

NAR Issue Summaries

Commercial / Mark-to-Market

NAR Committee:

Commercial Federal Policy Committee

What is the fundamental issue?

On May 25, 2010, the Financial Accounting Standards Board (FASB), an independent body that sets U.S. accounting standards, proposed an accounting rule change in an effort to create greater transparency in financial statements. Specifically, the proposal would require banks to report the fair value and amortized cost of a loan on their balance sheets, a method known as “fair value” or “mark-to-market” accounting. This would force financial institutions to take huge write downs or losses, particularly during periods of economic distress, and result in a further contraction of credit to the real estate industry, prolonging our nation’s economic recovery.

Background: In 2007, FASB reinstated mark-to-market accounting for complex financial instruments such as mortgage-backed securities. Many industry analysts feel that this action escalated the financial crisis. However, in April 2009, FASB passed a proposal to relax these rules by giving companies more leeway when valuing assets, which helped calm financial markets. The changes came after Congress criticized FASB for the damaging effects of mark-to-market accounting, where assets valued at market prices had to be written down, even if a company intended to hold a particular asset to maturity – causing markets to freeze up and forcing more write-downs. While the intent of their latest proposal is to create greater transparency, FASB again has failed to fully acknowledge/account for the negative economic consequences of expanding mark-to-market accounting rules.

I am a real estate professional. What does this mean for my business?

If implemented, the proposed mark-to-market rules would reduce the availability of credit for real estate. Banks would be forced to take unjustified losses on assets that decline in value, which would require many financial institutions to hold more capital.

While this rule would pose a significant challenge for large commercial banks, smaller regional and community banks would be hit the hardest, especially ones with high commercial real estate exposure. Since commercial real estate loans are typically longer-term assets, the proposal would mandate onerous write-downs and potentially cause many smaller financial institutions to fail. As a result, credit for the real estate industry as well as for other businesses and consumers would be further constrained, hindering our nation’s economic recovery.

NAR Policy:

NAR is concerned that the recent FASB mark-to-market accounting proposal will dramatically reduce the availability of capital for real estate, especially in light of the residential and commercial real estate liquidity crisis. NAR calls for more flexible mark-to-market accounting rules and encourages the use of other more

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practical valuation tools to assist with valuing assets in illiquid markets. NAR will continue to work with FASB and policymakers to ensure that any fair value accounting rule changes will not compromise access to credit for businesses and consumers.

Opposition Arguments:

Opponents of NAR policy will argue that Mark-to-Market accounting is a valuable way to measure and recognize economic losses, which provides a realistic summary of a company's financial situation by accurately accounting for the changes in the price of assets and liabilities on a daily basis.

Legislative/Regulatory Status/Outlook

FASB accepted public comments on its mark-to-market proposal until September 30, 2010. NAR submitted comments to FASB on September 24, 2010.

In January 2011, FASB tentatively approved an accounting model that would allow companies to carry a variety of financial instruments at amortized costs. Soon thereafter, this decision was finalized, which backtracks from FASB's original proposal to fair value loans held by banks.

Current Legislation/Regulation (bill number or regulation)

No actions at this time.

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