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US Regional Real Estate

Arkansas
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ARKANSAS

Law and Practice

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1. GENERAL

1.1 Main Substantive Skills

Arkansas requires all attorneys to graduate from an American Bar Association (ABA) accredited law school and pass the Uniform Bar Examination.

Arkansas does not recognize a legal specialization for real estate law. However, a qualified attorney must have experience in the following areas: drafting purchase agreements and leases, title and survey review, and secured transactions and lending.

Real estate attorneys should also familiarize themselves with tax rules and regulations (both state and local), environmental issues, entity formation, bankruptcy, insurance, and government oversight and zoning. Many real estate attorneys specialize in one or several of these areas.

Finally, real estate attorneys should learn how to communicate effectively and negotiate with other parties, lenders, title companies, and government actors to achieve a desired outcome for clients.

Until recently, attorneys practicing real estate law commonly maintained a general practice of law as well. The current trend is toward attorneys focusing their practice more exclusively on real estate law issues, given the growing complexity of regulatory and business issues.

1.2 Most Significant Trends

See the **Arkansas Trends and Developments** chapter in this guide.

1.3 Impact of New US Tax Law Changes

CARES Act and CAA

The Coronavirus Aid, Relief, and Economic Security Act (CARES Act) is the largest new tax law change over the last year. Passed on March 27, 2020 in response to the COVID-19 pandemic, the CARES Act created notable programs like the Paycheck Protection Program (PPP). It also authorized the first set of stimulus payments, additional unemployment benefits, and forgiveness of certain loans.

The Consolidated Appropriations Act, 2021 (CAA), passed on December 27, 2020, followed up on many CARES Act provisions and provided further relief for taxpayers suffering from the effects of the pandemic.

The CARES Act and CAA impacted the US tax code in a multitude of ways. Generally, the most impactful tax-related provisions are as follows.

Fixing the "retail glitch"

Under the Tax Cuts and Jobs Act of 2017 (TCJA), qualified improvement property (which generally includes most improvements to the interior of commercial buildings) was treated as nonresidential real property and therefore did not qualify for 100% bonus depreciation otherwise available under the TCJA. The CARES Act fixed this, allowing business owners to take full advantage of bonus depreciation on qualified improvement property through 2022. The fix applies retroactively, which may allow certain taxpayers to claim a refund for tax years 2018 and 2019.

Suspending the net operating loss (NOL) limitations

The TCJA limited NOL deductions for tax years beginning after December 31, 2017 to 80% of taxable income in the year of the deduction and generally disallowed NOL carrybacks. The CARES Act lifted the taxable income limitation on the use of NOLs for taxable years beginning before January 1, 2021.

The CARES Act also temporarily reinstated a modified carryback period, allowing NOLs incurred by a corporation in a tax year beginning after December 31, 2017 and before January 1, 2021 to be carried back to each of the five tax years preceding the tax year of the NOL (note: an NOL arising during this period that a taxpayer elects to carry back must be carried back to the earliest year within the five-year period in which the taxpayer has taxable income). This allowed some businesses to use NOLs to generate much-needed cash.

Modification of Excess Business Loss Limitations

For tax years beginning after December 31, 2017, the TCJA provides that noncorporate taxpayers are permitted trade or business deductions only up to the amount of the income or gain attributable to that trade or business plus USD250,000 (USD500,000 in the case of joint filers). The CARES Act lifts this limitation for tax years beginning in 2018, 2019, and 2020. For tax years beginning in 2021 through 2026, taxpayers may treat excess business losses as NOLs for purposes of determining a NOL carryover in the following year.

Modifying the business interest expense limitation

The TCJA limited the amount of deductible business interest to 30% of a taxpayer's adjusted taxable income, with any excess carried forward indefinitely. The CARES Act raised the limitation from 30% to 50% for tax years beginning in 2019 and 2020 and, for tax years beginning in 2020, taxpayers subject to the limitation may elect to use either their 2019 or 2020 income for purposes of calculating adjusted taxable income. The effect is that taxpayers subject to the limitation can deduct additional interest expense.

Note that partnerships are still subject to the 30% limitation, but partners allocated excess business interest in a tax year beginning in 2019 will be treated as having fully deductible business interest in the following tax year equal to 50% of that allocated excess business interest amount with the remaining 50% of such allocated excess business interest being subject to the general limitations applicable to excess business interest.

Modifying the depreciation period for residential rental property

Under the TCJA, a real property trade or business could elect out of the business interest expense limitation rules. In return, however, the real property trade or business must use slower depreciation on its residential and nonresidential real property and qualified improvement property. Generally, the slower depreciation was 30 years for property placed into service in 2018 or later, and 40 years for property placed into service before 2018. The CAA amended this to apply the shorter 30-year term to all residential real property, even those properties placed into service before 2018. This makes the real property trade or business election more favorable for taxpayers who own residential real property purchased before 2018.

Clarifying that expenses paid with PPP funds are deductible

After the CARES Act was passed, the IRS issued Revenue Ruling 2020-27, which generally provided that business expenses paid for with funds of a forgiven PPP loan would not be deductible. The CAA, however, clarified that all normally deductible expenses are still deductible even if paid for with funds from a forgiven PPP loan. The state of Arkansas has followed suit, clarifying that forgiven PPP loans are excluded from taxable income, and expenses paid for with funds from a forgiven PPP loan are deductible to the same extent as under general state tax laws.

Treasury Regulations

The IRS also issued several significant Treasury Regulations as follows.

Final regulations under Section 1031
The TCJA limited Internal Revenue Code (IRC) Section 1031 exchanges to real property. In December 2020, final Treasury Regulations were released that define "real property" for purposes of Section 1031.

Final regulations under Section 1061
The TCJA created IRC Section 1061, which generally requires a three-year holding period for a carried interest holder's share of capital gains earned through a partnership to be eligible for the lower tax rates applicable to long-term capital gain (as opposed to the normal one-year holding period for long-term capital gain treatment). The Final Regulations (TD 9945) expand on the new rule and provide additional guidance to taxpayers.

IRS Notices
Extension of deadlines
The IRS issued Notice 2020-23 on April 9, 2020, which extended deadlines for certain time-sensitive taxpayer actions. Specifically, if the deadline fell anywhere between April 1 and July 14, the deadline was extended to July 15. This extension covered a broad range of actions, most notably (for real estate investors) the time to complete a 1031 transaction and to defer capital gain through an investment in a qualified opportunity zone fund. Additionally, the IRS issued Notice 2020-39 and Notice 2021-10, which provide additional relief (generally in the form of extended deadlines) for qualified opportunity zone funds and their investors.

2. SALE AND PURCHASE

2.1 Ownership Structures
Most commercial real estate is owned by an entity, with the most common being a limited liability company, though corporations and, more rarely, limited partnerships are also used.

Some transactions are structured as tenants-in-common agreements where multiple parties each own an undivided interest in a property, but these arrangements are usually only done in the context of tax-deferred transactions.

