



THE COMMUNITY RECOVERY AND ENHANCEMENT (CRE) ACT - H.R. 1147

Frequently Asked Questions

How serious is the commercial real estate lending problem?

According to a February 4, 2011 hearing by the Troubled Asset Relief Program (TARP) Congressional Oversight Panel (COP), approximately \$1.4 trillion in commercial real estate debt is set to mature through 2013, with \$2.8 trillion maturing through 2020. Nearly half of the loans maturing from 2011 to 2015 are financially “underwater” – where the outstanding balance on the loan is more than the value of the property. The health of the commercial real estate sector is directly linked to that of the nation’s economy. As these adverse conditions persist, unemployment rates will remain high, personal incomes will be foregone and consumer spending, the driving force of the U.S. economy, will continue to stagnate.

What does this situation mean for banks?

Since the beginning of 2008 through the third quarter of 2010, commercial banks have incurred almost \$80 billion of losses related to commercial real estate exposure. It is estimated that over the next few years those banks, particularly the smaller community and regional banks, can expect to incur between \$80 and \$120 billion of additional losses. Approximately two-thirds of the commercial real estate debt is held by banks with less than \$100 billion in total assets. A significant portion of these smaller banks continue to have outstanding commercial real estate loan exposure equal to or greater than 300%. These high commercial real estate concentrations have been a driving factor in the observed increase in bank failures over the past two years. In 2010, bank failures rose to 157, up from 140 in 2009.

ICSC supports an incremental solution that will greatly reduce the risk of a financial meltdown in the commercial property sector. What is the proposal in a nutshell?

The Community Recovery and Enhancement (CRE) Act (H.R. 1147), provides temporary tax incentives designed to attract new equity for existing real estate projects. The incentives are simple: bonus depreciation on the new equity investment and a deduction of losses that

are not subject to the passive loss limits. A key condition of the proposal is that at least 80% of the invested capital is used to reduce the outstanding balance of the commercial mortgage debt, with the remainder going to energy efficiency or tenant improvements. The new equity investors will negotiate with the existing owners for their share of the income, losses and residual value of the investment. They will be able to depreciate their investment through a one-time 50% bonus depreciation. The immediate infusion of equity capital earmarked to paying down debt will lower loan-to-value ratios on existing loans and improve debt coverage ratios, easing debt market concerns and favorably impacting the broader economy.

Who benefits under this proposal and how?

If H.R. 1147 is enacted, all parties would have to contribute to the success of the undertaking:

Property Owners:

- subject to negotiation, would have to give up a percentage of their interest in their property;
- would avoid foreclosure, allowing for the potential to realize future gain;
- would own property that is better capitalized;
- would have the opportunity to improve the property, bring in new tenants and create new jobs.

New Investors:

- would be able to invest in undervalued commercial real estate assets and take advantage of the upside potential without having to navigate the foreclosure process;
- would be able to depreciate their investment with a one-time 50% bonus;
- would be able to deduct passive losses from the investment against other gains.

Financial Institutions, Banks:

- would get a significant pay-down on existing loans;
- would be able to convert a troubled loan into a performing loan thereby avoiding property foreclosures and capital write-offs;
- would have new funds to reinvest in their communities.

Frequently Asked Questions (continued)

(Continued on reverse.)

Taxpayers and Consumers:

- by recycling private capital, this proposal would help reduce loan losses for struggling banks that would otherwise be dependent on the dwindling FDIC insurance fund;
- this would not be an open-ended tax break, but would require specific uses of funds to accomplish policy goals (reducing the exposure community banks have to problematic commercial real estate debt);
- a reduction in bank failures would limit revenue losses from failed banks, real estate business and their tenants, and avoid the related loss of jobs.

How would this proposal attract new investors?

Tax incentives are offered to the new investor in the form of 1) a 50% bonus depreciation on the investment and 2) losses from the depreciation permitted without regard to the passive loss limitations. The proposal is also short-term in nature, to drive investment sooner rather than later.

Is this simply a government bail out for commercial real estate owners who took on too much credit?

The CRE Act does not create a new federal program or government guarantee. It is a private market solution with an incentive to new investors based on the after-tax return on investment. While there would be an upfront revenue loss to the Federal government, that outlay would eventually be recaptured upon the taxable sale of the asset and through reduction of future depreciation benefits.

If no action is taken, there will be far greater costs to the taxpayer and consumers in the form of FDIC fees to support the insurance fund as the federal government absorbs wide-spread bank losses. Such was the level of concern that, in a February 2010 COP report, the suggestion was made that the government proactively add capital to banks whose commercial real estate loan exposure exceed certain levels as a means of providing a cushion against potential commercial real estate losses. At the time, it was recommended that unutilized TARP funds be redirected for this purpose.

Furthermore, developers and previous investors are not protected from the consequences of their decisions. In order to preserve any potential for future gain from their troubled investments, they must be willing to give up substantial ownership in the asset to the new investors. Additionally, the current owners

cannot use the new capital to cash themselves out – it must be dedicated to deleveraging the asset or providing capital improvements to the property. Everyone must give a little to get a little.

Ultimately, taxpayers will benefit from a reduction in potential bank failures and an increase in small business lending after the threat of large losses from commercial real estate loans is reduced.

Will this proposal work for all properties?

H.R. 1147 is not a silver bullet to solve all of the problems for the commercial real estate industry and the lenders that hold troubled loans. Likewise, this proposal will not apply to all properties – the fundamentals have to be right. Some foreclosures and write-downs of loans are inevitable, but this option could take pressure off of banks with large commercial real estate portfolios, unlock capital, reduce bank losses and help restore asset values for the commercial real estate market.

Why is this a good proposal?

H.R. 1147 is the only plan aimed at helping the largest sector of commercial real estate owners and developers – small to medium private businesses that own and operate commercial properties. Furthermore, retail tenants continue to have a hard time accessing credit from regional and community banks and this proposal could help both groups once local lending has been revived.

What about other solutions to address the commercial real estate crisis?

There is no single solution; it will take a number of complementary ideas to ease the looming commercial real estate crisis. The CRE Act is offered as an incremental and temporary plan to jumpstart equity investment into America's communities.