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ECONOMIC STIMULUS

[Final Stimulus Package on its Way to the White House; Bonus Depreciation Provision Includes Leasehold Improvements](#)

Congress yesterday gave final and overwhelming approval to a \$152 billion economic stimulus package that authorizes tax rebates for most Americans (including seniors, veterans and veterans' widows) and tax incentives for business investment. The compromise, which emerged in the Senate yesterday afternoon after intense partisan negotiation, also amends the House version so that illegal aliens cannot receive rebate checks. The final bill cleared the Senate by a vote of 81-16, and cleared the House shortly thereafter with a final tally of 380-34.

Welcoming yesterday's bipartisan action, President Bush said the short-term economic growth package "is robust, broad-based, timely, and it will be effective. This bill will help to stimulate consumer spending and accelerate needed business investment." Treasury Secretary Henry Paulson, who addressed The Real Estate Roundtable's 2008 State of the Industry Meeting last week, added that the IRS will begin preparations for issuing 130 million rebate checks even before the measure is signed by the president. "Payments will be largely completed this summer, putting cash in the hands of millions of Americans at a time when our economy is experiencing slower growth," he stated (*BNA Daily Report for Executives*, Feb. 8).

The bill's business tax incentives include 50 percent bonus depreciation for investments made during 2008 (with a transition rule for projects under written binding contract in 2008 and placed in service by Jan. 1, 2010.

That property must have a production period of more than one year and cost more than \$1 million). For qualifying investments, which include leasehold improvements, furniture and business equipment, taxpayers will be able to deduct 50 percent of the cost plus the first year depreciation immediately, with the balance depreciated over the normal cost recovery period (39 years for leasehold improvements; 3 or 5 years for equipment). For office and retail properties, the bonus depreciation for leasehold improvements is particularly helpful. Hotels and apartments will benefit from items such as furniture, appliances and televisions being eligible for the accelerated write off.

Several other provisions supported by the real estate industry, which were included in last week's Finance Committee bill, were ultimately dropped during yesterday's talks. These included provisions to increase the volume cap for mortgage revenue bonds and allow proceeds to be used temporarily for home mortgage refinancing and multi-family projects; extend the commercial building energy efficiency tax deduction and business tax credits for solar energy property, qualified fuel cells, and stationary microturbine power plants; and allow net operating losses (NOL) to be carried back five years. The National Association of Home Builders and financial institution trade groups



Nancy Pelosi, Speaker of the House, *center*, addresses the economic stimulus bill on Capitol Hill on Feb. 7, 2008. With Pelosi are John Boehner, House Minority Leader, *left*, Henry Paulson, U.S. Treasury Secretary, *second left*, Mitch McConnell, Senate Minority Leader, *second right*, and Harry Reid, Senate Majority Leader, *right*. Photo: Chris Kleponis/Bloomberg News



U.S. Treasury Secretary Henry Paulson, *right*, prior to speaking at The Roundtable's 2008 State of the Industry Meeting in Washington, DC on Feb. 7, 2008.

economic stimulus and real estate markets. Accompanying Paulson is Roundtable Chairman Christopher J. Nassetta (President and CEO, Hilton Hotels Corporation), *left*.

fought particularly hard for the NOL provision.

The Roundtable, which has urged swift congressional action to keep the economic slowdown from developing into a full-blown recession, welcomed yesterday's bipartisan agreement. "Over the longer term, the marketplace will correct many of the distortions that exist in today's economy. However, in the immediate term, a robust stimulus package . . . is necessary," said

Roundtable President and CEO Jeffrey DeBoer, *right*. He added, "The general approach of acting quickly to spur consumer spending, provide additional refinancing options to homeowners, boost confidence and encourage businesses to accelerate investments is the right tonic for today's economic slowdown."



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BUDGET AND TAX OUTLOOK

President's Budget Calls for \$2.3 Trillion in Tax Cut Extensions Over Next Decade

In the opening salvo of budget-and-tax battles to come, President Bush on Monday unveiled a FY2009 budget plan that proposes over \$2 trillion in tax cuts through 2018, the bulk of which would go toward extending the tax relief he pushed through in 2001 and 2003 (*The Wall Street Journal*, Feb. 4). This includes the lower individual income tax rates, 15 percent capital gains and dividends rates, and estate tax phase-out that are due to expire in 2011.

Bush's proposal to temporarily extend individual Alternative Minimum Tax (AMT) relief is expected to be acted on by Congress in 2008, and debate will likely intensify this year over whether to extend the rest of the expiring tax provisions. But, with Democrats largely opposed to extending most of the Bush tax cuts (bipartisan efforts on estate tax reform continue) and already proposing other ways to spend this federal revenue, these discussions will likely not begin in earnest until a new president is sworn in next year.