There have been no recent changes in the most frequently used ownership structures.

2.2 Important Jurisdictional Requirements
There are no special requirements for transferring specific types of real estate; the same instruments are used to transfer all types of real estate.

2.3 Effecting Lawful and Proper Transfer of Title
A title is transferred with a deed. There are three forms of deeds: general warranty deeds, special warranty deeds and quitclaim deeds. Quitclaim deeds provide no promises that a seller has good title to a property. General warranty deeds and special warranty deeds both promise that the seller has title to the property, though they vary in the breadth of the warranties, with special warranty deeds containing fewer assurances than general warranty deeds. Commercial transactions are almost always effectuated with a warranty deed.

A deed must be executed and acknowledged by a notary, and must then be recorded in the county clerk's office where the property is located.

2.4 Real Estate Due Diligence
Typical due diligence includes:

- review of a title commitment and special exception documents;
- review of a survey;
- review of an environmental site assessment (ie, Phase I);
- a building inspection; and

- a zoning verification.

Lawyers usually review and provide comments on all of these, except a building inspection. Review of these due diligence items by attorneys has remained a substantive part of legal practice in Arkansas.

2.5 Typical Representations and Warranties for Purchase and Sale Agreements

Representations and warranties can vary widely in purchase and sale agreements, and many have no representations and warranties. However, the most common are as follows:

- the environmental condition of a property;
- the existence of any pending lawsuits or government actions concerning a property;
- the existence of any leasehold or prescriptive interests in a property;
- the existence of any legal or regulatory violations on a property;
- the authority of the parties to enter into an agreement;
- the availability of utilities;
- the zoning designation of a property; and
- a seller's ability to provide marketable title at closing, free of any liens.

The law does not automatically provide for any representations or warranties. However, federal law requires sellers of residences built before 1978 to disclose that the property could have lead-based paint.

A buyer has two typical remedies for misrepresentation: a suit for breach of contract, or a suit for fraud if the misrepresentation was intentional. Some purchase and sale agreements may provide for alternative remedies, such as termination of the agreement or liquidated damages.

Sellers often want to limit the representations and warranties to the "best knowledge" of the seller, which effectively means that the seller will only be held liable if they give an intentional misrepresentation. A seller cannot limit its liability for fraud. Some buyers and sellers negotiate indemnification provisions relating to contractual representations and warranties that provide caps and limitations for such indemnification. Purchase agreements also typically include a term for representations and warranties after a closing.

2.6 Important Areas of Law for Foreign Investors

There are no special issues in Arkansas for foreign investors. While the law does not prohibit direct foreign investment, most foreign investors choose to establish an American company to take title to a property.

Arkansas has not seen any major changes in practice due to recent changes to CFIUS.

2.7 Soil Pollution and Environmental Contamination

Under the federal Comprehensive Environmental Response, Compensation and Liability Act of 1980 (CERCLA), any landowner can be held liable for the environmental contamination of a property, even if the buyer did not cause the contamination. Buyers typically hire an environmental consultant to perform a Phase I environmental site assessment to determine the risk of contamination prior to purchasing a property.

The allocation of liability is negotiable between a buyer and a seller, but, most often, the buyer agrees to assume the liability after closing, unless the seller intentionally concealed a known problem.

2.8 Permitted Uses of Real Estate under Zoning and Planning Law

A buyer usually ascertains zoning by reviewing the online records of the municipality where a property is located. It may be necessary to call the planning office in smaller cities that do not have zoning maps online.

It is usually prudent to request a zoning verification letter from the municipal planning office, even though these letters are not generally enforceable in court if they contain an error. Most title companies will sell an endorsement to the title policy insuring the zoning designation of the property, but such endorsement typically requires a zoning verification letter from the applicable municipal office.

Contract zoning is not permitted in Arkansas, so it is not possible to enter into specific development agreements with municipalities. However, most municipalities offer some derivation of "planned zoning", where the landowner and the municipality can negotiate a zoning designation unique to the property.

2.9 Condemnation, Expropriation or Compulsory Purchase

The government has the right to condemn land for a public purpose. The government must pay just compensation for the land. The government can take land immediately and then litigate over the actual value of the land, though, in practice, the government will usually negotiate for several months prior to taking land.

There is no certain way to gauge the risk of a taking, though property near roads that might be expanded in the future is at greatest risk.

2.10 Taxes Applicable to a Transaction

Arkansas assesses a transfer tax of USD3.30 per USD1,000 of the purchase price for the sale of real property. The tax is typically shared equally between a buyer and seller, though this is negotiable. The transfer tax does not apply in certain exempt transactions; for example, Arkansas exempts transfers to subsidiaries and transfers for consideration of less than USD100.

No transfer taxes or recording taxes are payable in connection with transfers of ownership interests or change of control in a property-owning company.

2.11 Rules and Regulations Applicable to Foreign Investors

There are no Arkansas-specific rules or regulations that apply to foreign investors.

3. REAL ESTATE FINANCE

3.1 Financing Acquisitions of Commercial Real Estate

Most commercial real estate transactions in Arkansas are financed through banks. Alternative lenders, such as insurance companies and retirement systems, are less frequent. The state will occasionally provide some or all of the financing, though this is generally reserved for industrial development projects.

Most lenders will require individual guaranties when making loans to privately held companies, and underwriting decisions are often made based on the financial strength of the individual principals of the borrower.

3.2 Typical Security Created by Commercial Investors

The standard security instrument for real property is a mortgage, though a deed of trust can be used as well. The mortgage usually includes a fixture filing and an assignment of rents and leases, as applicable.

3.3 Regulations or Requirements Affecting Foreign Lenders

Foreign lenders are generally not required to register to do business if they do not maintain a physical presence in the state and only engage in limited activities related to loans secured by real property.

3.4 Taxes or Fees Relating to the Granting of Enforcement of Security

There are no mortgage taxes in Arkansas. The transfer tax only applies to a sale of real property and is not triggered by a foreclosure or deed in lieu of foreclosure. The only fees required to be paid in connection with recording of a mortgage are nominal recording fees, which are calculated as USD15.00 for the first page of a recorded document, and USD5.00 for each additional page of such document.

3.5 Legal Requirements before an Entity Can Give Valid Security

An entity must have the legal authority to sign a financing instrument. This is sometimes verified through an attorney's opinion letter, where the borrower's attorney will opine as to the entity's authority.

3.6 Formalities When a Borrower Is in Default

Arkansas offers both judicial and non-judicial foreclosure for when a borrower is in default. Judicial foreclosure is the most common method used for foreclosing commercial properties.

3.7 Subordinating Existing Debt to Newly Created Debt

Secured debt can become subordinate to newly created debt when the creditors agree and record appropriate subordination agreements. Tax liens can trump secured debt.

3.8 Lender's Liability under Environmental Laws

Arkansas law does not impose additional liability on lenders for environmental liability over and above that imposed by federal law. Lenders who hold foreclosed property are generally immune from environmental liability, but can forfeit this immunity by operating the foreclosed property.

