

MARK-TO-MARKET ACCOUNTING RULES IMPACT BANKS

Some experts believe that “mark-to-market” accounting rules have forced banks to take steep write-downs on performing assets such as commercial mortgage-backed securities (CMBS), exacerbating the liquidity crisis. These rules have been improperly forcing banks to report billions in losses due to temporary conditions, which have made banks tighten their credit standards and reduce their loan volume for real estate lending.

On April 2, 2009, the Financial Accounting Standards Board (FASB) passed a proposal to relax current mark-to-market accounting rules by giving companies more leeway when valuing assets, a step that could encourage banks to trade their distressed assets more freely and thereby encourage greater lending activity to stimulate the commercial real estate industry. FASB will now allow companies to use their judgment to a greater extent in determining the “fair value” of their assets.

Despite FASB’s encouraging rule change, other new accounting changes have created uncertainty and concern amongst businesses, banks and real estate investors. On June 12, 2009, FASB adopted FAS 166 and FAS 167, which will take effect for most firms on January 1, 2010.

Under FAS 166, companies will be required to bring off-balance sheet assets such as CMBS onto their own balance sheets, potentially forcing banks to raise billions of dollars in new capital and further reducing the amount of lending in an already dried up credit market. Specifically, this rule change calls for the elimination of the concept of a “qualified special purpose entity” (QSPE), which allowed banks to securitize commercial real estate loans and to keep these investments off their balance sheets.

According to the *Journal of Accountancy*, FAS 167 will change “how a company determines when an entity that is insufficiently capitalized or not controlled through voting (or similar rights) should be consolidated. The determination is based on, among other things, an entity’s purpose and design, and a company’s ability to direct the activities of the entity that most significantly affects the entity’s economic performance.”

Both FAS 166 and FAS 167 accounting standards could force costly changes for many banks and firms, creating a significant setback to the revival of the CMBS market as well as the revitalization of commercial real estate liquidity.

New Provisions Protect Tenants Who Rent Foreclosed Properties

New legislation—S. 896, the “Helping Families Save Their Homes Act of 2009,” includes provisions to protect tenants from eviction as a consequence of a foreclosure affecting the property being rented. For example, many families living in rental housing throughout the United States were previously getting evicted without any prior notice when the home was foreclosed upon. Much of the time, the rental family had no idea the home was in delinquency or subject to foreclosure until their eviction occurred.

Under the new law, which went into effect in May 2009, tenants must receive 90-days notice prior to being evicted when their rental home is foreclosed upon. In addition, tenants must be allowed to stay in the property through the end of their lease, with two exceptions:

- The new owner wants to occupy the property as a personal residence.
- There is no lease (tenant lives month-to-month), or

there is a lease but state law allows the lease to be terminated at any time upon notice.

Notification must be provided by the “immediate successor in interest.” In some cases, this notification will come from the bank (when they assume the home), and in other cases, it may come from the new owner. A number of states have existing laws protecting tenants. This law will pre-empt existing state law, except where the state law offers greater protection. The protections of this law apply only to “bona fide” tenants, e.g., those who have a contract; those whose lease was the result of an arms-length transaction; and the rent for the property is not substantially less than the fair market rent. Under any conditions, tenants may still be evicted if they violate the lease terms. These provisions expire on December 31, 2012. HUD recently issued a notice that provides an overview of these tenant protection provisions and outlines the basic guidelines of the program.



TALF AIMS TO REPAIR CREDIT CRISIS

In June 2009, responding to the growing credit crisis, the Federal Reserve officially launched the Term Asset-Backed Securities Loan Facility (TALF) to include commercial mortgage-backed securities (CMBS). This program was also expanded to include loans with five-year maturities to help investors finance the purchase of AAA-rated CMBS. Extending TALF to include five-year loans accommodates the longer-term nature of commercial real estate loans because property owners typically take out loans of five, seven or 10 years and refinance the big principle payments necessary when the loans come due.

S&P's expected downgrades complicate the government's TALF program to make financing more available for commercial real estate. Under the current guidelines of TALE, only AAA-rated CMBS are eligible for this program. However, many believe that the federal government will expand TALF guidelines to include loans that were initially AAA-rated, regardless of their current ratings.

In mid-August 2009, the Federal Reserve System and Department of the Treasury announced a six-month extension of TALE, prompted by worries over the meltdown in commercial real estate. The original sunset date of December 31, 2009 was extended to June 30, 2010 for newly issued commercial mortgage-backed securities (CMBS) and to March 31, 2010 for other asset-backed securities and CMBS sold before January 1, 2009, also known as "legacy CMBS."

Last January 2009, IREM adopted a statement of policy urging Congress and the federal government to provide favorable relief to the commercial real estate industry in order to stabilize and provide liquidity to the commercial real estate credit markets. And to help achieve this goal, the IREM policy statement specifically called for the Federal Reserve and the Treasury to exercise their authority to implement and/or expand TALF and encourage its purchase of CMBS and conventional commercial real estate loans.

As reported in *TheDeal.com*, an online resource for corporate and financial dealmakers, TALF has a \$1 trillion capacity to lend to investors in order to purchase new asset-backed securities in consumer and commercial real estate debt. It quotes a Fed statement, as follows: "Conditions in financial markets have improved considerably in recent months, nonetheless, the markets for asset-backed securities (ABS) backed by consumer and business loans, and for commercial mortgage-backed securities (CMBS), are still impaired."



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