capital remains available both on the debt and equity side, notwithstanding a recognition that interest rates will continue to rise in the near term. There are also a number of investors that have an appetite for retail acquisitions, but there has been some pricing dislocation which has slowed transactional activity. Overall, the message we took away from RECON was one of cautious optimism and a recognition that bricks and mortar retail needs to continue to evolve to stay relevant. Benesch works with clients on retail real estate acquisitions, dispositions, recapitalizations (debt and equity), leasing matters, and development and redevelopment projects that they are pursuing.

To speak with someone further about Benesch's Real Estate & Environmental capabilities, please contact:

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