3.9 Effects of Borrower Becoming Insolvent

Arkansas follows federal bankruptcy laws if a borrower becomes insolvent and files for bankruptcy. State law, however, governs the perfection of mortgages and deeds of trusts on real estate and security interests in personal property. Lenders run the risk of having their security interests avoided by the bankruptcy trustee if the security interest is not perfected in conformity with state law.

With respect to mortgages and deeds of trust, lenders should be sure that the documents are in proper form and properly executed and acknowledged in the manner provided by law prior to recording with the appropriate recording office. Likewise, lenders should be certain that financing statements are in proper form and filed in the appropriate recording office in a timely manner.

Lenders can also gain additional protection from insolvency risks through the use of guaranty agreements from principals or affiliates of the borrower. Lenders should also consider the use of forbearance agreements with borrowers. Typical forbearance agreements include provisions acknowledging the validity and enforceability of loan documents, validity and amount of debt, existence of loan defaults, borrower and guarantor releases of lender and the like.

3.10 Taxes on Mezzanine Loans

Any recordings (mortgages, assignment of rents and leases, etc) relating to mezzanine loans secured by real estate will be subject to the standard recording fees in the county where the property is located, as outlined in **3.4 Taxes or Fees Relating to the Granting of Enforcement of Security**. There are no existing, pending, or proposed rules, regulations or requirements proposing or establishing taxes for mezzanine loans related to real estate.

4. PLANNING AND ZONING

4.1 Legislative and Governmental Controls Applicable to Design, Appearance and Method of Construction

The amount of controls applying to various aspects of new buildings or refurbishments can vary significantly depending on the municipality, with larger municipalities tending toward applying more controls. Outside of a few special districts established for aesthetic controls, most municipalities do not directly dictate design or appearance standards, as long as the building conforms to the height and size requirements established for a particular zoning district.

Practically, some municipalities may want to review design plans before granting zoning changes. Those districts with aesthetic controls typically have more detailed standards for construction and design, and occasionally have review boards.

4.2 Regulatory Authorities

In most cases, a municipality is responsible for regulating the development and designated use of individual parcels of real estate. Municipalities produce rules and regulations in the form of zoning, building, and development codes, generally enforcing the codes through the municipality's planning commission.

Counties are authorized to create a planning board and enact a zoning code for unincorporated areas within the county. Many counties in Arkansas, however, have not enacted a zoning code.

At the state level, the Arkansas Department of Energy and Environment regulates the area of environmental protection, including regulations relating to air quality, energy, hazardous and solid waste, and water quality. The Division of Arkansas Heritage, on the other hand, regulates the area of historical preservation.

At the most local level, neighborhoods often form property owners' associations to enforce restrictive covenants.

4.3 Obtaining Entitlements to Develop a New Project

Parties must generally apply with the relevant municipality to obtain entitlements for new projects. Entitlements include permits, site plan approval, plats, variances, and rezoning. Minor entitlements generally take two to three months to obtain a decision, while major entitlements can take up to six months.

Applications

The form of application varies depending on the entitlement sought. Applications for permits, site plan approval, plats, and minor variances typically involve submission of a cover letter, site plan or plat, and an application fee. Applications for major variances and rezoning may additionally require submission of certain title documents, traffic studies, landscape plans, or building specifications. Most municipalities also require a preapplication conference with planning staff to review these larger projects and ensure the application package is complete.

Review, Notice, and Hearing

For most entitlements, the application is reviewed by municipal staff and forwarded to the planning commission for review. Applicants generally must post notice at the property and provide notice by certified mail to adjacent property owners before the planning commission review. Some municipalities also require a neighborhood meeting for significant entitlements. The planning commission will then make either a final decision (for minor entitlements) or a recommendation to be forwarded to the city council for final approval or denial (for major entitlements).

Any member of the public may comment at any stage during the process by sending a letter to the municipality or by appearing at the planning commission or city council meeting.

Variances

Municipalities often have a different process for variances. Planning staff may approve very minor variance requests, but more significant variance requests typically run through a separate board of zoning adjustments after review by the municipal planning staff. Decisions of the board of zoning adjustments are final, although they can be appealed.

4.4 Right of Appeal against an Authority's Decision

Final decisions from municipalities may be appealed to circuit court. The appeal must include specific certified records and be filed within 30 days of the municipality's final decision. The intricate procedural rules require strict compliance.

The standard of review at the circuit court falls into one of two categories. The first category involves decisions by the municipality that are legislative in nature. These include rezoning decisions, recognition of new permissible uses under a zoning code, and any other amendments to the zoning code. These appeals are rarely successful because a municipality is held to an "arbitrary and capricious" standard, which essentially means that the court will defer to the municipality's decision absent some overwhelming reason.

The second category involves decisions by the municipality that are administrative in nature. These include permitting decisions, site plan review decisions, and any other simple applications of the zoning code to the facts. The court here will review the case on a de novo basis, which means it will substitute its judgment for that of the municipality. These appeals have a better chance at success.

4.5 Agreements with Local or Governmental Authorities

Typically, the rezoning process requires a developer to donate right-of-way and utilities to a municipality as part of the approval process.

Arkansas does not recognize transferable development rights. Additionally, while Arkansas recognizes tax increment financing, such projects are uncommon because of state restrictions on the use of certain property tax revenues.

4.6 Enforcement of Restrictions on Development and Designated Use

Municipalities may deny municipal services to a rogue developer and sue for an injunction to stop a development when city approval has not been sought. Most municipalities may also revoke existing building permits and any other entitlement-related permits for noncompliance. Finally, municipalities may levy fines, file lis pendens, or make claims under certain security bonds required to be filed by developers and contractors.

Private restrictions (ie, restrictive covenants and bills of assurances) may be enforced at law or in equity under the principles of general property and contract law.

5. INVESTMENT VEHICLES

5.1 Types of Entities Available to Investors to Hold Real Estate Assets

Arkansas recognizes the following typical entities available to investors:

- limited liability companies (including the "series" variant);
- corporations;
- general partnerships (including the limited liability variant); and
- limited partnerships (including the limited liability variant).

5.2 Main Features of the Constitution of Each Type of Entity

Limited Liability Companies

LLCs are distinct legal entities owned by members, managed by either members or managers, and governed by an operating agreement. LLCs are the most used entity to invest in real estate because they have the most flexible structure. They have minimal corporate formalities and few mandatory statutory rules. The series LLC variant allows users to segregate assets into quasi-separate entities within the LLC.

Arkansas adopted the Uniform Limited Liability Company Act, Revised (ULLCA), in 2021. It will be codified at Ark. Code Ann. § 4-38-101 et seq.

As of September 1, 2021, all Arkansas LLCs (both currently existing and thereafter created) will be subject to the ULLCA.

