



Mark-to-Market Rule Gains More Critics

Momentum to suspend controversial fair value accounting rule could gain steam as banks continue to write down assets.

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Even as a U.S. House of Representatives financial services subcommittee on capital markets plans a hearing on mark-to-market accounting rules this Thursday, the Securities and Exchange Commission will likely not suspend the controversial fair market accounting rule that has forced banks to write down billions of dollars worth of secured real estate assets, Reuters reported this week.

The mark-to-market rule requires banks and certain publicly traded entities to value the assets on their balance sheets based on the current street price for those assets. Critics contend that the rule forces banks to write down their assets to toxic asset, fire-sale market-bottom prices, regardless of the motivating factors behind those asset sales. In the multifamily sector, for example, an unstabilized and distressed asset that is traded for a sub-5 percent cap rate must be factored into the balance sheet valuation of any otherwise healthy and stabilized properties that might have net operating income demanding a much higher valuation.

"If we had gotten rid of mark-to-market, I would render that this entire recession would not have happened," offers Matt McManus, chairman of NAI BlueStone Real Estate Capital, a Philadelphia-based commercial real estate investment banking and advisory firm that secures debt, mezzanine, equity, and sponsor equity financing for investors, operators, owners, and developers. "Every single transaction out there that trades hands forces the entire remaining market to reflect that transaction. It is not representative of the real market, and it is not representative of real values. It is a vicious cycle, a downward spiral."

Federal Reserve chairman Ben Bernanke has maintained in public comments that he does not support suspension of the mark to market rule, which was found to be effective in dealing with Enron and other corporate fraud schemes that sought to artificially over-valuate assets.

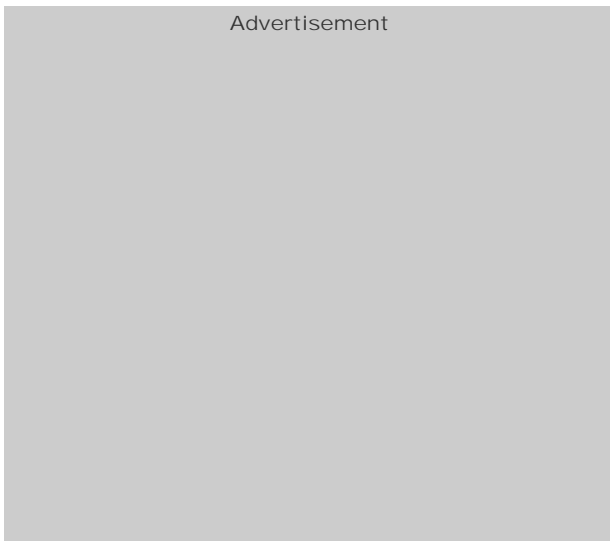
Even private equity firms that were slow to negatively value positive cash flow multifamily assets might be caught in the mark-to-market vortex, McManus warns. "A lot of private firms hoped the economy would turn around or something would be done to the mark-to-market rule where everyone who was subject to it would be relieved from it and values would therefore

come back up," he says. "A lot of them are beginning to concede that the rule isn't changing and everyone has to mark down their holdings. Really, at this point, the economic impact is irreversible."

Nevertheless, major industry associations and lobbying groups are asking Congress to provide some type of mark-to-market relief. In a March 9 letter to the House Committee on Financial Services, the Mortgage Bankers Association, the National Association of Home Builders, the National Association of Realtors, and the Institute of Real Estate Management joined 12 federal home loan banks and other signatories in calling for immediate action to correct the "procyclical impact" of "flawed" mark-to-market accounting rules.

"The inability of businesses, investors, and government to properly value assets in disorderly markets has created uncertainty and a loss of confidence that has led to a self-reinforcing cycle of write downs and further economic contractions," the letter says.

McManus argues that anything will be better than nothing when it comes to mark-to-market alleviation. "When assets are incorrectly valued, bank capital is out of balance and they can't lend," he says. "They have got to temporarily lift this rule, or at the very least modify it. As it is set in the books right now, it is a really dangerous rule that is causing a lot of unnecessary hurt and pain to all financial institutions."



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