

Bay Area Real Estate: Market Trends, Threats and Opportunities

JUNE 23, 2020

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Panelists



Brad Marsh
Co-Managing Shareholder
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Bill Benton
Vice Chairman
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Juliet Song
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Marcum LLP
San Jose

Agenda

- Introductions
- Outlook of Real Estate Markets – Bill Benton
- Federal Tax Changes Impacting Real Estate– Juliet Song
- State and Local Impact – Brad Marsh
- Q&A



**Newmark
Knight Frank**

- **MARKET UPDATE**
- **SUBLEASE SITUATION**
- **MARKET FORECAST**
- **HISTORY | FUNDAMENTALS**
- **“SPREADIFICATION” | WFH - IMPACT ON SIZE NEEDS**
- **POSITIVE SIGNS**



MARKET UPDATE

4Q19



Vacancy
(city wide)

3.2%

Class A
Asking Rates

\$92.41

Under
Construction

3.3M RSF

Tenant
Demand

8.1M RSF

Q Net
Absorption

526 K RSF

Avg Construction
Costs (from shell)

\$165+ PSF

4Q19 TO 2Q20

SUBLEASE SITUATION

MARKET FORECAST

HISTORY \ FUNDAMENTALS

“SPREADIFICATION” | WFH -
IMPACT ON SIZE NEEDS

POSITIVE SIGNS

4Q19

2Q20



4Q19 TO 2Q20

SUBLEASE SITUATION

2Q20



MARKET FORECAST

HISTORY \ FUNDAMENTALS

“SPREADIFICATION” | WFH - IMPACT ON SIZE NEEDS

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SUBLEASE SITUATION

4Q19 TO 2Q20

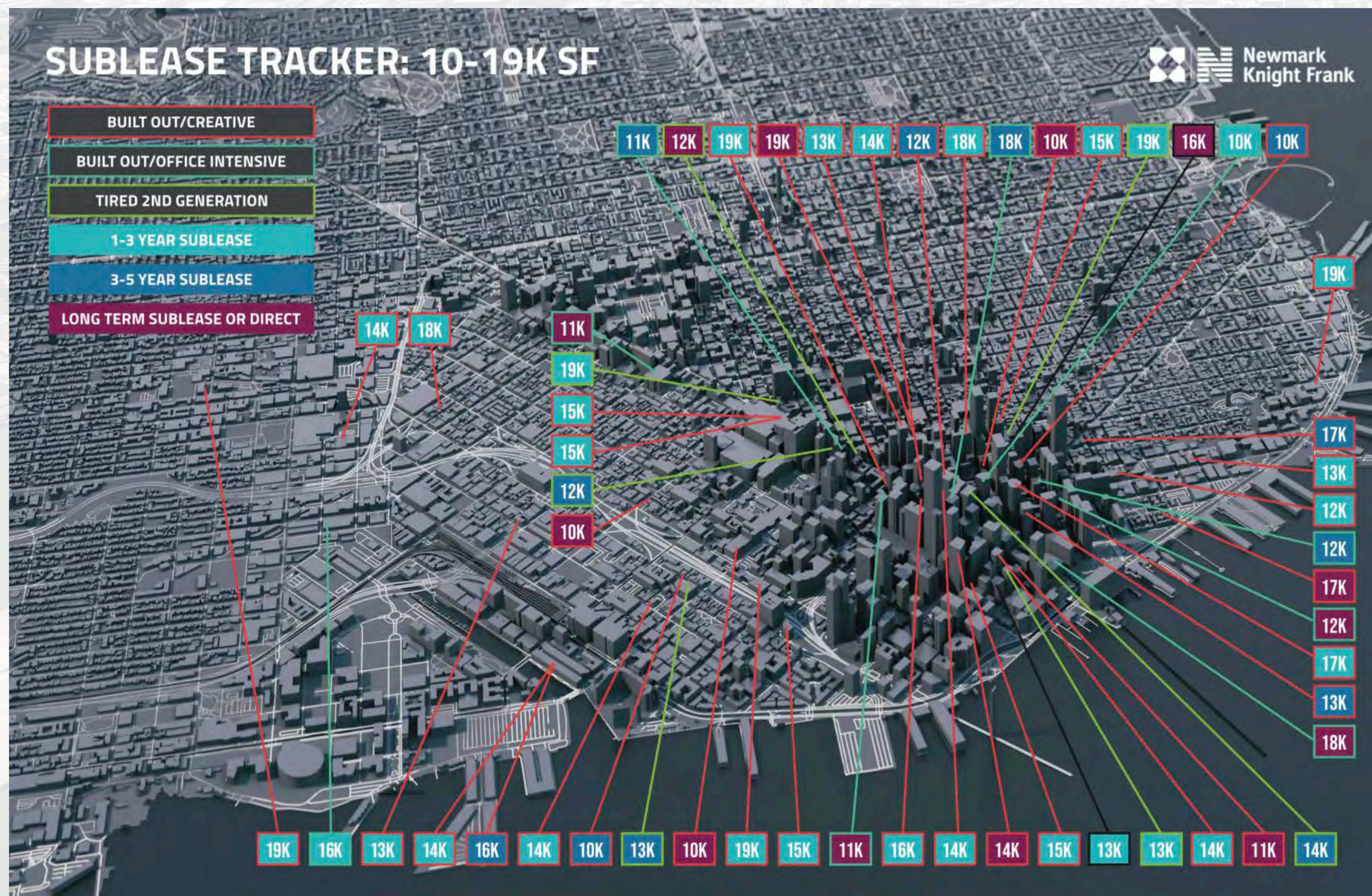
SUBLEASE SITUATION

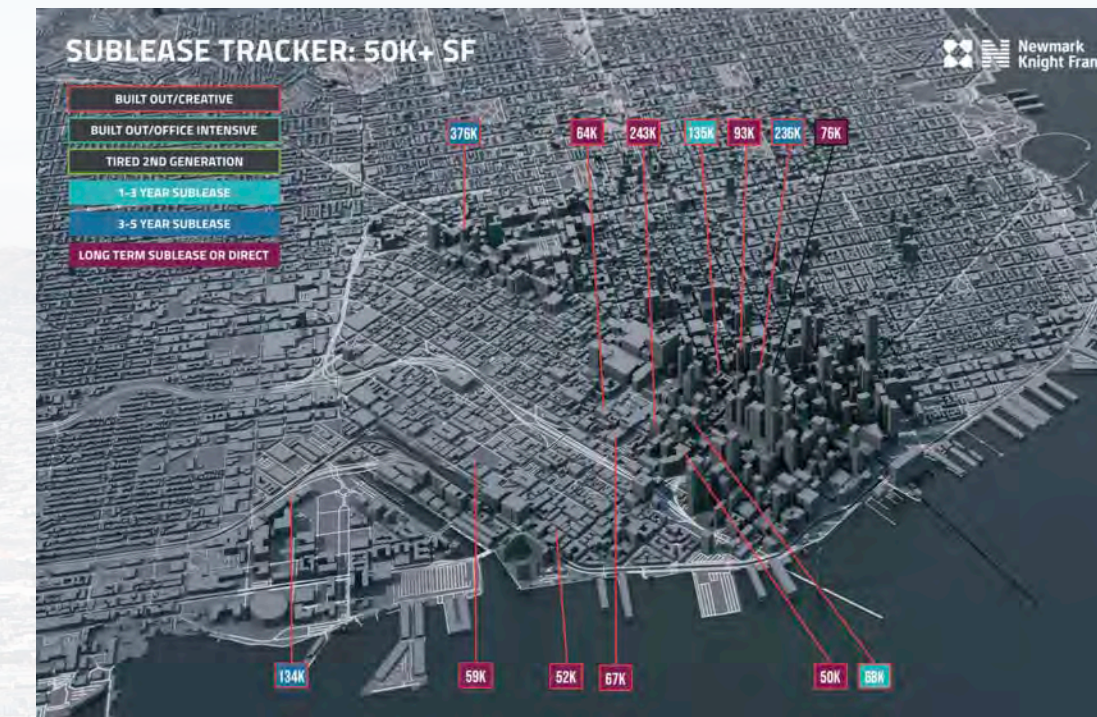
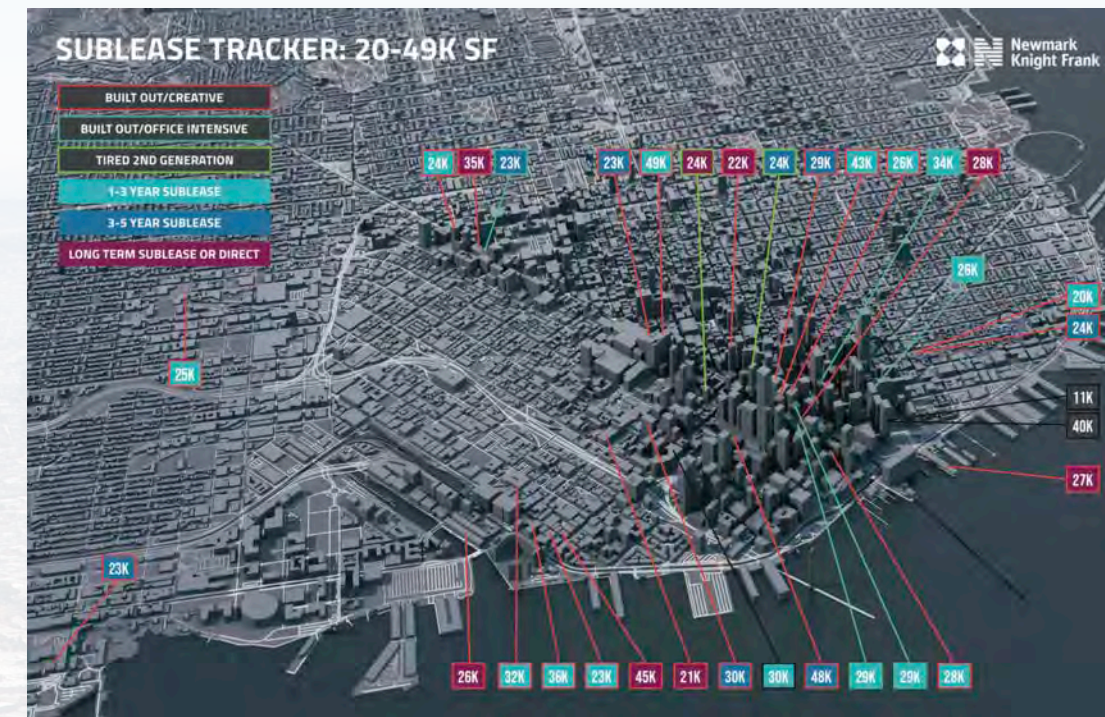
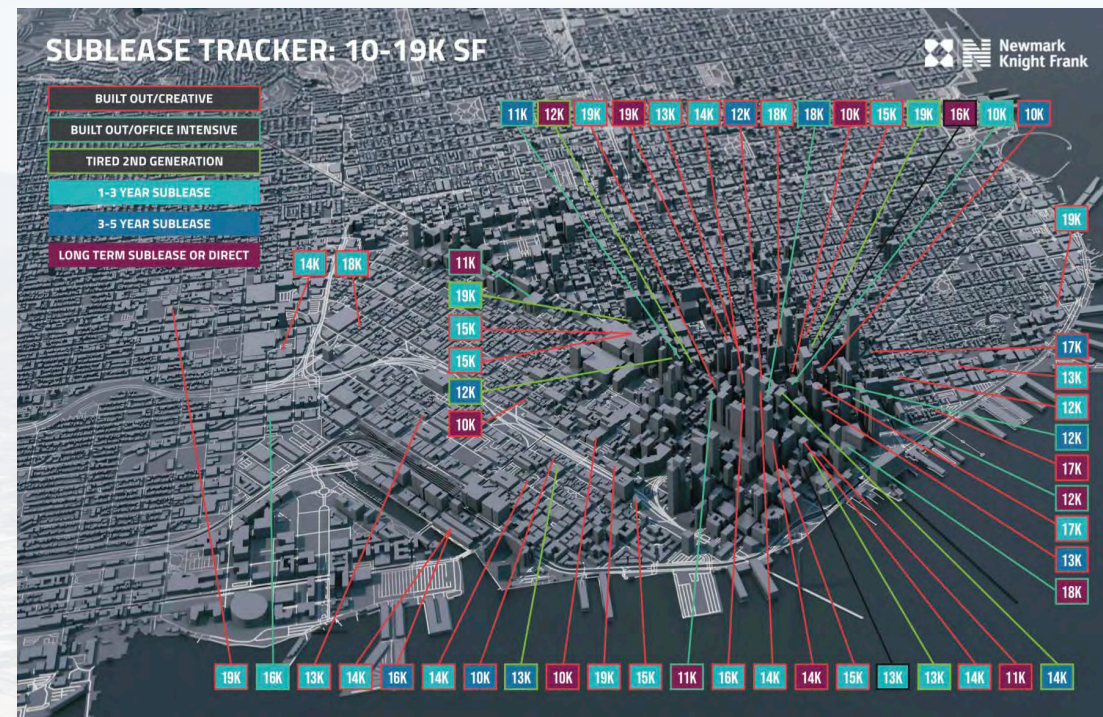
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HISTORY \ FUNDAMENTALS

