

## **MARK-TO-MARKET ACCOUNTING REQUIREMENTS AND AD&C FINANCING SOME QUESTIONS AND ANSWERS**

**Q: I have heard that changes may be made to the mark-to-market accounting rules. Where does this stand?**

**A:** Yes, Congress is pressuring the governing bodies of accounting make changes because it is felt the mark-to-market requirements are contributing to the financial crisis by forcing banks and other institutions to take unnecessary massive write-downs of assets and capital. The Financial Accounting Standards Board (FASB), which is responsible for establishing Generally Accepted Accounting Principles in the U.S., has issued for public comment proposals to improve the mark-to-market process.

**Q: What has NAHB been doing on this issue?**

**A:** NAHB is working with a coalition of housing and finance organizations to obtain solutions to mark-to-market accounting problems. The coalition has undertaken a series of meetings with key members of Congress to make the case for the urgent need for mark-to-market changes. The coalition has also delivered that message to the Department of Treasury, Securities and Exchange Commission, FASB, International Accounting Standards Board and the Public Company Accounting Oversight Board. The coalition has developed specific recommendations for revisions to mark-to-market accounting rules and guidance. FASB's proposed changes are consistent with the coalition's recommendations.

**Q: Will changes to mark-to-market accounting rules relieve pressure for banks to require additional equity contributions on outstanding AD&C loans to builders and developers?**

**A:** Not directly or significantly. There is much misunderstanding on this question. Mark-to-market, or fair value, accounting is applied to financial assets, such as mortgage-backed securities, that are actively traded in a recognized market. The objective is to provide investors accurate reports on the changing value of these securities, which fluctuate in price as mortgage interest rates and expectations of mortgage defaults vary over time. The problem with the current system of mark-to-market accounting is that it is resulting in exaggerated accounting adjustments to financial institution income and capital based on losses that may never occur as well as excessively low price readings derived in impaired markets. So, while changes to mark-to-market accounting will ease capital pressures to allow banks greater capacity to work with customers on loan problems, it will not provide any direct relief for AD&C borrowers.

The mark-to-market accounting rules do not apply to AD&C loans since these assets do not undergo trades that establish market values. AD&C loans are governed by a different set of accounting rules that require them to be reported at amortized cost, unless they are

impaired. A loan is considered impaired when it is determined that full repayment is unlikely. When impaired, an AD&C loan is not marked to a market value but, rather, is valued based on the degree to which contractual principal and interest payments are expected to be satisfied. It is the fact that this determination is heavily influenced by the appraised value of the lot, house, or subdivision that is the subject of and collateral for the loan that leads many to conclude that AD&C loans are marked to market based on reappraisals. While AD&C loan values may be reduced when lower appraisals are obtained, such reductions are not the result of mark-to-market accounting rules and may not even occur if the institution can demonstrate that the principal and interest on the loan will be paid in full and on schedule.

**Q: But the reality is that banks increasingly are asking builders and developers to contribute additional equity due to low-ball appraisals that do not accurately reflect the economic value of a project. Can't they fix this problem by changing the accounting rules that apply to AD&C loans?**

**A:** No. The problem with inappropriately large equity calls on outstanding AD&C loans is the result of faulty appraisals that, more and more, are based on distressed sales and excessive discounts based on overly pessimistic estimates of absorption rates. Even if the accounting rules were altered for AD&C loans, faulty appraisals would still lead to burdensome equity demands on builders because banks must comply with the loan-to-value guidelines in regulatory real estate lending rules, which are applied independently of accounting requirements.

**Q: What can be done to obtain relief from excessive equity calls on outstanding AD&C loans?**

**A:** NAHB is working to obtain improvements and reforms in appraisals and more flexibility in applying the regulatory guidelines for real estate loans. NAHB has joined forces with the Appraisal Institute, the trade association for appraisers with higher levels of experience and training, to seek better appraisal practices and higher appraiser qualification standards, which are needed to accurately determine values in the more complex transactions occurring in today's housing markets. NAHB is also dealing directly with the bank regulators to seek adjustments in real estate lending rules and examination practices that will facilitate completion of viable projects and repayment of outstanding loans. NAHB is asking key members of Congress to urge the regulators to take these actions.

*For more information on mark-to-market accounting and AD&C loan problems, please contact John Dimitri in NAHB's Housing Finance Department at (800) 368-5242 or [jdimitri@nahb.com](mailto:jdimitri@nahb.com).*