Corporations

Corporations are distinct legal entities owned by shareholders, managed by a board of directors, and governed by bylaws. Corporations are subject to extensive formalities. Corporations provide broader liability limitations than other entities, but they are less common than LLCs in real estate transactions because of their double taxation.

Arkansas has two corporation acts currently in effect. All corporations formed today are governed by the Arkansas Business Corporation Act of 1987, codified at Arkansas Code Annotated Sections 4-27-101 to 1908. This act is an enactment of the Model Business Corporation Act; thus, Arkansas corporation laws largely match the prevailing laws across the country.

General Partnerships

At its most basic level, a general partnership is an association among individuals to carry on a business for profit. Because the general partnership at common law was not an entity distinct from the partners, all partners were fully liable for all obligations of the partnership. Additionally, general partnerships required no filing with the state. The Uniform Partnership Act of 1997 (UPA) changed the common law to recognize general partnerships as distinct entities; however, partner liability is unchanged, and filing is still not required. Arkansas has adopted the UPA governing general partnerships.

General partnerships are older and rarely used, except in legacy situations where an entity predates the more efficient LLC structure, which only became common in the 1990s. General partnerships are sometimes preferred over LLCs and corporations because general partnerships are not subject to franchise taxes, while LLCs and corporations are. The Arkansas franchise tax is so low, however, to render this difference immaterial.

Arkansas also recognizes limited liability partnerships (LLPs), which have a general partnership structure with limited liability for all partners.

LLPs must file with the state to receive the limited liability protection. Because LLPs encompass most general partnership benefits without personal liability of the partners, LLPs are more common than general partnerships.

Limited Partnerships

Limited partnerships (LPs) are similar to general partnerships, except LPs must have at least one general partner and at least one limited partner. The limited partners are not liable for the obligations of the partnership; however, the limited partners generally have little say in the management of the business. Unlike general partnerships, LPs must file with the state to receive the special LP status. Arkansas has adopted the Revised Uniform Limited Partnership Act.

Arkansas also recognizes the limited liability version of a limited partnership, the limited liability limited partnership (LLLP). The LLLP is identical to an LLP except for the existence of limited partners in an LLLP.

Special Tax Entities

Real estate investment trusts (REITs)

REITs are corporations that may limit taxation on the entity level and instead pass the tax through to individual investors. The Internal Revenue Code determines the REIT requirements, and Arkansas has incorporated the federal requirements into its own income tax rules.

To qualify as a REIT, a corporation must meet the following requirements:

- distribute at least 90% of its income to shareholders each year;
- be managed by a board of directors or trustees;
- have fully transferrable shares;
- have a minimum of 100 shareholders after its first year;
- have no more than 50% of its shares held by five or fewer individuals during the last half of the year;
- invest at least 75% of its assets in real estate and cash; and
- derive at least 75% of its income from real estate.

Any retained income will be taxed at corporate rates, so REITs typically distribute all income to shareholders as dividends each year. REIT dividends are often subject to ordinary tax rates rather than preferable capital gains rates, which offsets some of the tax savings at the entity level.

S-corporations

Like REITS, s-corporations are not state business entities but are instead determined by a federal tax election. The s-corporation election allows certain small businesses to receive pass-through taxation.

To qualify as an s-corporation, the company must be a corporation or, alternatively, an LLC or partnership which has elected to be taxed as a corporation. The company may not be a bank or insurance company. The company must also meet the following requirements:

- all shareholders are US citizens or residents;
- all shareholders are individuals, estates, or certain trusts;
- no more than 100 shareholders;
- no more than one class of stock;
- profits and losses are allocated in proportion to each shareholder's ownership interest; and
- all shareholders consent to the election.

S-corporation status is superior to traditional c-corporation tax status, as the s-corporation status avoids the entity-level tax. S-corporation status is also preferred by certain LLCs with members wishing to reduce self-employment taxes. Most real estate investors, however, prefer LLCs over s-corporations because LLCs are more flexible.

5.3 Tax Benefits and Costs

For federal tax purposes, most entities besides corporations can elect to be treated as disregarded, partnerships, or corporations. Corporations must be taxed as corporations. Entities are classified for Arkansas income tax purposes in the same manner they are classified for federal tax purposes.

Disregarded Entity Classification

Entities classified as disregarded for federal income tax purposes typically have the same tax benefits and costs as if the investor owned the property in his/her/its individual capacity. Most single-member real estate investors select this classification to avoid taxation at the entity level.

Partnership Classification

Generally, multi-party real estate investors prefer the partnership tax classification. The federal income tax benefits of such a classification include the ability to:

- deduct distributive share of losses against the investor's share of partnership liabilities; and
- generally receive a distribution in-kind of the investor's pro rata share of the real estate owned by the partnership in a non-recognition, or deferral, transaction.

Entities classified as a partnership for federal income tax purposes may also afford more flexibility. For example, the partnership agreement or operating agreement may generally provide for special allocations of tax items and/or the grant of a carried interest to the real estate fund manager (or general partner) or a person who renders services to the entity.

Corporation Classification

Most real estate investors do not elect to be taxed as traditional corporations or s-corporations. Investors who transfer the real estate out of the entity usually must recognize a deemed sale, resulting in entity-level gain to the extent the fair market value of the property exceeds the entity's adjusted basis.

Franchise Taxes

In addition to the above benefits and costs, Arkansas imposes franchise taxes on entities domiciled within the state and on foreign entities registered to transact business within the state. The rates are as follows:

- LLCs – USD150;
- corporations with authorized stock – 0.3% of the par value of the issued and outstanding capital stock, pro-rated based on the value of the corporation's assets in Arkansas divided by the corporation's total assets (minimum tax of USD150);
- corporations without authorized stock – USD300; and
- partnerships – none.

5.4 Applicable Governance Requirements

Limited liability companies have minimal corporate formalities and extensive abilities to establish custom governance requirements. Partnerships have flexibility in the governance structure but are subject to more formalities. Corporations, particularly c-corporations, are the most rigid in terms of formality.

For further details of the governance requirements for each entity, see **5.2 Main Features of the Constitution of Each Type of Entity**.

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6. COMMERCIAL LEASES

6.1 Types of Arrangements Allowing the Use of Real Estate for a Limited Period of Time

The most common method the law recognizes for the temporary use of real estate is a lease. Leases are a recognized interest in real estate and grant a tenant the right to use the real estate for a certain amount of time. Leases must be in writing if the term is longer than one year.

Other less common temporary arrangements include a life estate or a license. A life estate grants the life tenant full use of the real estate and automatically terminates at the death of the life tenant or of another party. Life estates must be in writing. Conversely, a license is typically terminable at will and is normally used for very short-term arrangements. Licenses convey no recognized interest in real estate and thus need not be in writing.

Though they are not necessarily limited in time, easement agreements grant a holder the right to limited use or enjoyment of another's real estate. Most easements are appurtenant, allowing the holder to use a portion of the servient property in order to benefit the holder in the use or enjoyment of the holder's own property. Other easements are in gross, allowing the holder to utilize the servient property for some purpose unrelated to the use of the holder's own property. For example, access easements are a common form of appurtenant easement, while utility easements are a common form of an easement in gross.

