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PRINCIPAL REAL ESTATE

The “One Big Beautiful Bill Act” and implications for commercial real estate

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The “One Big Beautiful Bill Act” (OBBA), which was signed into law on July 4, 2025, preserves and, in many cases, strengthens the tax advantages of owning U.S. commercial real estate (CRE), both equity and debt. These provisions have the combined impact of lowering taxable income while increasing cash on cash returns and net operating cash flow. Additionally, section 899 (which was expected to have negative implications for foreign investment in the U.S., given its retaliatory tax measures) was removed from the final bill. Bottom line, the final bill is widely viewed to have net positive implications for the U.S. commercial real estate market.

KEY TAX IMPLICATIONS

Bonus depreciation

Reinstates and permanently extends 100% depreciation of qualified property acquired and placed in service after January 19, 2025. While bonus depreciation does not apply to the building itself, certain equipment and improvements to the property are eligible. This is a significant incentive for capital investment in commercial real estate since the full purchase price of any qualified property can be deducted from taxable income in the year of acquisition. It is especially impactful to value-add strategies.

Section 199A pass through deduction for individuals

Permanently extends a key feature of the tax code, the 20% deduction for pass-through business income from individuals’ taxable income. This will have positive implications for individual investors in real estate partnerships, and REIT dividends will continue to automatically qualify for the deduction.

163(j) interest deduction

Permanently reinstates the EBITDA definition of income for purposes of the section 163(j) limit on the deduction of business interest. This change means that depreciation and amortization are not deducted from the denominator for calculating the business interest expense limitation. This change can benefit investors in commercial real estate because depreciation and amortization may be significant, thereby allowing for greater deduction of business interest expense from taxable income.

State and Local Tax Deduction (SALT)

Preserves the full federal deductibility of business-related state and local property taxes. It increases the cap on the state and local income tax deduction from $10,000 to $40,000 for five years, 2025-2029. The $40,000 cap will be adjusted for inflation but will also be subject to a phase-down for individuals with a modified adjusted gross income over $500,000.

Taxable REIT Subsidiary ("TRS") Asset Test

Increases the TRS asset threshold from 20% of the value of the REIT's assets to 25%. This increases flexibility in the value of investments a REIT can hold via a TRS.

OTHER IMPORTANT PROVISIONS OF THE BILL FOR REAL ESTATE

Low-income housing tax credit ("LIHTC")

The bill permanently increases the State housing credit ceiling (i.e., the amount of housing credits available for allocation by a state) on the 9% LIHTC by 12%. For the 4% LIHTC (for projects financed with tax-exempt private activity bonds) the tax-exempt bond financing threshold is reduced from 50% of aggregate basis of the building & land to 25%. This is beneficial to affordable housing investments.

Opportunity zones

The legislation permanently extends the Opportunity Zone (OZ) tax incentives, including the full exclusion of capital gain on OZ investments held for 10 years. Beginning in 2027, the bill also provides a rolling, 5-year deferral period for prior gain that is invested in an opportunity zone. The legislation provides for a re-designation of OZ census tracts by State governors every 10 years. It also redefines low-income census tracts eligible for OZ designation as those with a median income of 70% of the statewide median level (as opposed to 80%). OZ investments would be eligible for a 10% basis bump-up after 5 years. The bill establishes additional benefits for rural OZs, including a lower substantial improvement test for real estate projects, as well as transparency/reporting measures for all opportunity funds.

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