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4Q19 TO 2Q20

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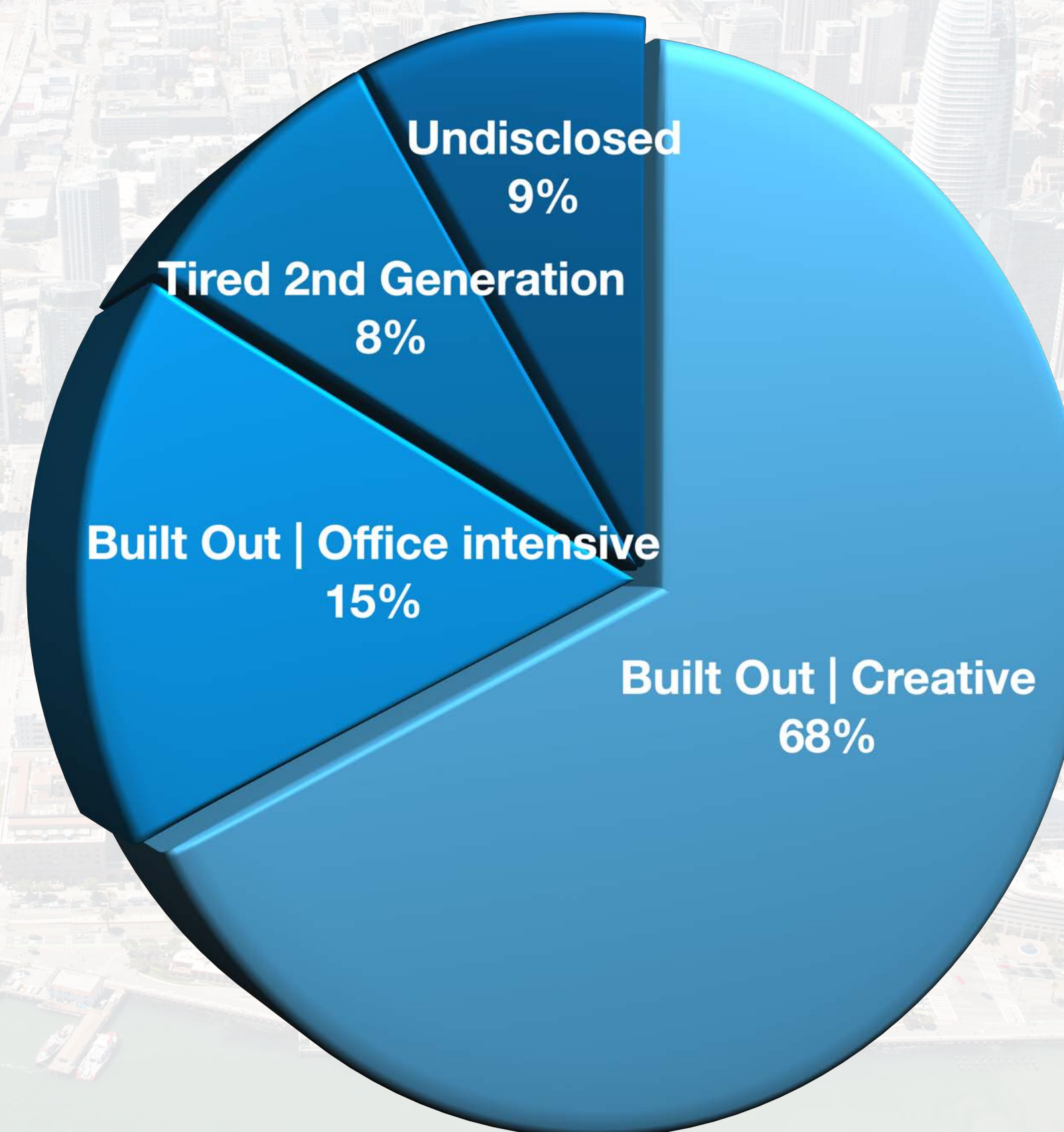
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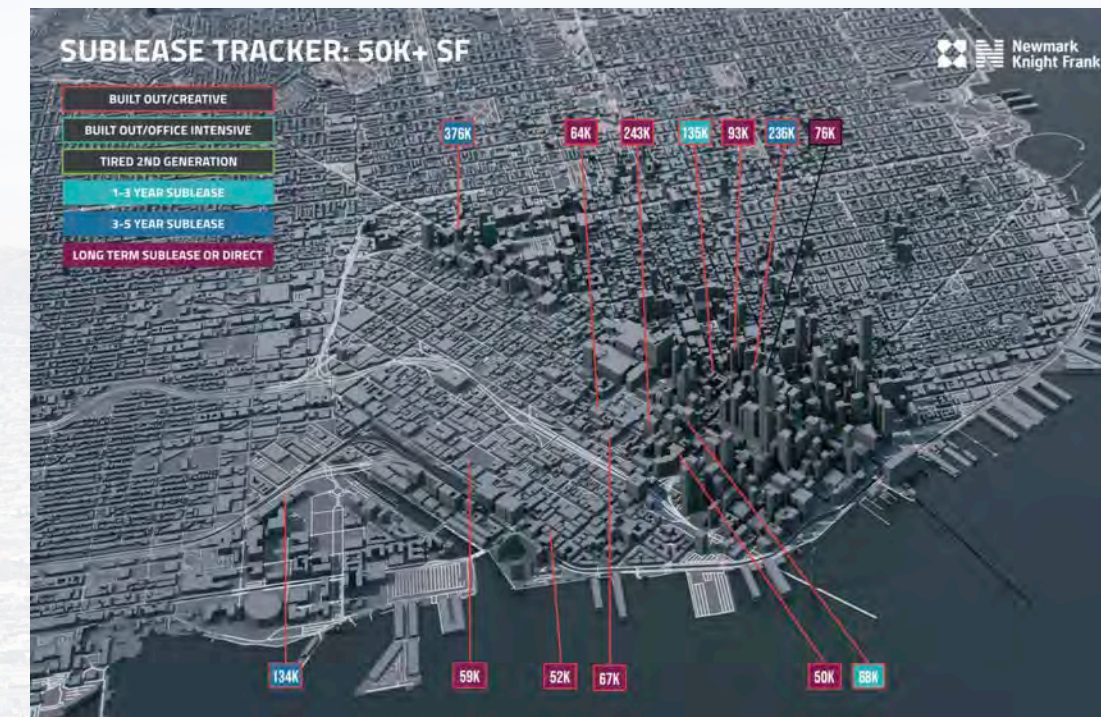
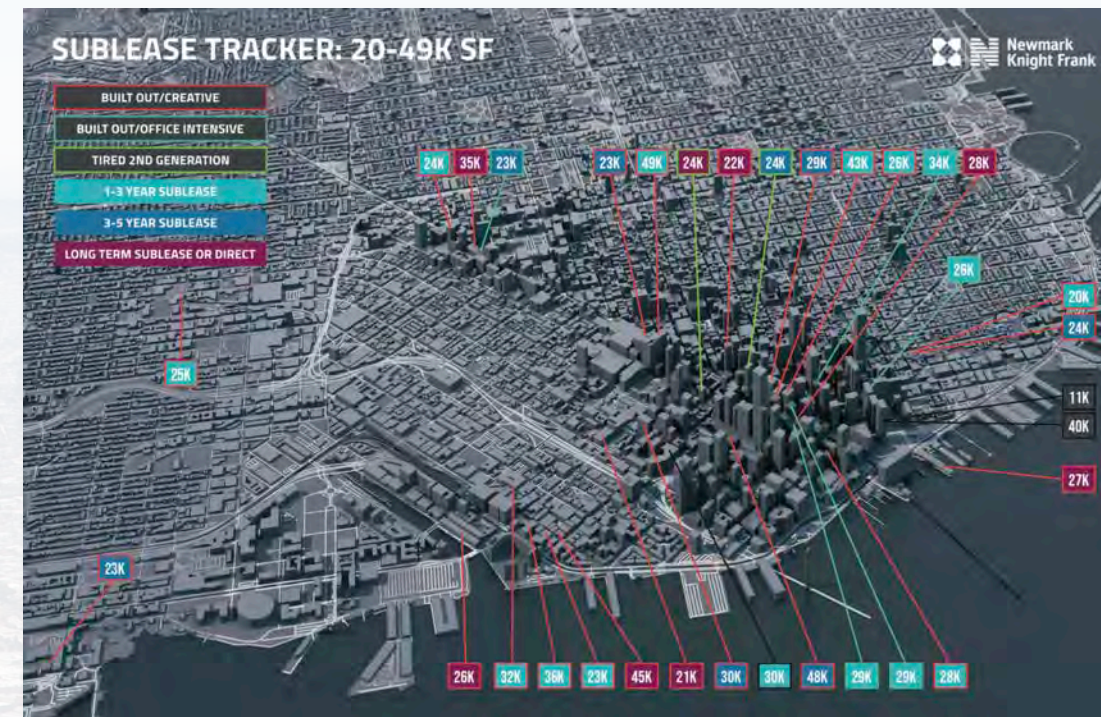
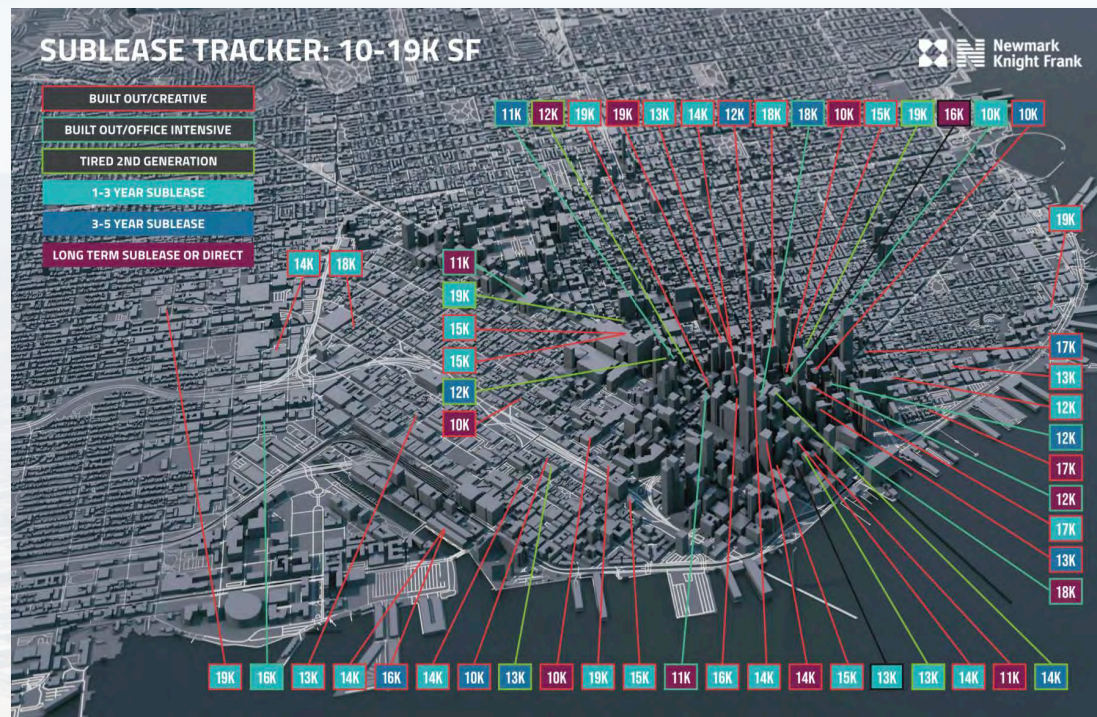
“SPREADIFICATION” | WFH - IMPACT ON SIZE NEEDS