6.2 Types of Commercial Leases

Term of Years

Commercial leases are almost always for a term of years, ending automatically on a certain date unless the parties have negotiated renewal terms (which most commercial tenants typically do). These leases must be in writing if the term is longer than one year.

Leases for a term of years can further be broken down into traditional leases and ground leases. The principal differences are the length and the amount of the tenant's control. Traditional leases are typically shorter, and a landlord retains control over uses and maintenance.

In ground leases, the tenant has almost the same control and responsibilities as the owner. Tenants in ground leases often construct the building themselves. Ground leases are typically "triple net," in which the tenant will pay all taxes, insurance, and maintenance on the real estate during the term. Ground leases are long, with 20 years usually being the minimum duration.

Periodic

Commercial leases are occasionally periodic, whereby the lease continues indefinitely for successive intervals until one party terminates. These leases need only be in writing if the periodic interval is longer than one year.

6.3 Regulation of Rents or Lease Terms

Arkansas does not control rents or lease terms for commercial leases.

6.4 Typical Terms of a Lease

The length of a lease term is highly variable. For commercial leases, though, a common duration is ten years, with the option to renew for an additional ten years.

The frequency of rent payments is negotiable, though monthly is the most common.

If the lease is silent as to duration, Arkansas common law presumes a periodic tenancy based on the frequently of rental payments (ie, annual payments create a year-to-year lease; monthly payments create a month-to-month lease).

The maintenance and repair of real property is also highly negotiable. Most commonly, a landlord will maintain the common areas, the building envelope, and the structural systems, and a tenant will maintain everything else. If the lease is silent, the default is that the tenant is responsible for maintenance.

6.5 Rent Variation

Whether a rent amount will stay the same for the duration of a lease is negotiable, but the amount usually increases periodically throughout the lease. The amount usually increases by a fixed percentage or is tied to the inflation rate.

6.6 Determination of Changes in Rent

If rent is to be changed, how it is done is negotiable. Most commonly, rent goes up by a fixed amount, a fixed percentage, or the rate of inflation.

6.7 Payment of VAT

Arkansas does not have a value-added tax (VAT) or other levy on rent. However, a landlord is subject to ordinary income taxes.

6.8 Costs Payable by Tenant at the Start of a Lease

At the start of a lease, tenants usually pay a deposit equal to the first month's rent, plus a prepayment of the first month's rent and common area maintenance charges.

Capital improvements may be paid by the tenant, but in most cases the landlord will contribute some amount towards the cost of improvements. The landlord may also pay for the entire amount of the cost of improvements at the time such improvements are made, with the portion to be paid by the tenant repaid to the landlord over the term of the lease.

6.9 Payment for Maintenance and Repair

Tenants typically pay for the maintenance and repair of the leased premises. Common area maintenance and repair, on the other hand, is more negotiable. Most leases require a tenant to reimburse the landlord for the tenant's pro rata share of the cost to maintain the common areas.

6.10 Payment for Services, Utilities and Telecommunications

Utilities and telecommunications services can generally be separately metered and paid for directly by a tenant. If the services cannot be separately metered, the tenant will pay its pro rata share.

6.11 Insuring Real Estate That Is the Subject of a Lease

Typically, a landlord carries insurance on a building and its common areas while a tenant insures the interior of the premises and the tenant's personal property. The tenant usually reimburses the landlord for its pro rata share of the landlord's insurance, which typically covers damage from fires, storms, and other casualties.

6.12 Restrictions on the Use of Real Estate

A landlord can impose restrictions on a tenant's use of a real estate. Typically, the landlord will restrict the use to one permitted activity, such as running a restaurant. The law does not impose further restrictions as long as the use complies with applicable zoning restrictions.

6.13 Tenant's Ability to Alter or Improve Real Estate

Typically, a tenant is only permitted to modify the interior of a premises. Most landlords also want the right to review and approve the plans in advance.

6.14 Specific Regulations

Residential leases are subject to the detailed provisions of the Arkansas Residential Landlord-Tenant Act of 2007. Commercial leases, however, are largely subject to common law and the terms of the lease contract itself.

6.15 Effect of Tenant's Insolvency

Standard federal bankruptcy laws apply in the event of a tenant's insolvency. The bankruptcy court may permit the tenant to terminate the lease.

6.16 Forms of Security to Protect against Tenant's Failure to Meet Obligations

The most common types of security are security deposits, usually in the amount of one month's rent, and/or personal guaranties from the individual owners of the entity tenant.

6.17 Right to Occupy after Termination or Expiration of Lease

A tenant does not have the right to continue to occupy real estate after the expiry of a lease. A tenant may be evicted through one of several means, but the most common method is to file an unlawful detainer suit against the tenant, which is described in more detail below.

6.18 Right to Terminate Lease

Any failure of a tenant to abide by the terms of a lease agreement can trigger the right to terminate the lease. The most common event is the tenant's failure to pay rent.

6.19 Forced Eviction

A tenant who is in default can be forced to vacate, with the most common method being a suit for unlawful detainer, where the tenant must be given a warning letter three days before filing suit. After the suit is filed and the tenant is served, the tenant has five days to answer the lawsuit. The landlord is entitled to a writ of possession if the tenant does not appropriately answer the lawsuit within the five-day period. The sheriff will assist with the eviction after the courts issue a writ of possession.

From a timing perspective, usually the hardest part is serving the tenant with the lawsuit. If the landlord can promptly serve the tenant, and the tenant does not contest the eviction, the tenant can usually be removed within two weeks.

6.20 Termination by Third Party

There are two circumstances where the government may terminate a lease:

- if the government takes the leased premises for a public purpose; or
- if the government enjoins the use of the leased premises because of a violation of the law, such as failure to pay taxes or operating an illegal business.

In the case of taking leased premises for a public purpose, the government must pay just compensation for the taking. The government will offer an amount that it considers fair, but the tenant and landlord may challenge the amount in court and allow a jury to decide what is fair. The landlord usually receives the entire amount for the value of the premises, while the tenant usually just receives the cost of relocating.

A lender may be able to terminate a lease if it becomes the owner of the premises (ie, landlord/borrower default results in a foreclosure by the lender, or acceptance of the premises by the lender pursuant to a deed in lieu of foreclosure). While the ultimate result depends on the facts of each situation, a lender is able to foreclose the leasehold interest upon foreclosure of the property. Alternatively, when taking title to a property by a deed in lieu of foreclosure, generally the lender takes title subject to existing leasehold interests.

In many situations, lenders, tenants, and landlords will enter into subordination, nondisturbance, and attornment agreements to govern the rights of the respective parties in the event a lender assumes possession of the premises after a landlord default.

