

UPDATE

News of Developments in the Financial Sector and Related Areas

* *IN THIS ISSUE* *

Net Operating Losses

Quarterly Banking Profile

Subordination, Nondisturbance and Attornment Agreements

Net Operating Losses

In November 2009, President Obama signed into law the Worker, Homeownership and Business Assistance Act of 2009 (the "Act") which among other things, extends the net operating loss ("NOL") carryback period from two years to as many as five years for NOLs rising in 2008 and 2009. In order to pay for the extension of the NOL carryback period, the Act delays until 2018 the implementation of changes in interest expense allocations that were expected to increase the foreign tax credits that could be claimed by U.S. corporations.

The American Recovery and Reinvestment Act of 2009 (the "ARRA") extended the NOL carryback period from two to five years for NOLs rising in 2008 for certain small businesses with gross receipts of \$15 million or less. The NOL carryback provisions of the Act expands the relief provided under the ARRA to most business and expands the time period to include NOLs arising from the year 2009.

An NOL generally represents the amount by which a taxpayer's business deductions exceed its gross income. Under present law, an NOL may be carried back two years and carried forward up to twenty years to offset taxable income in such years. Subject to limitations as set forth in the Act, a taxpayer may make a special election to carryback NOL deductions for up to five years for losses incurred in a tax year beginning or ending in either 2008 or 2009. The Act does not limit carrybacks for the first four years of the carryback period, but for year five, the carryback is generally limited to fifty percent of the taxpayer's taxable income in that year.

Under present law, an NOL reduction cannot reduce the taxpayer's alternative minimum taxable income ("AMTI") by more than ninety percent of the AMT. Under the Act, the ninety percent limitation is suspended on the use of any alternative tax NOL deduction attributable to carrybacks of the applicable NOL for which an extended carryback period is elected.

The Act also provides an election to life insurance companies to increase the present law carryback period for "losses from operations" from three years to up to five years. The "losses from operations" carryback for life insurance companies is limited to fifty percent of taxable income in the fifth year.

The Internal Revenue Service has issued Revenue Procedure 2009-52 which provides guidance to taxpayers electing to carryback a NOL to offset taxable income.

Because the Act and the Revenue Procedure are technical in nature, taxpayers are encouraged to seek the advice of a tax professional.

Quarterly Banking Profile

The Federal Deposit Insurance Corporation ("FDIC") has issued its *Quarterly Banking Profile* reflecting the financial results for the third quarter of this year. The FDIC noted that asset quality has continued to deteriorate. Both the quarterly net charge-off rate and the percentage of loans and leases that were noncurrent (90 days or more past due or in nonaccrual status) rose to the highest level in the 26 years that insured institutions have reported this data. Insured institutions charged off \$50.8 billion in uncollectable loans during the quarter and noncurrent loans and leases increased by \$34.7 billion during the third quarter. At the end of September 2009, noncurrent loans and leases represented 4.94 percent of the industry's total loans and leases.

The net worth of the FDIC's Deposit Insurance Fund fell below zero for the first time since the third quarter of 1992. The fund balance of negative \$8.2 billion reflects a \$38.9 billion contingent loss reserve that has been set aside to cover estimated losses for anticipated closings over the next year.

The number of institutions on the FDIC's *problem list* rose to its highest level in 16 years. At the end of September 2009, there were 552 insured institutions on the problem list, up from 416 on June 30, 2009. This is the largest number of problem institutions since December 31, 1993, when there were 575 institutions on the list. Problem institutions are characterized as those institutions having a risk of failing and being closed by the FDIC. Total assets of problem institutions increased during the quarter from \$299.8 billion to \$345.9 billion, the largest level since the end of 1993. The

Quarterly Banking Profile is available on the website of the FDIC at www.fdic.gov.

Subordination, Nondisturbance and Attornment Agreements

Subordination, nondisturbance and attornment agreements are often referred to as *SNDA agreements*. They are generally utilized in connection with real estate leases when there is a mortgage by the landlord to a lender. SNDA agreements provide protection for the lender in that the lessee agrees to subordinate its interest to the lender's mortgage and in the event of foreclosure by the lender of its mortgage, the lessee agrees to attorn to the new owner and recognize the new owner as the landlord under the lease.

SNDA agreements also provide protection for the lessee in that the lease will continue in the event of a foreclosure and a new owner, and the lessee's use of the premises will not be disturbed or impaired as a result of lessee subordinating its interest under the lease to the mortgage of the lender. For the benefit of the lender, the SNDA agreement will provide that the lease will be subject and subordinate to the mortgage, the lien imposed by the mortgage and all advances under the mortgage. For the benefit of the lessee, the SNDA agreement will provide that a new owner will not terminate or disturb the lessee's possession of the premises under the lease except in accordance with the terms of the lease, and the new owner will be bound to the lessee under the terms and conditions of the lease.

SNDA agreements should also provide that in the event of a default under the lease by the landlord, that the lessee will provide notice to the lender in order to provide the lender an opportunity to cure the default by the landlord. SNDA agreements provide important protections to both a lender and

to a lessee and should be utilized in the lease of premises subject to a mortgage.