POSITIVE SIGNS

SUBLEASES GREATER THAN 10K SF

- **5.2M SF** of subleases available as compared to a total of **1.7M RSF** of subleases signed in 2019
- **57** short-term subleases on the market
- **26** mid-term subleases on the market
- **17** long-term subleases on the market
- **75** built-out and creative subleases across all inventory
- Sublease **rates are declining** quicker than direct rates
- Sublandlords have reduced asking rents between **10-20%** within the last month
- Plug and play **subleases are of greater value** since construction has halted





4Q19 TO 2Q20

SUBLEASE SITUATION

MARKET FORECAST

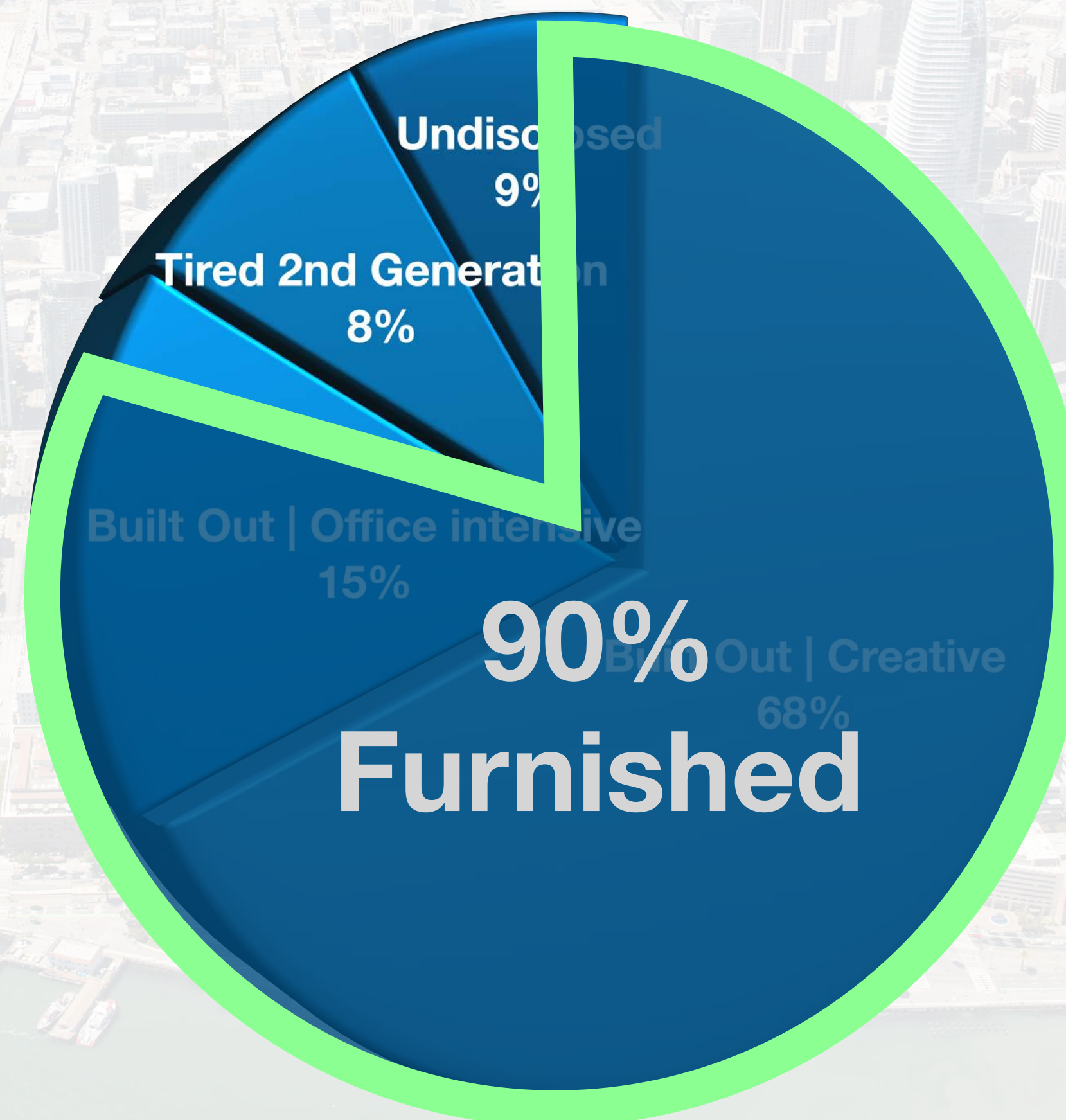
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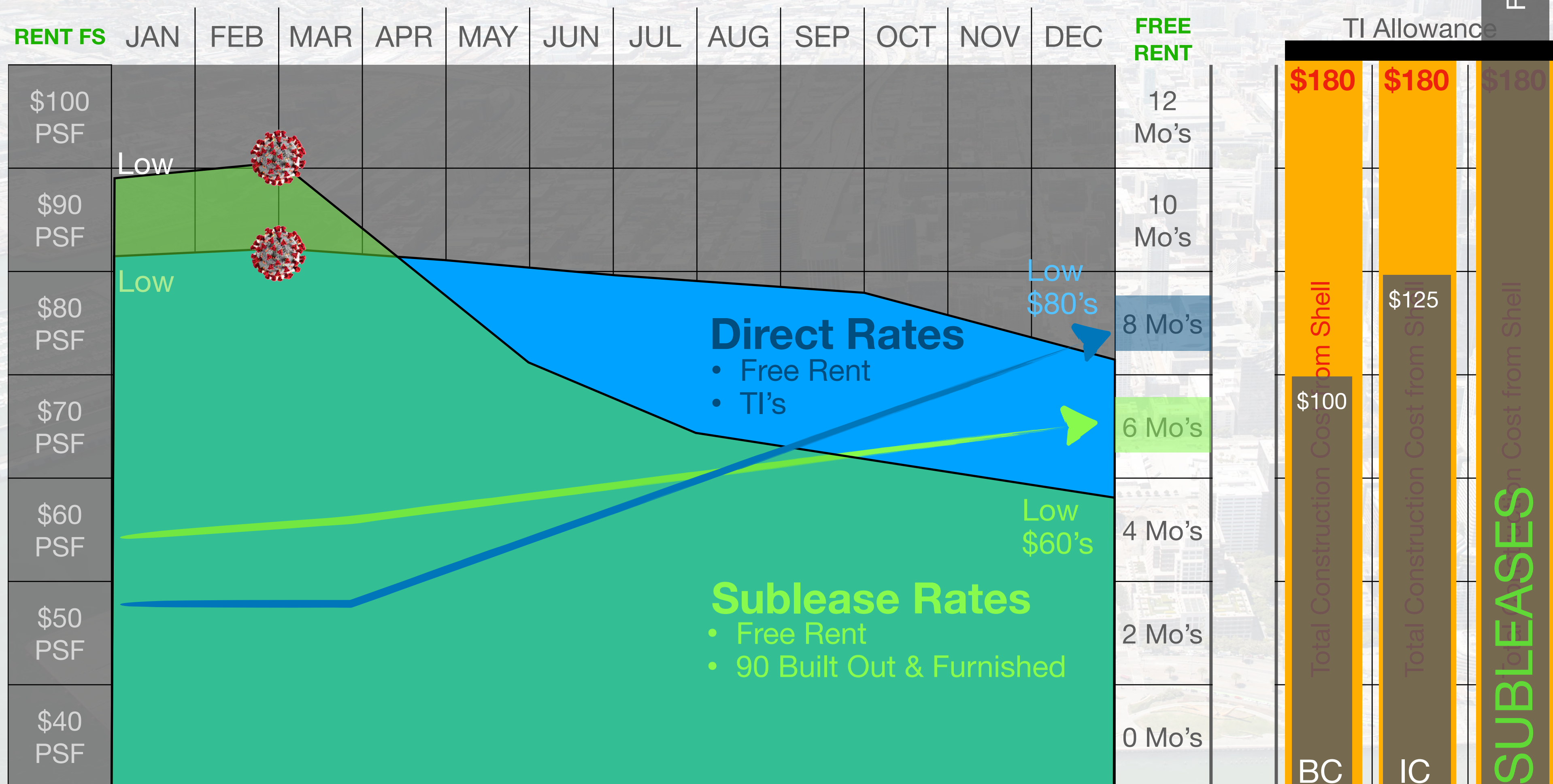




