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American Bankers Association
Mortgage Bankers Association of America
National Association of Home Builders
National Association of Realtors
National Council of Savings Institutions
U.S. League of Savings Institutions

May 1, 1991

The White House
1600 Pennsylvania Avenue, N. W.
Washington, D.C. 20009

Dear Mr. President:

You went ~~right to the heart~~ of America's current economic problems in your State of the Union Message, and your Administration has been taking appropriate steps to halt the economic downswing. We would like to applaud your recent efforts, including the ~~March 1~~ initiative to ease the "credit crunch" at thrift institutions and commercial banks.

We would also like to urge you to take further steps to limit the depth and duration of the current economic recession and to foster economic expansion. We believe that the real estate sector is key to this process. Housing and other types of construction traditionally have led the economy out of recessions, and this sector can once again perform that important role. But adjustments to government policy are needed if real estate is to recover, to gain momentum, and to serve as an engine of economic growth in 1991 and beyond.

The real estate sector was a major drag on the economy during 1990. Indeed, reductions in residential and nonresidential building accounted for more than half of the decline in real GNP in the fourth quarter, and construction spending certainly was a large negative in the first quarter of this year as well. But there are glimmers of hope, and housing starts and home sales may have hit cyclical lows in January. Housing and other forms of real estate now have the potential for a recovery that could help revive the overall economy and ignite an economic expansion.

Financing has always been the life blood of the real estate sector. Unfortunately, key arteries in the finance system recently have been clogged by unwise government policies and reactions by lenders. The potential real estate recovery could be severely limited unless decisive steps are taken to restore the proper functioning of the financing system. Government subsidies are not needed. But unnecessary impediments to flows of debt and equity capital must be removed so that reviving demands for real estate can be met.

The undersigned organizations represent business firms that build, sell and finance real estate. We are firmly united behind a package of recommendations that will help free up funds for real estate without federal outlays. Enactment of this package will permit us to supply the housing and other types of real estate that Americans demand as the country climbs out of recession and moves onward.

Our policy recommendation fall into several categories:

1. relief from the "credit crunch" that is constricting the availability of funds for the construction and development of housing and other real estate;

2. relief from an impending "appraisal crunch" caused by a shortage of appraisers who are able to meet new federally mandated requirements;

3. relief from tax provisions that are depressing property values and unduly limiting the supply of equity capital for income-producing real estate;

4. relief from excessive exposure to environmental liabilities being placed upon real estate lenders.

<u>Credit Crunch</u>

The shrinking supply of credit for the construction and development of real estate has been well documented during the past year. At this point, our key concern is the potential for the credit crunch to derail an incipient expansion. The breakdown of credit arrangements between builders and developers, on the one hand, and thrift institutions and commercial banks, on the other, threatens to seriously limit the impending recovery. The problem is likely to be especially acute in the rental market which serves citizens in modest economic circumstances.

Mr. President, you recognized this problem in your State of the Union Message this year. And on March 1, the Secretary of the Treasury and the federal regulators of thrifts and banks jointly announced a series of clarifications to accounting rules and examination procedures, along with one proposed rule change, that are designed to improve the "climate" for real estate lending and restore sensible balance to the examination process. We strongly endorse the philosophy behind this important set of measures.

We are concerned, however, that the spirit of the March 1 announcements is not finding its way to the examiners in the field; as a result, bank and thrift lending officers may not be convinced that there has been a real change. We urge you to take whatever steps are necessary to achieve the change in regulatory and lending climate that is promised by the March 1 initiative. These steps should include careful monitoring by the White House and the Treasury Department to assure that the message is being transmitted properly to the field by all the federal regulators.

One of the key elements of the March 1 package of clarifications dealt with real estate appraisals. During the past year, regulators have used appraisal techniques that yield unrealistically low "liquidation" values. Considering that real estate is a key asset supporting loans by financial institutions, the use of liquidation values drastically reduces the value of bank collateral and leaves banks with little choice but to curtail lending, as they've done. Clearly, a valuation system that better recognizes real estate, and real estate loans, as long-term assets should be restored.