7. CONSTRUCTION

7.1 Common Structures Used to Price Construction Projects

Construction contracts allocate price in a number of ways but generally follow one of three pricing schemes:

- fixed amount (or lump sum price);
- cost-plus a fee (general cost plus a percentage of the cost of the work); or
- cost-plus with a guaranteed maximum price (GMP).

These pricing concepts are project-dependent and address the applicable risk allocation and considerations related to:

- compensable costs;
- whether additional work is subject to compensation;
- who obtains the benefit of cost savings;
- any rights to audit the other parties' records; and
- situations that call for increases to the compensable costs of the work.

7.2 Assigning Responsibility for the Design and Construction of a Project

Construction projects allocate responsibilities in a variety of manners, depending on the type and complexity of the project. Generally, the contract terms should specify any responsibilities and contractual obligations between the owner, architect, contractor and any subcontractors. Of note, design-bid-build contracts (where an owner has already commissioned the design of a project prior to a contractor providing a price and executing the contract) have become more common in recent years, allocating the responsibility to design the project to the design-build contractor, whereby the project is substantially more undefined at the time the initial contract is entered into.

7.3 Management of Construction Risk

Common devices used to manage risk on a construction project are warranties and indemnifications.

Express Warranty

As a general rule, an express warranty excludes any implied warranty with respect to residential projects, but only if the contractual provision expressly covers the standards of workmanship. However, in order for an express warranty to exclude the implied warranties of habitability, sound workmanship and proper construction, the express warranty must expressly warrant the same.

Express Indemnity

Express indemnity arises by virtue of a contract and holds one liable for the acts or omissions of another over whom he has no control. Arkansas courts have held that the language imposing indemnity must be clear, unequivocal and certain. While no particular words are required, given that the liability of an indemnitor for the negligence of an indemnitee is an extraordinary obligation to assume, a court will not impose it unless the purpose to do so is spelled out in unmistakable terms.

Implied Indemnity

An implied indemnity agreement will only arise when there is a special relationship carrying with it a duty to indemnify, such as an employment versus independent contractor relationship. A party can be a third-party beneficiary to an indemnity agreement. However, a contract, including an indemnification agreement, will not be construed as having been made for the benefit of third parties unless it clearly appears that this was the intention of the parties.

Ultimately, these risk-management options should be specifically noted in the contract so as to ensure enforceability if any future issues arise. Both contractors and owners should be sure to obtain any liability insurance to protect against risk as well.

7.4 Management of Schedule-Related Risk

Delays on a project can occur for a variety of reasons. Depending on the cause, and if the delay is excusable or non-excusable, owners can seek compensation for any non-excusable delay on the part of a contractor. Missed deadlines can delay the start of revenues generated by a completed project and can result in losses such as lost profits, extended oversight costs, and the extended cost of professional time and services arising from the delay. Generally, compensable delay is based on the implied contractual obligation not to unreasonably hinder the performance of another party.

Incentives for completion ahead of schedule or achieving cost savings on a contract may be included in a construction contract. Such incentives are subject to negotiation between the parties.

7.5 Additional Forms of Security to Guarantee a Contractor's Performance

Depending on the cost of a project and an owner's relationship with a contractor, owners often seek other forms of security to guarantee a performance under a construction project, particularly with larger commercial projects. Letters of credit and personal guarantees are common on larger commercial projects or costly residential ones.

In order to protect against liens, owners often require the contractor to pay a bond. Payment bonds can substitute for any materialmen's lien filed. While a payment bond does not preclude the filing of a lien, it lessens the effects.

7.6 Liens or Encumbrances in the Event of Non-payment

Under Arkansas's construction lien laws, contractors, subcontractors, material suppliers, architects, engineers, surveyors, appraisers, landscapers and title insurance agents are entitled to materialmen's liens on a project. A construction lien cannot exist in Arkansas without a valid contract with the property owner, whether express or implied through the conduct of the parties. In Arkansas, there are distinct notice requirements that must be satisfied before a lien claimant can assert a lien, which vary, depending on whether the project is commercial or residential. These requirements must be strictly followed in order to obtain a valid materialmen's lien.

Actions to enforce the lien must be commenced within 15 months of filing the lien with the circuit clerk. If no action is taken on the lien by that time, it ceases to exist. In suits to foreclose construction liens, the contractor is a necessary party and must be made a party within the period provided in the act for the enforcement of such liens. Failure to do so results in dismissal of the lien action.

All construction liens have equal priority regardless of the date of filing of the account or lien, or the date when the labor or material was performed or furnished. With respect to priority against other encumbrances, construction liens date from the time the construction or repair first commenced.

In order to have a construction lien discharged prior to the entry of a final judgment, the owner of the property, any mortgagee or other person having an interest in the property, or any contractor, subcontractor or other person liable for the payment of the construction lien may file a bond with surety, in the amount of the lien claimed, with the circuit clerk or other officer with whom the lien is filed as required by law. Alternatively, a person desiring to contest a lien may bring an action pursuant to the statute, but the issues in the action will be limited to whether the lien was filed in the form required and whether all applicable notice requirements were satisfied. The lien may also be contested by declaratory judgment proceedings.

7.7 Requirements before Use or Inhabitation

Generally, prior to occupancy or use, local law requires certain obligations to be met, such as the issuance of a certificate of occupancy or the equivalent, and other inspection certificates. Insurance may also require certain conditions to be met prior to obtaining full coverage. The contractor can and often does make these local government requirements part of a construction agreement to protect against potential defective construction claims prior to completion of the project.

8. TAX

8.1 Sale or Purchase of Corporate Real Estate

Federal Taxation

The sale of corporate real estate is generally subject to federal income taxation. The federal income tax is payable by a seller (or in certain situations the owners of the seller) of the corporate real estate. The applicable rate will vary, generally depending on the federal tax classification of the seller, how long the seller has held the real estate, and the seller's use of the real estate (for instance, stock in trade, use in a trade or business, held for investment, allowable depreciation, etc).

If a seller of corporate real estate is classified as a disregarded entity or a partnership for federal income tax purposes, the applicable federal marginal rates will generally range between 10% and 37% for 2021, depending on the taxpayer's taxable income (note that the net investment income tax – imposed at a rate of 3.80% – and the alternative minimum tax may also apply).

Similarly, if a seller of corporate real estate is classified as an S-corporation, the applicable marginal rates will also generally range between 10% and 37% for 2021, depending on the shareholder's taxable income (as noted above, the net investment income tax and the alternative minimum tax may also apply). Certain rules applicable to S-corporations formerly classified as C-corporations for federal tax purposes can also affect the level at which the tax is paid (ie, the shareholder level or the entity level) and thus the applicable rate. The applicable rate with respect to a seller of corporate real estate classified for federal income tax purposes as a C-corporation is currently a flat 21%, but the Biden administration's tax plan would raise the applicable rate to 28%.

There are no exemptions to the federal income taxation resulting from the sale of corporate real estate. However, certain non-recognition, or deferral, provisions may be applicable (eg, IRC Sections 1031; 1033; 1400Z-2).