MARKET FORECAST

2Q20

2020



4Q19 TO 2Q20

SUBLEASE SITUATION

MARKET FORECAST

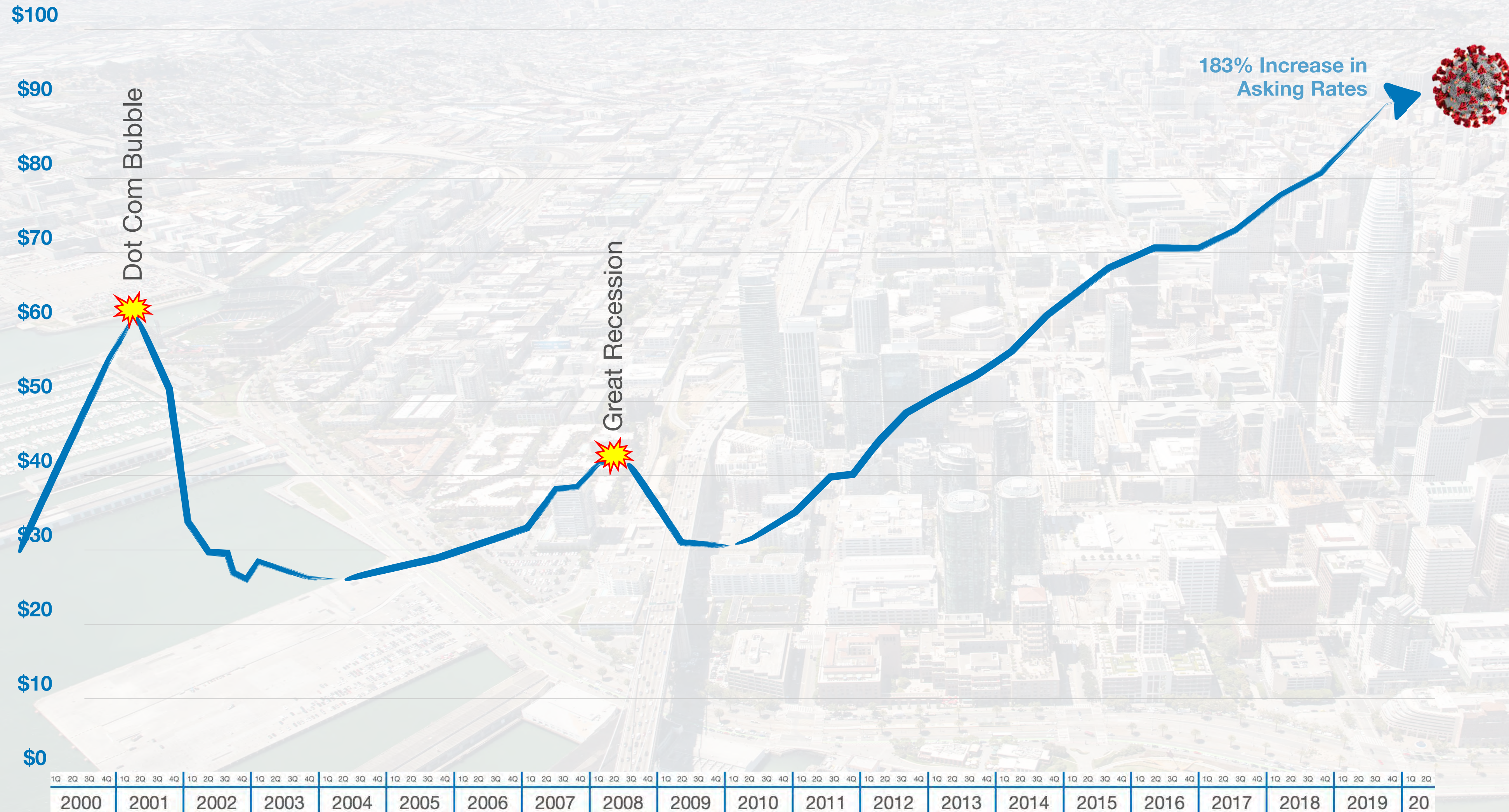
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HISTORY | FUNDAMENTALS



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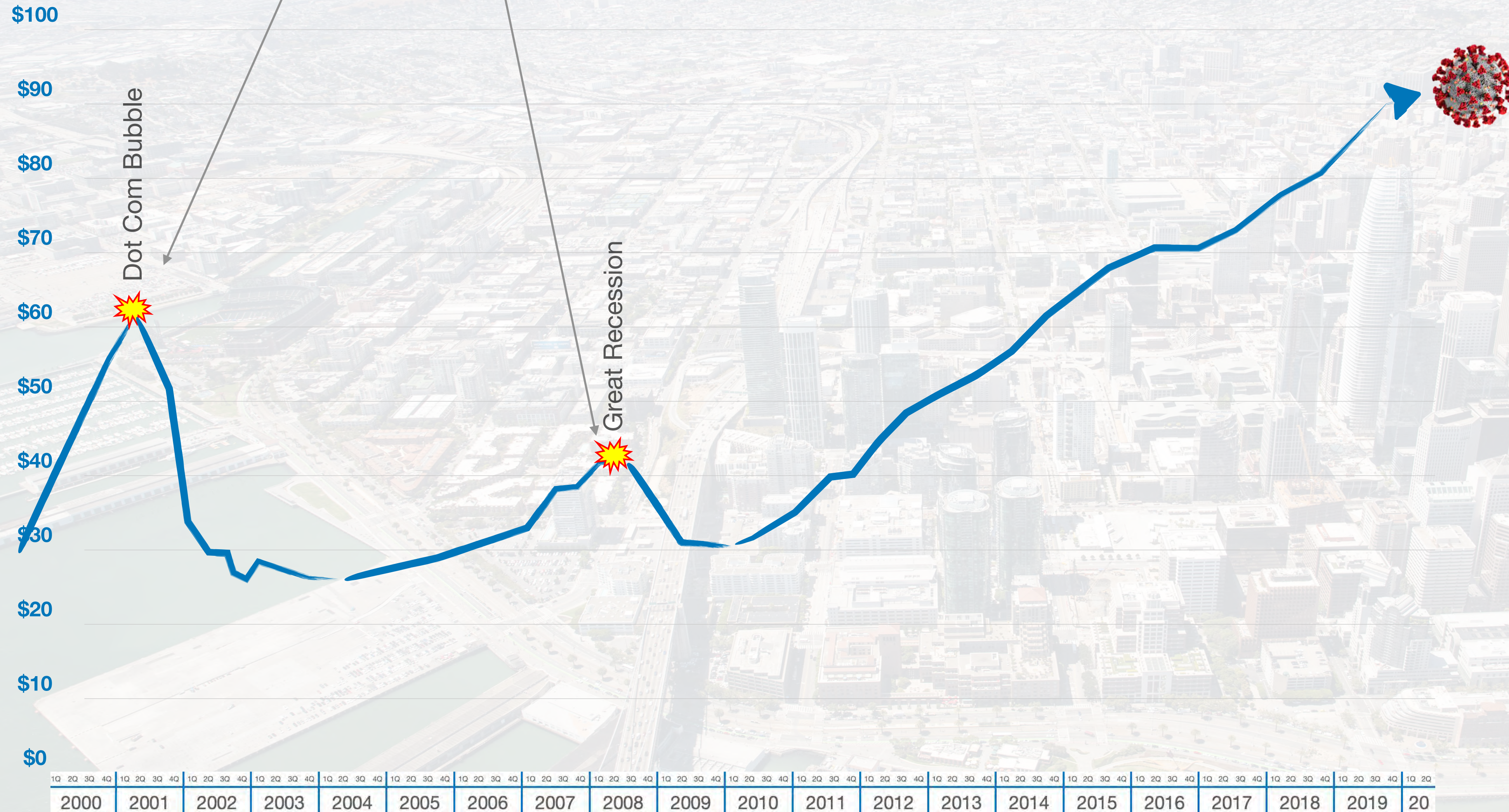
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2Q20

