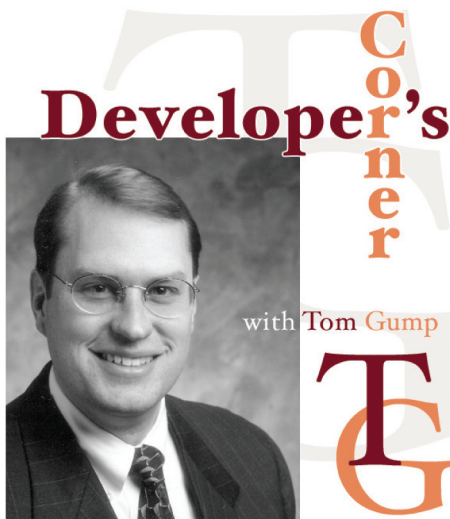


A developer's view of the stimulus package and other recent federal efforts to promote economic growth



By Tom Gump and Dan Piper

By now you have almost certainly heard about the American Recovery and Reinvestment Act of 2009 (the “Stimulus Act”) that was signed into law by President Obama on February 17, 2009. The approximately \$787 billion Stimulus Act is a broad mix of government spending and tax cuts aimed at stimulating economic growth. This column summarizes the Stimulus Act provisions and other federal government efforts that are most relevant for real estate developers.

First-time homebuyers tax credit

Perhaps the most important provision in the Stimulus Act, for real estate developers, is the expansion of the tax credit for first-time homebuyers. You may recall that in the Housing and Economic Recovery Act of 2008, Congress created a \$7,500 tax credit for first-time homebuyers. The tax credit was

designed to increase sales in the declining residential real estate market. Many observers, however, thought the tax credit did not go far enough. Indeed, the principal criticism of the tax credit was that it was not really a credit at all; rather, it was an interest-free loan that required taxpayers to repay the \$7,500 over a 15-year period.

The Stimulus Act makes several amendments to the first-time homebuyer tax credit. First, the credit’s original expiration date of July 1, 2009, is extended to December 1, 2009. Second, the Stimulus Act increases the maximum amount of the first-time homebuyer tax credit from \$7,500 to \$8,000. Third, and perhaps most importantly, the Stimulus Act eliminates the repayment requirement after a taxpayer has lived in the home for 36 months.

In spite of these changes, however, the tax credit continues to be criticized for not doing enough to turn around the real estate market. The real estate industry had pushed for a \$15,000 tax credit for all homebuyers, and many in the industry believe that the \$8,000 credit for first-time homebuyers alone will not be enough to improve conditions in the market. The critique also includes the scope of the tax credit, which applies only to purchases of a principal residence by a first-time homebuyer after December 31, 2008, and before December 1, 2009. (Purchases on or after April 9, 2008, and before January 1, 2009, continue to be governed by the first-time homebuyer credit as enacted in the Housing and Economic Recovery Act of 2008.) Finally, the credit is phased out for taxpayers with adjusted gross income in excess of \$75,000 (\$150,000 for joint filers).

FHA, Fannie Mae and Freddie Mac loan limits

In the Economic Stimulus Act of 2008, Congress temporarily increased loan limits for FHA, Fannie Mae and Freddie Mac mortgages. The Stimulus Act extends those increases throughout 2009. The goal of this change is to assist potential homebuyers who may have had difficulty obtaining mortgages in higher-cost markets.

Aid to communities

The Stimulus Act invests more than \$10 billion in affordable housing programs and community-based programs to reduce neighborhood blight. These provisions are intended to assist communities with high foreclosure rates by funding the purchase, repair and resale of foreclosed and abandoned properties. The investment here is designed to limit the negative impact that foreclosures are having on the real estate market in various communities.

Energy-related provisions

The Stimulus Act includes numerous provisions related to energy efficiency. For instance, it expands the tax credit available to individuals who make qualified energy efficient improvements, like installing new energy efficient windows, doors, air conditioners or furnaces.

Additionally, the Stimulus Act will provide \$6.3 billion to state and local governments to make investments in energy efficiency.