[Among the individual and corporate income tax reforms being floated by Democrats, House Ways and Means Committee Chairman Charles Rangel (D-NY) has proposed a \$1.3 trillion bill ([H.R. 3970](#)) that would permanently eliminate the AMT, create higher standard deductions for individuals, increase the phase-out threshold for the earned income tax credit, and reduce the corporate income tax rate from 35 percent to 30.5 percent.]



The President's budget also includes provisions to step up tax-law enforcement, with the goal of reducing the "tax gap," a measure of uncollected taxes. Based on 2001 returns, the IRS has estimated overall taxpayer compliance at 86%, leaving some \$290 billion in uncollected taxes.

The Congressional Budget Office (CBO) recently reported that extending the Bush tax cuts, coupled with AMT relief, would cost \$3.6 trillion over the next 10 years and leave a federal deficit of \$3.4 trillion (*Roundtable Weekly*, Jan. 25). Contrary to assertions by the White House and congressional Republicans, CBO concluded that expiration of the tax cuts would only have a "small" effect on economic growth.

In its newly released policy agenda for 2008, [An Agenda for a Strong Economy and Sustainable Communities](#), The Roundtable urges U.S. policymakers to consider any major tax changes carefully and deliberately, and to factor real estate's enormous economic contribution into their policymaking decisions. The report also warns that "seemingly simple tax 'fixes,' such as [last year's] carried interest proposal, often come with serious negative economic consequences." Aligning capital gains and depreciation recapture tax rates and providing certainty on estate tax policy are among the key tax policy recommendations in this year's agenda. [See .pdf copy of The Roundtable policy agenda.](#)



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CAPITAL AND CREDIT

Ratings Agencies Respond to Increased Scrutiny, Pressure for Reforms

Real Estate Lending Standards Tighten

Standard & Poor's yesterday became the latest of the major credit ratings agencies to announce reforms stemming from the subprime mortgage market meltdown (and its ongoing fallout on other parts of the U.S. debt market, including the market for commercial mortgage-backed securities [CMBS]). As *Bloomberg.com* reported, the agencies have increasingly come under fire from regulators and lawmakers for granting excessively high ratings to subprime-mortgage securities and then failing to act in a timely manner when defaults began to skyrocket.



S&P's reforms — which seek to increase transparency in the ratings process and eliminate potential conflicts of interest — include plans to hire an ombudsman; require greater disclosure of collateral backing structured finance securities; changes in risk measurement following losses in mortgage-backed securities; and limiting analyst coverage of particular issuers to five years.

S&P's primary competitors have also recently announced reforms in this area. Moody's, for example, has separated its credit-ratings operations from its marketing and analytics, and Fitch is reevaluating how it grades certain types of debt, according to Bloomberg.

Citing the real estate industry newsletter *Commercial Mortgage Alert*, *The Wall Street Journal* today reported that no CMBS have been issued during the past month — "the first time this has happened since October 1990." The ongoing paralysis of the CMBS market — promptly largely by a lack of confidence in the creditworthiness of various debt instruments and in the accuracy of current asset pricing — was among the topics addressed by Treasury Secretary Paulson and Senate Banking Committee member Charles Schumer (D-NY), *left*, during The Roundtable's State of the Industry Meeting last week.



In its [newly released policy agenda for 2008](#), The Roundtable warns that "ongoing paralysis of the CMBS market and diminished liquidity could lead to a diminution of collateral values. Additionally, portfolio lenders, such as banks and life insurers, can only absorb a percentage of the total demand for debt without an active CMBS market. Confidence must be restored to real estate capital markets to return markets to equilibrium."

Real Estate Lending Standards Tighten

In related news, a Federal Reserve report on Monday confirmed that bank underwriting standards for home mortgages and commercial real estate development loans tightened during the three-month period that ended Jan. 17. According to *USA Today* (Feb. 5), the quarterly survey "made it clear that a credit crunch, which started last summer with rising defaults in higher-risk subprime mortgages, has spread to better-off consumers."

In the [latest survey of senior loan officers](#), about 80 percent of domestic banks reported tightening their lending standards on commercial real estate loans over the past three months, a notable increase from the October survey. The net fraction of domestic banks reporting tighter lending standards on these loans was the highest since this question was introduced in 1990.



About 55 percent of foreign banks-up from about 40 percent in the October survey-indicated that they had tightened their lending standards on such loans. Concerning loan demand, about 45 percent of both domestic and foreign respondents, on net, reported weaker demand for commercial real estate loans over the past three months.



The latest survey included special questions about changes in bank terms on commercial real estate loans during 2007, expected changes in asset quality in 2008, and loss-mitigation strategies on residential mortgage loans. According to *Barrons.com*, a strong majority of [respondents expect loan quality to deteriorate in 2008](#) — consistent with recent trends and management rhetoric.

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