Fake Demand



4Q19 TO 2Q20

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4Q19 TO 2Q20

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**HISTORY |
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“SPREADIFICATION” | WFH -
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POSITIVE SIGNS

THREATS

- POLITICS
- GROSS RECEIPTS TAX
- PROP C & PROP C
- COST OF DOING BUSINESS

- COST OF LIVING

- HOMELESS
- RIOTS
- TALENT moves out
- TALENT not drawn
- TALENT does not need to be in SF

- THE COMPANIES ARE IN SF BECAUSE THE TALENT IS IN SF



SUPPLY AND DEMAND



“SPREADIFICATION” | WFH - IMPACT ON SIZE NEEDS

BC TECH AVERAGING 125 RSF/SEAT

| SEATS | RSF/SEAT | TOTAL RSF |
|-------|----------|-----------|
| 1,000 | 125 | 125,000 |

BC
125K RSF

IC 60% INCREASE IN RSF/SEAT FOR SPREADIFICATION

| SEATS | SPREADIFICATION | RSF/SEAT | TOTAL RSF |
|-------|-----------------|----------|-----------|
| 1,000 | 1.6 | 194 | 194,000 |
| 500 | NA | 125 | 62,500 |

IC
125K RSF

AC TECH AVERAGING 150 RSF/SEAT / 15% WFH

| SEATS | SEATS | RSF/SEAT | TOTAL RSF |
|-------|------------------|----------|-----------|
| 1,000 | | 150 | 150,000 |
| 850 | REDUCE HC BY 15% | 150 | 127,500 |

AC
127K

4Q19 TO 2Q20

SUBLEASE SITUATION

MARKET FORECAST

HISTORY \ FUNDAMENTALS

“SPREADIFICATION” | WFH - IMPACT ON SIZE NEEDS

POSITIVE SIGNS



POSITIVE SIGNS

 **GUSTO**
+/- 50,000 RSF



 **databricks™**
+/- 150,000 RSF
Very Active - BC, IC & AC

 **tubitv**
FREE TV & MOVIES
+/- 60,000 RSF



FOX

chime
+/- 150,000 RSF



 **PLAID**
+/- 90,000 RSF



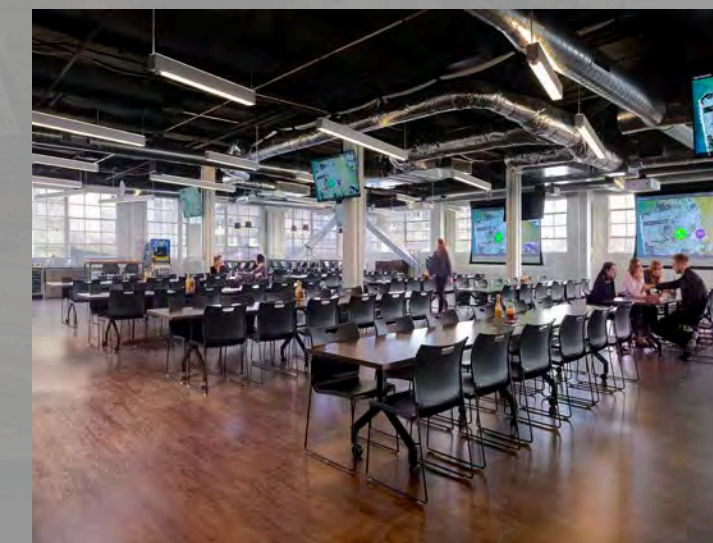
 **Amplitude**
+/- 60,000 RSF



 **Benchling**
+/- 60,000 RSF



 **alto
pharmacy**
+/- 60,000 RSF



4Q19 TO 2Q20

SUBLEASE SITUATION

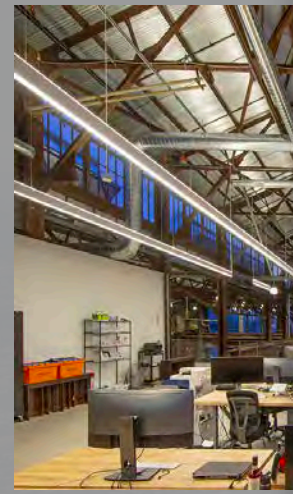
MARKET FORECAST

HISTORY \ FUNDAMENTALS

“SPREADIFICATION” | WFH -
IMPACT ON SIZE NEEDS

Bright Spots/Current Activity

 **GUSTO**
+/- 50,000 RSF



 **tubitv**
FREE TV & MOVIES
+/- 60,000 RSF



 **PLAID**
+/- 90,000 RSF



 **Benchling**
+/- 60,000 RSF



**Goldman
Sachs**

KKR

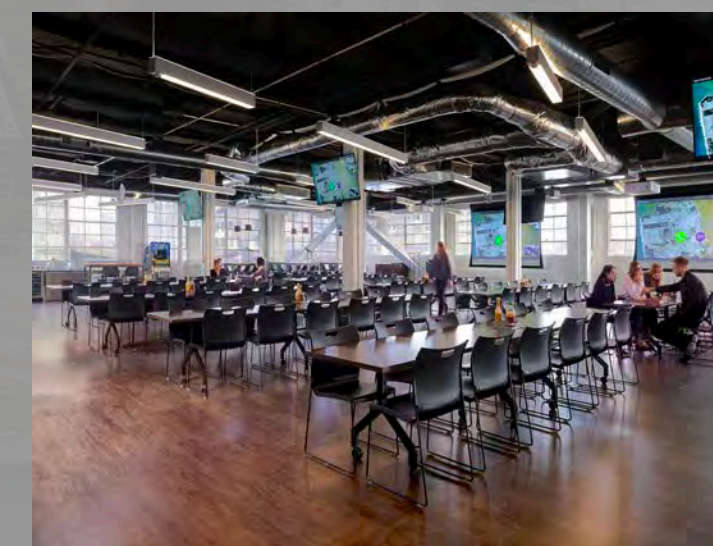
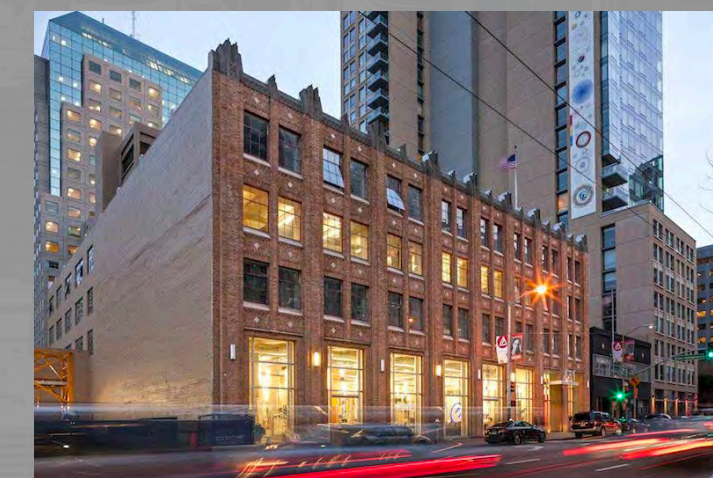
BLACKROCK

Levi's

SEPHORA

 **databricks™**
+/- 150,000 RSF
Very Active - BC, IC & AC

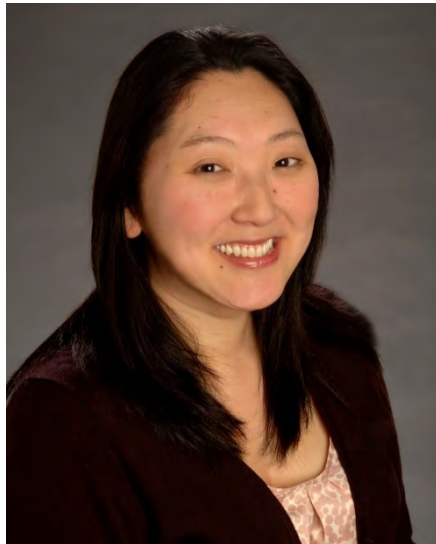
chime
+/- 150,000 RSF





**Newmark
Knight Frank**

THE CARES ACT: IMPACT TO BUSINESS ENTITIES



Juliet Song, CPA
Partner, Tax & Business Services
Northern California Real Estate Industry Leader

CARES Bill: QIP Bonus Depreciation Discussion

Bonus Depreciation is Allowed on Qualified Improvement Property (QIP) costs.