Appraisal Crunch

The Financial Institutions Reform, Recovery and Enforcement Act of 1989 requires the development and implementation of an entirely new and reformed appraisal industry, to be in place by July 1, 1991. It has become clear, however, that many states lack adequate appraiser educational and testing mechanisms. In addition, most states' laws will need amendment in order to comply with FIRREA.

In response to this situation, the Appraisal Subcommittee, which was established by FIRREA within the Federal Financial Institutions Examination Council, granted a six-month extension, until the end of 1991, to all states. But FIRREA is silent regarding whether the Appraisal Subcommittee is permitted to grant extensions beyond the end of 1991, to states which do not meet the Federal requirements. We believe that some states will need more time to meet the requirements of FIRREA.

Legislation has been introduced in the House (H.R. 2115), and is anticipated in the Senate, which would grant states more time to establish educational and testing programs to meet the appraisal requirements of FIRREA. We urge your support for this legislation.

Tax Provisions

The Tax Reform Act of 1986 severely restricted tax incentives for investment in rental real estate, including retroactive changes to passive loss rules. These changes in tax laws immediately altered the economics of building income-producing property and downgraded balance sheets for both current and future investors in multi-family and commercial property. Real estate values dropped immediately after the passive loss rules were enacted because of the retroactive application to existing properties. As property values declined, real estate loans were propelled into foreclosure and often ended up at the RTC or the FDIC as part of a failed financial institution's portfolio.

Legislation was introduced in both the 101st and 102nd Congresses to make modest adjustments to the passive loss rules. The bill (H.R. 1414) has been prepared by a bipartisan majority of the members of the House, and by a majority of the Ways and Means Committee. A companion bill will soon be introduced in the Senate.

The legislation makes significant improvements to the passive loss rules, but does not create broad tax shelter opportunities or generate a stimulus that would result in renewed overbuilding. Its principal benefits are two-fold. First, the legislation would permit real estate professionals who own rental real estate to deduct the costs of doing business. This removes the discriminatory taint on rental real estate activities for these business people. Second, the bill mitigates the harsh retroactive effect of the 1986 Act. Assets already in service were the ones most seriously damaged by the 1986 Act. Mitigating some of that damage will improve cash flow for owners of these properties and shore up values in real estate markets.

Lender Liability

In recent years, the courts have greatly expanded the liability of lenders for cleanup costs resulting from pollution caused by their borrowers. The courts have held lenders liable for cleanup on loans on which they foreclosed even when the lender had nothing to do with causing the pollution. Therefore, many types of businesses are finding it increasingly difficult, if not impossible, to obtain financing. These difficulties involve not only normal real estate lending but many small business loans as well, since it is very common for real estate to be used as collateral for small business loans.

Congressman John LaFalce and Senator Jake Garn have introduced bills (H.R. 1450 and S.651) designed to correct this problem by removing lender liability except in cases where the lender contributed to hazardous substance release. Both sponsors have stressed that the purpose of the legislation is to restore the original Congressional intent when the Comprehensive Environmental Response, Compensation, and Liability Act was enacted in 1980.

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Mr. President, we urge you to act immediately to ease the credit crunch that is afflicting real estate development and construction, and to forestall the potential appraisal crunch that is rapidly approaching. We also urge you to support legislation to alter the passive loss rules for real estate investors and to relieve lenders of excessive exposure to environmental liability.

These administrative and legislative adjustments do not involve government subsidies. To the contrary, they are straightforward adjustments that will improve the functioning of the real estate finance system and lead to a stronger economy and larger tax revenues. If our proposals are enacted promptly, American business will once again be able to build, sell and finance the housing and other forms of real estate that America needs. Without the adjustments, real estate will be unable to perform its typical role in the upswing of the business cycle.

Sincerely,

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