State Taxation

Consistency with federal law

Arkansas imposes a state income tax that generally adheres to the federal income tax law. Accordingly, the sale of corporate real estate by an Arkansas resident is generally subject to Arkansas income taxation, as is the sale of corporate real estate when the seller's business is carried on in Arkansas or when the corporate real estate is located in Arkansas. Arkansas income tax is payable by a seller (or in certain situations the owners of the seller) of the corporate real estate.

Similar to the federal tax law, Arkansas provides that taxpayers are not required to recognize gain from the sale of corporate real estate in certain situations. For example, Arkansas has adopted Code Section 1033, relating to gain resulting from involuntary conversions, and Code Section 1400Z-2, providing income tax incentives for investments in Arkansas qualified opportunity zones. Although Arkansas has not adopted Code Section 1031, it follows the general principle that gain from the exchange of property for like-kind property of a similar value is not recognized.

Arkansas has adopted Subchapter S of the IRC, and entities electing S-corporation treatment for federal purposes are deemed to have elected the same for Arkansas. These entities will generally pay tax on the S-corporation items of income, gain, loss and deduction at the shareholder level. Certain rules applicable to S-corporations formerly classified as c-corporations for Arkansas income tax purposes can affect the level at which the tax is paid (the shareholder level vs the entity level) and thus the applicable rate.

Provisions particular to Arkansas

In Arkansas, only 50% of a "net capital gain" (as defined by the Internal Revenue Code) is taxed. Additionally, the total amount of net capital gains in excess of USD10 million is excluded.

Arkansas has not adopted the bonus depreciation rules introduced in the TCJA. Arkansas property owners must instead reconcile federal and Arkansas depreciation annually.

Arkansas has also recently passed a new entity tax, Act 362 of 2021, which allows pass-through entities (whose owners would normally be subject to the USD10,000 SALT deduction limit) to elect to pay Arkansas tax at the entity level at a flat rate of 5.9%.

State tax rates

The applicable tax rate will vary, generally depending on the tax classification of the seller, how long the seller has held the real estate, and the seller's use of the real estate. If a seller of corporate real estate is classified as a disregarded entity, partnership, or S-corporation for tax purposes, the applicable Arkansas marginal rate for the 2021 ranges from 0% and 5.9%, depending on the taxpayer's taxable income. If alternately the seller is not classified as a disregarded entity, partnership, or S-corporation for tax purposes, the marginal corporate rate for 2021 ranges from 1% to 6.20%, depending on the entity's taxable income.

Transfer tax

In addition to income tax on any gains, Arkansas also imposes a real property transfer tax at the rate of USD3.30 for each USD1,000 of the purchase price. By statute, the transfer tax is borne half by the seller and half by the purchaser. However, a seller and purchaser can agree to allocate the tax burden differently. Furthermore, certain real property transfers are exempt from the transfer tax (for a list of exempt real property transfers, see Arkansas Code Annotated Section 26-60-102).

Local Taxation

There are no local taxes imposed on the sale or purchase of corporate real estate.

8.2 Mitigation of Tax Liability

Structuring an acquisition transaction as a transfer exempt from real property transfer tax is the general method by which the Arkansas real property transfer tax is mitigated.

8.3 Municipal Taxes

Persons operating a trade, business, profession, vocation or calling within a city in Arkansas are generally required to obtain a business license from that city and pay an annual license fee. Any exemptions that exist would be on a city-by-city basis.

8.4 Income Tax Withholding for Foreign Investors

Subject to certain exceptions, upon a foreign seller's disposition of a US real property interest, the purchaser or recipient of the real estate is treated as a withholding agent and generally required to withhold a tax equal to 15% of the amount realized by the foreign seller upon the disposition. The purchaser or recipient of the real estate is responsible for determining whether the seller is a foreign person; if the seller is a foreign person and the purchaser or recipient of the real estate fails to withhold, the purchaser or recipient may be held liable for the tax.

8.5 Tax Benefits

Depreciation deductions are generally viewed as a tax benefit of owning real estate and, in some instances, the depreciation deductions may be accelerated by obtaining a cost segregation study with respect to the real estate. Furthermore, in certain cases all – or a portion of – the gain resulting from the disposition of the real estate may be subject to federal income taxation at the preferred capital gain rates. Additionally, recognition of the gain from the sale or exchange of real estate may, under certain circumstances, be deferred under Code Section 1031.

In some instances, the ownership of real estate may result in the owner of the real estate (or the owners of the entity holding the real estate if the entity is classified as a disregarded entity, partnership or s-corporation for federal income tax purposes) receiving a federal (and possibly state) tax credit, which will reduce the overall tax liability of the owner (or, if applicable, the owners of the entity holding the real estate).

8.6 Key Changes in Federal Tax Reform

See **1.3 Impact of New US Tax Law Changes**.

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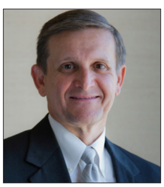

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Trends and Developments

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Introduction

Arkansas, like all states, spent most of 2020 fighting the COVID-19 pandemic and dealing with the resulting fallout. The virus impacted every facet of life, and the commercial real estate market was no exception.

COVID-19 in Arkansas

Arkansas was one of the few states to not have a full mandated governmental shutdown during 2020. Governor Asa Hutchinson instead chose to regulate specific industries where the risk of COVID-19 transmission was highest. Many cities in Arkansas issued stricter mandates than those issued state-wide, with some mayors declaring stay-at-home orders and others ordering city-wide curfews.

Governor Hutchinson closed schools, gymnasiums, indoor entertainment venues, casinos, and certain personal service providers such as massage parlors and salons for several months. He also limited restaurants and bars to takeout/delivery only. By summer, however, all business restrictions were relaxed or removed.

The Governor additionally ordered a state-wide mask mandate in July, which was lifted in April 2021. The state also prohibited indoor gatherings of more than ten people, eventually increasing the limit in some circumstances to 50. In April 2021, the Governor increased the limit to 100 people. All Arkansans aged 16 and up are eligible for the COVID-19 vaccine, and vaccination clinics are successfully operating throughout the state.

Real Estate Trends and Developments

Arkansas is poised to see new growth in the commercial real estate market in 2021 and onward. Overall, Arkansas's low population density, large rural regions, and extensive outdoor offerings make it a valuable location for businesses looking for safer and more spacious real estate in light of COVID-19.

The remainder of this article will discuss trends and developments in the following commercial real estate sectors: retail, hospitality, office, multifamily, and industrial.

Retail

The retail sector saw more uncertainty from the COVID-19 pandemic than any other sector except hospitality. The year-end vacancy rate for retail space in Arkansas was 16.9%, compared to a national vacancy rate of 5%. The average rental price in Arkansas is USD14.95 per square foot, compared to the national average of USD21.55 per square foot. (Unless otherwise specified, all vacancy rates and average rental rates referred to in this article come from the 2020 Central Arkansas Market Reports and the 2020 US Market Outlook Reports published by Colliers International.)