The legislative error in the TCJA is fixed and QIP now is eligible for immediate write-off. This provision is retroactive to enactment of the TCJA, December 2017.



CARES Bill: QIP Bonus Depreciation Discussion

- **Qualified improvement property, which means any improvement to a nonresidential building's interior.**
 - Made by the taxpayer (new requirement in CARES Act)
 - Made to an interior portion of a non residential (commercial, retail, factory) building enlargement of the building,
 - Made to a building that is already in service
- **However, improvements do not qualify if they are attributable to:**
 - The enlargement of the building,
 - Any elevator or escalator or
 - The internal structural framework of the building.
- **MACRS life decreased from 39 years to 15 years (40 yr ADS down to 20 year ADS) and eligible for 100% bonus depreciation.**

CARES Bill: QIP Bonus Depreciation Discussion

- **Considerations for Partnerships:**

- How to claim additional depreciation on QIP – partnership audit rules and Rev Proc 2020-23.
- If the partnership is subject to the new centralized partnership audit regime under section 6221, amended partnership returns for tax years beginning in 2018 are filed using form 8082 Administrative Adjustment Request, and the difference between the original and amended K1 is taken into taxable income in the year the amended K1 is received, not the year of original filing. This would make most amended returns filed under the new QIP CARES Act provision a 2020 tax year item.
- Rev Proc 2020-23 allows partnerships subject to the centralized audit regime the option to file an amended 1065 instead which allows the partners to receive amended K1s rather than include the change in the 2020 (or later) tax year.
- This should be considered along with the interaction with NOL carryback provisions and, for taxpayers subject to 163(j) interest limitations, the impact to interest deductions.

CARES Bill: Business Tax Provisions

- **More Business Interest Expense allowed.** Under the TCJA, net business interest is limited to 30% of Adjusted Taxable Income (unless certain exceptions apply). For 2019 and 2020 this is increased to 50%
 - If an election was made out of 163(j) business interest expense limitations as a real property trade or business, ADS depreciation is required on QIP and 100% bonus is not available.

CARES Bill: Business Tax Provisions

- **Net Operating Losses subject to a 5 year carryback and not limited by 80% of Taxable Income Rule.** This applies to NOLs from 2018, 2019 or 2020.
 - Consider/remember rate differentials for prior years (Corp 35% vs 21%, Individual 39% vs 37%)

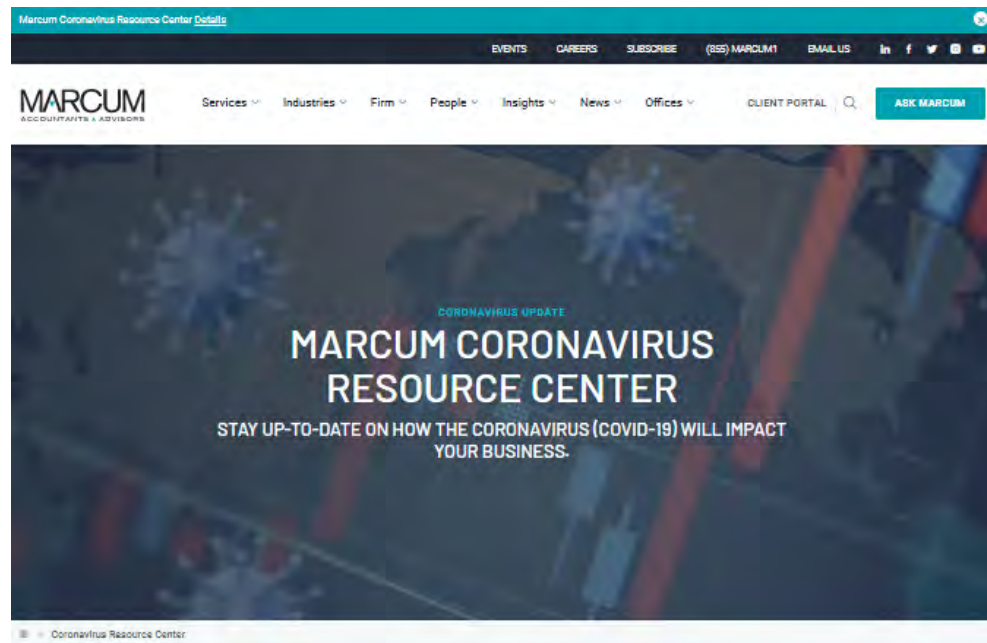


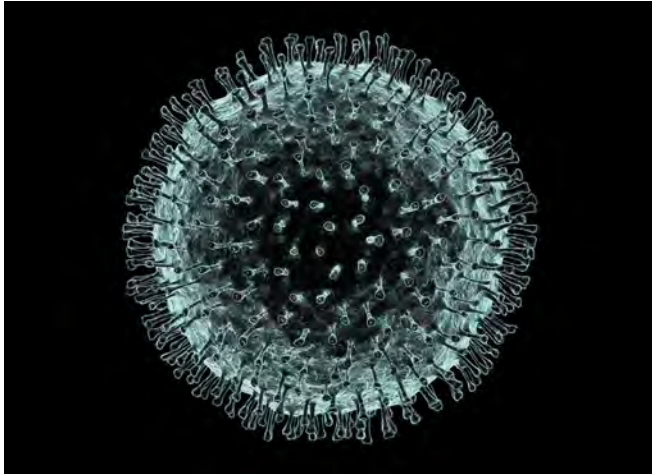
Notice 2020-26

- This Notice provides some guidance on the ability to use forms 1045 or 1139 to claim (instead of using Forms 1040X or 1120X) for claim NOL carrybacks. These forms are generally due within 12 months of the close of the tax year in which the NOL arose. For calendar year 2018 returns, this would be December 31, 2019, which has already passed.
- The Service grants a six-month extension of time to file Form 1045 or 1139, as applicable, to taxpayer taxpayers with a tax year beginning in 2028 and ending before June 30, 2019. This applies only for carrybacks of an NOL (see discussion below regarding corporate AMT credits). For a calendar year taxpayer, NOL carrybacks can be filed for the 2018 tax year by **June 30, 2020**.

Marcum LLP COVID-19 Tax Resources

External Website www.marcumllp.com/coronavirus





B.A. R.E. S.A.L.T. Update

Bradley R. Marsh

Shareholder, Greenberg Traurig



Initial Set of Governor's Orders

- [March 16, 2019](#) - Authorizes local governments to halt evictions for renters and homeowners, slows foreclosures, and protects against utility shutoffs for Californians affected by COVID-19.
- [March 27, 2020](#) – Statewide order banning eviction orders for renters affected by COVID-19 through May 31, 2020. Prohibits landlords from evicting tenants for nonpayment of rent and prohibits enforcement of evictions by law enforcement or courts. Tenants must declare in writing, no more than seven days after the rent comes due, that the tenant cannot pay all or part of their rent due to COVID-19. Tenant must retain documentation to that effect. Tenant would remain obligated to repay full rent in a timely manner and could still face eviction after the enforcement moratorium is lifted.
- May 29, 2020 – Extended March 27, 2020 order and additional 60 days, through end of July, 2020.



Judicial Council Follows Governor

- April 6, 2020 - the Judicial Council of California issued an emergency rule suspending eviction actions. A court cannot issue a summons on a complaint for an eviction unless the court finds that the action is necessary to protect public health and safety. The rule applies until 90 days after Gov. Newsom lifts the state of emergency or the Judicial Council amends or repeals the rule.
- Has been criticized.
- Presently considering modifying order further.



