

Covered Bonds Update – June, 2011

On June 22, 2011 the House of Representatives Financial Services Committee approved the Covered Bonds bill. The legislation intends to establish a regulatory framework for covered bonds which are securities issued by banks and backed by pools of loans. Several economists now believe that covered bonds in the United States have the potential to supplement securitization and to form part of a well-diversified liquidity management program for financial institutions and other issuers. Covered bonds allow banks to raise funds by selling bonds to investors. The bond is backed by the collateral of the asset and the banks contract to repay. Investors like covered bonds because the investor has recourse against both the financial institution who issued the bond and the assets that back the bond. Therefore, banks who issue bonds have a stake in assuring the long-term viability of the mortgages underlying the bond.

IREM members took this issue to the Capitol Hill Visit Day on April 13, 2011, emphasizing the importance of a covered bond market in the United States. The bill passed out of committee with a bipartisan vote of 44-7.

Three amendments to the bill were passed. Please see below for a synopsis of the amendments and how they impact real estate practitioners.

Maloney Amendment (Passed by voice vote)

Extends the time period the FDIC has to sell off a covered bond program after a bank fails, from 180 days to 1 year. NAR and IREM supported this amendment.

Campbell Amendment (Passed by voice vote)

Establishes a cap on the number of covered bonds a single institution can issue, based on the percentage of an issuer's total assets, to be determined by the relevant regulator. NAR and IREM did not favor this amendment because the caps could decrease the amount of capital available.

Garrett Amendment (Passed by voice vote)

Limits non-bank covered bond issuers to institutions under the regulation of the Federal Reserve. NAR and IREM supported this amendment.

The bill has yet to win approval by the Federal Deposit Insurance Corporation. FDIC Chairman Sheila Bair has expressed apprehension in supporting the legislation due to the fear that her agency's deposit insurance fund could be put at risk if the debt instruments default.

As of now, the White House supports the bill, but there is no companion legislation in the Senate to date. IREM legislative staff is following this legislation closely and will report back when necessary.

FASB – Lease Accounting Update

Since the IREM Capitol Hill Visit Day in April, much has happened with regard to the Financial Accounting Standards Board (FASB) Lease Accounting proposed changes. Under these new rules, entities must recognize assets and liabilities arising from lease contracts which is different from current regulations that allow leases to be considered operating expenses which do not appear on balance sheets. This could lead to a bloated balance sheet that would result in a host of potential problems. With the

Financial Accounting Standards Board's (FASB) proposed changes to lease accounting standards, many firms and organizations have expressed concern. Over 780 comment letters were sent to FASB and the International Accounting Standards Board (IASB), most with a concern over how a company's balance sheet could be misinterpreted if rules are not well-reasoned. IREM participated in the comment period by submitting letters addressing concern with the proposed changes.

Both FASB and IASB concluded that lease accounting proposed changes will be delayed due to a high level of apprehension by multiple industries, particularly the real estate sector. Due to re-exposure of the changes, the final rule will more likely be delayed from 2011 to early 2012, with a 60-90 day comment period. With no firm date mentioned, the implementation date will more likely be moved to 2015 or 2016 to allow more time for adjustments.

IASB Chairman David Tweedie and FASB Chairwoman Leslie Seidman both stated that the timeline extension will allow both Boards to further examine revenue recognition, leasing, financial instruments and insurance projects. Ms. Seidman also noted that the common theme among the comment letters was the concern over an unnecessarily added level of complexity to the already onerous accounting process. She also addressed the smaller businesses not having the resources to implement the new lease accounting changes; both boards will be looking into how these new standards can be managed better with regard to smaller companies.

In late May FASB and IASB reversed a compromise they had offered earlier to the leasing industry. It was decided they would not create a two-model approach for lease accounting. Rather, they are using their original, single-model proposal. The boards originally proposed that all leases be treated as financing transactions. Prior to May, companies protested that short-term leases should be treated as simple rental agreements, so the boards agreed to develop a two-model approach.

There is much to be ironed out with regard to the lease accounting language. IREM legislative staff has been monitoring this issue closely and have been active in conference calls and coalition efforts to ensure FASB and IASB understand our concerns with the proposed changes. There have been talks of another comment period and IREM will be certain to give comments if necessary.

Term Extensions Update – June, 2011

The Term Extension issue has been a hot subject since the IREM Capitol Hill Visit Day in April, 2011. Currently, lenders are not offering term extensions because they are wary of oversight and regulatory concerns. For properties that can support their current debt, a simple loan extension is a reasonable and practical solution. As most commercial loans are short term, these loans refinance frequently. Lenders that extend the term of the current loan (instead of refinancing at the end of the loan term) avoid an equity gap—which is mutually beneficial for borrower and lender. Federal guidance to encourage more usage of term extensions within the banking industry is a strategic tool that needs to be utilized for commercial loan transactions.

After bringing this important matter to the Hill, IREM Capitol Hill Day Coordinators were asked to send a letter to their respective Congressional members and request they send out a letter regarding term extensions to Chairman Bernanke and Secretary Geithner. The letter to Bernanke and Geithner simply requested that they provide guidance to financial institutions encouraging sensible term extensions for performing and stable properties. As we said to our elected officials, this is necessary to shore up

commercial real estate markets in order to prevent another economic collapse. IREM legislative staff will continue to monitor this important issue and report back updates if necessary.