Developers of wind energy projects will be interested to know that the Stimulus Act has extended the “production tax credit” by three years, and also created an option, available to many devel-

opers of energy projects, to turn tax credits into direct cash, under a grant program by which the government will underwrite 30 percent of a project's cost.

Transportation improvements

Under the Stimulus Act, approximately \$46.7 billion is allocated to capital investment in transportation, including improvements to highways, bridges, transit and rail. These investments may create opportunities for developers located in close proximity to the improvements.

Other federal efforts:

The Homeowner Affordability and Stability Plan

On February 18, 2009, President Obama proposed the Homeowner Affordability and Stability Plan (the "Plan"). The Plan is designed to reduce the number of foreclosures, which have plagued the housing market. There are two major components of the Plan. The first major component is aimed at borrowers who have remained current on their mortgage payments, but who have been unable to refinance their mortgages to obtain a lower interest rate because their homes have decreased in value and they do not have the equity required to refinance. Under the Plan, these borrowers will have an opportunity to refinance into a 15-year or 30-year fixed rate loan. Eligible loans include those where the first mortgage (including any refinancing costs) will not exceed 105 percent of the current market value of the property. Complete eligibility details will be announced on March 4, 2009, when the program starts.

This first component of the Plan has already been criticized, however. Some have argued that it does not go far enough because it is limited to loans held or securitized by Fannie Mae or Freddie Mac. Others argue that it goes too far because it bails out some borrow-

ers who will have no difficulty making their payments.

The second major component is directed toward borrowers who are already behind or struggling to stay current on their mortgage payments. While the first component applies only to mortgages held or securitized by Fannie Mae or Freddie Mac, the second component applies to all mortgages regardless of who owns or services them. Under this component, mortgage lenders will be given \$1,000 to modify borrowers' mortgages and will continue to be paid "success" fees of up to \$1,000 per year that the borrower is able to stay current on the loan. In that sense, the Plan is not only designed so that lenders will reduce interest rates and lower monthly payments, but also to encourage lenders to reduce the principal amounts of the loans.

The Plan similarly provides incentives for borrowers, including a program that pays down the amount of a mortgage by up to \$5,000 for borrowers who make five years' worth of timely payments under a modified loan. The Plan appears to be a temporary solution only. After five years, payments are expected to increase at a gradual rate. To qualify for this type of mortgage modification, a borrower must (a) occupy the home as the borrower's primary residence; (b) have a monthly mortgage payment that is greater than 31 percent of the borrower's monthly gross income; and (c) have a loan that does not exceed current Fannie Mae and Freddie Mac loan limits. Final eligibility guidelines will be available on March 4, 2009.

The Plan's second component has also been the subject of criticism. Many believe that it does not do enough for struggling homeowners because the program is voluntary, and lenders need not modify any mortgage loan if they choose not to do so. Others have argued that the government should not be making incentive payments to lenders or bor-

rowers who simply do what they should already be doing—modifying loan agreements to create workable solutions and making timely payments.

Purchases of mortgage-backed securities and toxic assets

In other efforts, the Federal Reserve has begun to purchase mortgage-backed securities in an attempt to drive down mortgage interest rates. Additionally, Treasury Secretary Timothy Geithner has announced -- though not in much detail -- plans for a public-private partnership for purchasing toxic assets from banks. This effort is designed to reintroduce confidence in the banking system so that banks will begin lending again.

Conclusion

It is clear that Congress and the Obama administration are beginning to take bold steps in an effort to stimulate the economy. It remains unclear, however, exactly how quickly and how effectively these steps will lead to economic growth and a turnaround in the real estate market.

Dan Piper is an associate in Fredrikson & Byron's Real Estate Group. He assists clients with a variety of commercial and residential transactions, including the sale, acquisition, leasing, and financing of properties.

Tom Gump, Principal and Managing Broker of Neighborhood Development Partners, LLC, invites comments and questions about this column. He can be reached at Neighborhood Development Partners, LLC, 750 Second Street N.E., Suite 100, Hopkins, Minnesota 55343; (952) 224-9140; or via email: omg@ndp-mn.com.