Localities Follow Governor

- Just a Sample:

- Alameda
- Berkeley
- Contra Costa
- Marin
- San Francisco
- San Mateo
- Santa Clara



Legislation



- [AB 1436](#) (UPDATE: PRESENTLY STUCK IN APPROPRIATIONS) would bar landlords from evicting tenants for up to 90 days after the state of emergency is lifted, and would prohibit landlords from using nonpayment of rent during the pandemic as grounds for an eviction in the future. It would also give tenants 15 months to pay back rent from that time period, after which landlords could claim any unpaid rent in civil court. However, tenants would still have to keep up with current rent after the state of emergency is lifted, or face possible eviction.
- AB 2501 (VOTED DOWN) would establish a temporary moratorium on mortgage foreclosures in apartment buildings during the coronavirus crisis.

Legislation

- **SB 939 (VOTED DOWN)** would allow some hospitality tenants to terminate leases if negotiations with landlords to modify terms aren't successful during coronavirus.
- **SB 1431 (UPDATE: PRESENTLY STUCK IN APPROPRIATIONS)** would provide that COVID-19 was a Calamity authorizing a mid-year revaluation and more immediate property tax relief.
- **SB 1410 (ACTIVE)** would establish a tax credit program for rental property owners who have experienced a rent loss that accrued during the state of emergency declared by the Governor related to COVID-19.



Local Property Tax Administration

SACRAMENTO – *California State Association of Counties (CSAC) and the California Association of County Treasurers and Tax Collectors issue the following statement regarding the COVID-19 crisis and the April 10th property tax deadline.*

“Taking care of Californians is our top priority, and counties, cities, and schools are burning through local reserves to do so. Any delay in payments beyond the April 10 property tax deadline, for individuals or businesses that can pay, will tip local governments into insolvency at a time when our residents need us the most.

Counties will use all existing authority to cancel penalties and other charges for homeowners, small businesses, and other property owners that are unable to pay their property taxes due to circumstances caused by COVID-19 on a case-by-case basis. However, property owners who can pay or that haven’t been directly affected by COVID-19, including international corporations and out-of-state landlords, still need to pay on time to keep critical government services running. Assisting taxpayers in this way is not new to Tax Collectors, who most recently worked to help those who were affected by the Camp and Woolsey fires.

A subsequent statement does not include the references to corporations and out-of-state property owners.

Local Property Tax Administration

- All Counties required payment of tax by 4/10, other than:

| | | |
|----------------------|-------------|---|
| Imperial | May 1, 2020 | Audio message available by calling (442) 265-1270 |
| Kern | May 4, 2020 | http://www.kcttc.co.kern.ca.us/ |
| San Francisco | May 4, 2020 | https://sftreasurer.org/property-tax-deadline-statement |
| San Mateo | May 4, 2020 | https://tax.smcgov.org/ |

- Counties vary greatly on whether they will accept partial payments and how tax penalties and/or interest may be waived.
- No extension of deadlines for 571-L personal property renditions; due May 7.

New Governor Order

- **May 6, Governor Newsom signed an executive order:**
 - **April 10 payment deadline extended for most homeowners and certain business property owners. Prior to order, property taxes had to be paid by April 10 to avoid the imposition of a 10% late-payment penalty and other charges. Now, 10% penalty and other charges are suspended through May 2021 if, among other things, the taxpayer demonstrates it has suffered economic hardship, or was otherwise unable to timely pay the taxes, due to the COVID-19 pandemic, or any local, state, or federal government response to COVID-19.**
 - **The executive order also extends the annual filing deadline for the Business Property Statement (Form 571-L) from May 7 to May 31.**

Split Roll – Current Law/Debate

- Currently, all locally assessed properties are treated equally under Proposition 13.
- Several failed prior attempt to modify/split Proposition 13:
 - Proposition 167 (1992; not passed by voters),
 - SB 1662 (2002) and AB 1013 (2001) AB 2492 (2010) would have required more frequent reassessment of properties owned by legal entities. Did not make it to ballot.
- Proponents argued that nonresidential property are not revalued as frequently thereby shifting the burden to homeowners who have more frequent changes in ownership.
- Also addresses the competitive disadvantage (higher property taxes) for some new businesses which enter the state.



Will Proposition 13 Split?

- The first version of the split-roll tax ballot initiative qualified for the November 2020 ballot in October 2018.
- In August 2019, the campaign Schools and Communities First, which is behind the proposal, announced that signatures would be collected for a revised version of the ballot initiative.
- Those signatures are being checked right now and it appears that it will qualify for the ballot this November 2020/Presidential election.
- Once those signatures are collected the, first version will be withdrawn and the second will be the only version on the ballot.

Split Roll – Current Proposal

- Amends the Constitution to require commercial and industrial properties, except those zoned as commercial agriculture, to be taxed based on their market value.
- Residential excluded (single family and multifamily).
- Multi-use partially excluded.
- Small business exclusion for owners with \$3 million or less in holdings in California that would still get Proposition 13 protections.
- Exemption for a small business's tangible personal property up to \$500,000.

Split Roll – Current Proposal

- Net increase in annual property tax revenues of \$7.5 billion to \$12 billion “in most years.”
 - Revenue would be distributed to the state to supplement decreases in revenue from the state’s personal income tax and corporation tax due to increased tax deductions and counties to cover the costs of implementing the measure. Then, 60 percent of the remaining funds would be distributed to local governments and special districts, and 40 percent would be distributed to school districts and community colleges.

For Split Roll – \$19,736,009

- California Democratic Party
- California Federation of Teachers \$637,190
- California Teacher's Association \$6,001,553
- Chan-Zuckerberg Initiative (yes, that Zuckerberg) \$2,115,000
- Joe Biden (2020 Presidential Candidate)
- League of Women Voters
- Oakland Mayor Libby Schaaf
- Oakland Unified School District
- San Francisco Mayor London Breed
- San Francisco Foundation \$1,066,300
- SEIU California State Council \$3,519,467
- U.S. Senator Kamala Harris



Against Split Roll – \$3,226,413

| | |
|--|-----------|
| • BNSF Railroad | \$100,000 |
| • California Asian Pacific Chamber of Commerce | |
| • California Assessor's Association | |
| • California Beer and Bev. Distributors | \$100,000 |
| • California Business Properties Association | |
| • California Business Roundtable | \$266,490 |
| • California Chamber of Commerce | |
| • California Taxpayers Association | \$139,000 |
| • California Women Leadership Association | |
| • Howard Jarvis Taxpayers Association | |
| • United Latinos Vote | |
| • Western Manufactured Housing Communities Assn. | \$100,000 |
| • Willie Brown | |



| Poll | Support | Oppose | Undecided | Margin of error |
|---|----------------|---------------|------------------|------------------------|
| <u>PPIC (likely voters)</u> 4/1/2020 - 4/9/2020 | 53.00% | 47.00% | 1.00% | +/-3.7 |
| <u>PPIC (likely voters)</u> 11/3/2019 - 11/12/2019 | 46.00% | 45.00% | 9.00% | +/-4.3 |
| <u>PPIC (likely voters)</u> 9/16/2019 - 9/25/2019 | 47.00% | 45.00% | 8.00% | +/-4.2 |
| <u>PPIC (likely voters)</u> 4/5/2019 - 4/15/2019 | 54.00% | 45.00% | 1.00% | +/-4.0 |
| <u>PPIC (likely voters)</u> 1/20/2019 - 1/29/2019 | 49.00% | 43.00% | 8.00% | +/-4.0 |
| <u>PPIC (likely voters)</u> 10/27/2018 - 11/5/2018 | 56.00% | 40.00% | 4.00% | +/-4.4 |
| USC Dornsife/Los Angeles Times (eligible voters) 9/17/2018 - 10/14/2018 | 46.00% | 22.00% | 31.00% | +/-4.0 |
| <u>PPIC (likely voters)</u> 3/25/2018 - 4/03/2018 | 53.00% | 42.00% | 5.00% | +/-4.4 |
| AVERAGES | 50.50% | 41.13% | 8.38% | +/-4.13 |



Questions?



Brad Marsh
Co-Managing Shareholder
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San Francisco



Bill Benton
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