In light of the pandemic, demand is decreasing for many types of businesses and their accompanying retail space, including big box stores and non-essential goods and services. While small "mom and pop" shops were generally the first to close or file bankruptcy, national retailers are following. Conversely, demand has stayed consistent (and, in some cases, increased) for essential services, including automotive sales and care, grocery, banking, medical, and pharmacy.

The retail sector will see changes going forward. Landlords and investors will look for creative ways to fill big box spaces as stores close their doors, which bodes well for industrial tenants. Additionally, many retailers will continue to integrate digital technology and contactless shopping experiences into their day-to-day business model.

Overall, there are expected to be increased vacancies into 2021 as retailers continue to shift to online or close permanently. Increases in vacancies will create a market favorable to tenants, who will have an abundant supply of retail space and will have negotiating power for advantageous lease terms.

Hospitality

Like the retail sector, the hospitality sector was hit hard by the pandemic. According to the National Association of Realtors, about 40% of the job losses in 2020 were in the leisure and hospitality industry. Arkansas' major tourism areas likewise saw a drop in business; for example, Fayetteville and Bentonville saw a 19% year-over-year decrease in tourism tax revenue, Little Rock saw a 22% decrease, and Hot Springs saw an 11% decrease, according to Arkansas Business. Even as certain hospitality subsectors like restaurants have started picking back up, demand for hotels, travel, and event planning has remained low.

Restaurants perfecting curbside ordering, drive-thrus, and delivery orders fared best during 2020. Going forward, restaurants will continue to consider drive-thrus and strategically placed parking for curbside service a vital part of any space. Sit-down restaurants will likely integrate outdoor eating areas into their seating plan when possible. Finally, demand will continue to increase for fast-food and fast-casual restaurants as eating "to-go" becomes more and more a way of life.

Prospects for 2021 are better but still not great, with a continued decline in business travel off-setting increasing leisure travel. Cities are hoping to see the business travel rebound in 2022 and 2023, helping the hospitality industry to get back on track.

Arkansas' nickname, "The Natural State," has served it well during the pandemic. As people took to the outdoors in 2020, Arkansas's lakes, mountains, parks, and trails provided a beautiful backdrop for gatherings, exercise, eating, and leisure. This trend is expected to continue into 2021 as individuals select outdoor-related options for their weekend getaways.

Office

The office sector was not hit as hard as the hospitality and retail sectors, though its future is still uncertain. The year-end vacancy rate for office space in Arkansas was 18.1%, compared to a national vacancy rate of 13.2%. The average rental price for office space in Arkansas is USD15.35 per square foot, compared to the national average of USD41.79 per square foot.

Demand is decreasing for downtown office spaces. Many companies are looking instead to low-rise buildings in suburban areas with less shared space and additional private offices. However, other companies have found lower costs and higher productivity in working from home (WFH) and therefore plan to make WFH a standard company policy. Needing less traditional office space going forward, these WFH companies will likely counteract the increase in demand for larger suburban spaces.

Overall, in contrast to retail tenants, office tenants have mostly kept their existing spaces while determining what the future will look like for their

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company (ie, whether certain employees will be WFH permanently or whether a move to a larger space with additional private offices is necessary, etc). Companies entering into new leases or lease renewals in 2020 generally negotiated for shorter lease terms in light of uncertainty about the future, and this trend of shorter leases is expected to continue. This market sector will likely see more movement in 2021 as the pandemic slows down and companies settle into their new normal.

Multifamily

Somewhat surprisingly, demand for multifamily units has stayed strong despite the focus on social distancing and despite WFH employees' desire for more spacious home offices. According to data collected by ApartmentList.com, while average rent prices decreased by 1.3% nationally during 2020, the average prices in Arkansas increased by 3.4%. At the end of 2020, the average rent price for a two-bedroom apartment in Arkansas was USD764, compared to USD1,091 nationally.

Arkansas is seeing the benefits of having a relatively low population density, as many individuals are moving away from crowded gateway markets in search of more space and lower rent prices. Like many secondary markets around the country, the central and northwest Arkansas regions are growing in population.

Likewise, the residential single-family market has boomed. The single-family home market ramped up over the summer and stayed hot throughout the second half of 2020, largely due to lower interest rates and the renewed focus on homes as a place of employment, socialization, and school during the pandemic. The market slowed in early 2021 due to a supply shortage of single-family homes, most homes having been bought up in 2020 and few new homes being built due to the increased cost of materials. The higher demand for apartments in Arkansas, then, is likely explained by both the increasing population and the difficulty of finding single-family homes.

Multifamily real estate is generally divided into Class A (newest and top of the line), Class B (older but well maintained), and Class C (oldest and generally in less desirable locations). Of the three classes, Class B multifamily units are performing most strongly in Arkansas. Class B units provide a less-expensive option for former Class A tenants and provide more stability for landlords than Class C buildings, where tenants experience more frequent job loss. However, Classes A and C will likely revitalize in 2021 and onward as financial prospects stabilize for tenants.

Evictions in Arkansas continue to be challenging. First, the CDC national moratorium on evictions for non-payment of rent has been extended until June 30, 2021. Additionally, many courts are still hearing fewer cases than normal, and eviction dockets are low in priority for courts with overloaded schedules. With eviction an unlikely prospect, landlords have generally been willing to work with tenants on rent abatements and delayed payment. However, landlords will likely resume regular collection efforts as the courts resume normal proceedings in mid- to late 2021.

Industrial

The industrial sector was at an all-time high in Arkansas last year. Simply put, all products purchased online must still be assembled, stored, and shipped in a physical space. As e-commerce and demand for essential goods were booming in 2020, retailers struggled with slow overseas shipping times. In response, retailers aimed to increase their safety stock and have therefore needed more warehousing and storage space. This practice of expanded safety stock (and the accompanying need for more storage space) is expected to continue into 2021.

The year-end vacancy rate for industrial space in Arkansas was 10.2%, compared to a national vacancy rate of 5.4%. The average rental price in Arkansas is USD5.36 per square foot, compared to the national average of USD6.38 per square foot.

While the vacancy rate increased slightly during 2020, this was largely because the existing spaces were not satisfactory to companies needing specialized spaces. Companies needing specialized space have instead started new construction, which is ongoing into 2021.

The industrial sector's success should bode well for rural parts of Arkansas, which offer lower costs and more space. Additionally, the continued importance of final mile delivery systems will probably lead to increased investment in warehousing and storage spaces in rural Arkansas.

Conclusion

Overall, the real estate market will likely see an increasing demand for flex space – space allowing for warehousing, storage, and service – going into 2021 and beyond. Tenants will likely have more bargaining power with landlords who have vacant spaces in the available supply. Short-term leases, as opposed to long-term, may also become a new norm.

Moving forward, the Arkansas market looks strong. Arkansas is well suited to the changing landscape of commercial real estate, as demand across several sectors for buildings with spacious layouts in suburban areas continues to increase.

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