

GOOD NEWS FOR REAL ESTATE INVESTORS?

U.S. TREASURY BEGINS RELEASING DETAILS OF FINANCIAL STABILITY PLAN

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On February 25, 2009, the U.S. Treasury Department released the terms of the Capital Assistance Program ("CAP"). In doing so, the Treasury Department took the first step towards providing much-needed details of the new "Financial Stability Plan" announced in February by Treasury Secretary Timothy Geithner. According to the Treasury Department, the CAP is the core element of the Financial Stability Plan, and is intended to, among other things, increase the willingness of banks to lend in the current weak economic environment. For many real estate investors and others, this is welcome news. This alert identifies the key elements of the Financial Stability Plan that real estate investors and lenders should watch as further details of the Plan emerge from the Obama administration.

The information in this alert has been obtained from a new website set-up by the Treasury Department at www.financialstability.gov, including the Financial Stability Plan Fact Sheet, which can be found at www.financialstability.gov/docs/fact-sheet.pdf.

KEY ELEMENTS OF THE FINANCIAL STABILITY PLAN

- Financial Stability Trust - Including the CAP
- Public-Private Investment Fund
- Consumer and Business Lending Initiative
- Transparency and Accountability Agenda - Including Dividend Limitations
- Affordable Housing Support and Foreclosure Prevention Plan
- Small Business and Community Lending Initiative



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SUMMARY OF THE KEY ELEMENTS

Establishment of the Financial Stability Trust

Forward Looking Assessment/Stress Test. Federal banking regulators will perform a comprehensive forward looking assessment of what banks will need to continue lending through this severe economic downturn and will include (a) increased transparency and public disclosure requirements, (b) coordinated, accurate and realistic assessments by federal regulators, and (c) forward looking assessments including a comprehensive "stress test" to determine whether the 19 largest banks with assets in excess of \$100 Billion have the capital necessary to continue lending and to absorb the potential losses that could result from an even more severe decline in the economy than currently projected.

Capital Assistance Program. According to the Treasury Department, the CAP will encourage banks who have undergone the "stress test" to access private capital markets to raise any additional capital needed, while at the same time establishing a Treasury provided "capital buffer" in the form of mandatory convertible preferred shares to help absorb losses and serve as a bridge to receiving increased private capital. The government capital will operate as a form of "contingent equity" to ensure banks the capital strength to preserve or increase lending in a worse than expected economic downturn (including such assumptions as a 22%

drop in home prices this year and unemployment topping 10% next year). Some of the components of the CAP include:

- Capital provided under the CAP will be in the form of a preferred security that is convertible into common equity at a 10% discount to the price prevailing prior to February 9th.
- CAP securities will carry a 9% dividend yield and would be convertible at the issuer's option.
- After 7 years, the security would automatically convert into common equity.
- Recipients of capital under the CAP will be subject to limitations on executive compensation, paying dividends, and repurchasing shares.
- As part of the eligibility requirements for receiving capital under the CAP, banks must submit a plan for how they intend to use the capital to increase lending levels above levels that would have been possible without government support.

Creation of a Public-Private Investment Fund

The Financial Stability Plan would establish a public-private investment fund to remove "legacy assets" (formerly called "toxic assets") from the financial institutions' balance sheets. According to Treasury Secretary Geithner, this will help create a market for real estate related assets that are at the center of the current financial crisis. This new program will involve putting public funds alongside private capital to remove these legacy assets. Essentially, the Treasury will provide a portion of the money to purchase the legacy assets from financial institutions and private investors will provide the rest of the funds. Public financing would be used to further leverage the public seed capital and the Treasury may provide

debt financing to private investors for their share of the funds. However, the details of such public-private financing have not yet been explained.

Consumer & Business Lending Initiative

Up to \$1 Trillion. In order to unfreeze lending to consumers and businesses, a core component of the Financial Stability Plan, according to Geithner, is to broaden and expand the resources of the previously announced but not yet implemented Term Asset-Backed Securities Loan Facility (“TALF”). The Consumer & Business Lending Initiative will provide incentives for private investors to invest in auto, small business, credit card and other consumer and business credit products, but will increase the previously authorized \$20 Billion designed to leverage \$200 billion of lending from the Federal Reserve to \$100 Billion which is designed to leverage up to \$1 Trillion of new loans.

Perhaps most important for real estate investors, this new Initiative will also expand the initial reach of TALF to now include commercial mortgage-backed securities (including \$1.7 Trillion of outstanding commercial and multi-family mortgages) and may possibly be further expanded to include other asset classes, such as non-Agency residential mortgage-backed securities and assets collateralized by corporate debt. Considering that over one-half of all commercial loans that will mature in 2009 are held in the CMBS sector, this Initiative comes as welcome relief for everyone in real estate.

New Era of Transparency, Accountability, Monitoring and Conditions

Many have criticized TARP for its lack of accountability standards and monitoring by the Treasury of the financial institutions aided by TARP. According to Geithner, and as seen in the recently released requirements of

the CAP, going forward, “the Financial Stability Plan will call for greater transparency, accountability and conditionality with tougher standards for firms receiving exceptional assistance.”

Housing Support and Foreclosure Prevention

As described in more detail in the Homeowner Affordability and Stability Plan unveiled by President Obama on February 18, the key components of the plan to help millions of homeowners are:

- Drive down overall mortgage rates.
- Commit \$50 Billion to prevent avoidable foreclosures of owner-occupied middle class homes.
- Help bring order and consistency to the various efforts to address the foreclosure crisis by establishing loan modification guidelines and standards for government and private programs.
- Require all Financial Stability Plan recipients to participate in foreclosure mitigation plans consistent with Treasury guidance.
- Build flexibility into hope for homeowners and the FHA to enable loan modifications for a greater number of distressed borrowers.

Small Business and Community Lending Initiative

Geithner also explained when he introduced the Financial Stability Plan that the Treasury Department and the SBA will soon announce the launch of a Small Business and Community Bank Lending Initiative designed “to arrest the precipitous decline in SBA lending – down 57 percent last quarter from the same quarter a year earlier” through:

- Use of the Consumer & Business Lending Initiative to finance the purchase of AAA-rated SBA loans to

unfreeze secondary markets for small business loans.

- Increasing the Guarantee for SBA Loans to 90%.
- Reducing Fees for SBA 7(a) and 504 Lending and Provide Funds for both oversight and speedier and less burdensome processing of loan applications.

Although some specifics regarding the Financial Stability Plan are starting to emerge, what has been disclosed still is mostly skeleton with little meat on the bones. Presumably, further details will follow from the Obama administration in the coming weeks and months including the specific actions to be taken by the various governmental agencies that will turn or attempt to turn the Financial Stability Plan into reality. Stay tuned and we will keep you apprised of these details as they emerge.

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