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STIMULUS BILL ALERT **Economic Growth and Development**

SMALL BUSINESS AND THE ECONOMIC RECOVERY

One of the most debilitating aspects of the current economic situation in the U.S. is the near collapse of the credit markets for small business and consumer loans. This bulletin will focus on the most significant efforts by the Federal government and Federal Reserve to jump-start these credit markets, and the status of those efforts.

TARP – The Troubled Asset Relief Program

The first of the financial system "bailout" bills enacted by the Congress was the Emergency Economic Stabilization Act of 2008, that became law on October 3, 2008. This Act authorized the U.S. Secretary of the Treasury to spend up to $700 billion to purchase distressed assets, and to make direct capital infusions into commercial and investment banks. The program created by this Act is known as the Troubled Asset Relief Program ("TARP"). The TARP was originally designed to focus largely upon the purchase of illiquid asset-backed securities. However, the purpose of the TARP has evolved over the last 6 months as the economic situation has deteriorated.

The first $350 billion of the TARP bailout money mainly was used to directly inject capital into troubled banks in exchange for preferred stock. In theory, the injection of this relatively low cost capital would stabilize the balance sheets of the recipient banks, and encourage them to begin offering loans to credit-worthy applicants (both businesses and consumers). To date, this use of the TARP funds has had little appreciable effect on the credit market.

Shortly before his inauguration, President Obama prevailed upon President Bush to seek authority to distribute the remaining $350 billion in TARP funds to the U.S. Treasury for future stimulus projects. After extended debate about the need for more transparency in the TARP, Congress granted authority for the expenditure of these additional monies.

To date, the first round of TARP funding has had essentially no impact on small and medium-size businesses, and their need for access to credit. Similarly, the bulk of the funds in the second round of funding is not likely to have any direct impact upon the credit needs of these businesses. The second round will be aimed at particular industries, such as the recent announcement of a $5 billion TARP-funded loan facility for the auto supply industry.

However, two additional broad-based programs that will receive seed capital from the TARP funds should, theoretically, begin to thaw these vital credit markets.

TALF – The Term Asset-Backed Securities Loan Facility

On March 3, 2009, the Federal Reserve and the Treasury Department announced a program specifically aimed at thawing the small business and consumer lending markets. This program is known as the Term Asset-Backed Securities Loan Facility, or "TALF."

The TALF is designed to finance up to $1 trillion in new lending to small business and consumers, by creating initially a $200 billion Loan Facility that will be available to private investors seeking to purchase certain AAA-rated asset backed securities ("ABS").

This Loan Facility will be funded by the Federal Reserve Bank of New York, and partially backed by TARP funds. The TALF is designed to replace the ABS market that was thriving before last year's credit collapse. In light of the fact that the ABS market was annually handling approximately $1 trillion in securities backed by various consumer and small business loans, it is not surprising that the goal of the TALF is to enable the issuance of a similar amount of ABS.

The TALF provides low interest, three-year loans to investors to induce them to purchase the new AAA rated securities. Borrowers can request TALF loans in minimum amounts of $10 million and can pledge the new ABS instruments as security. Requests for the first round of loans were first accepted on March 17, 2009.

The first TALF round was met with robust demand during its first week. The first TALF deal was a $1.3 billion offering of Nissan ABS designed to free up capacity for Nissan to make auto and truck retail loans. The Nissan deal was four to five times oversubscribed in the first eight minutes after it was announced. In addition, Ford Motor Credit Co. conducted a similar $2.7 billion offering.

In light of these early deals, it is now anticipated that the TALF program will positively impact the availability of credit. According to the Federal Reserve, the TALF may now be expanded to include other types of securities, including securities backed by mortgages, buyers of business equipment, leases to car rental companies and auto dealer loans.

If the TALF program continues to perform as it has this week, we may finally be seeing the end of the credit crunch for small and medium sized businesses, as well as consumers.

Stimulus Bill Provisions

The American Recovery and Reinvestment Act of 2009 (the "Stimulus Bill") was enacted into law on February 17, 2009. Among the myriad of programs addressed in the Stimulus Bill were two sets of provisions specifically aimed at small and medium-sized businesses. These provisions deal with: (i) loosening the credit crunch; and (ii) providing additional business-oriented tax breaks.

Stimulus Bill Credit Provisions

As noted above, the last quarter of 2008 witnessed an almost complete collapse of the small business and consumer credit markets. In large part, the collapse was caused by the virtual disappearance of the ABS market. The inability of lenders to remove small loans from their balance sheets, through securitization in the ABS market, caused the freeze of business and consumer lending that is just now starting to thaw as a result of the implementation of the long-delayed TALF plan. However, the Stimulus Bill did not address these issues. In fact, the only provisions in the Stimulus Bill affecting small and medium-sized businesses are a number of enhanced tax deductibles and credits.

Stimulus Bill Tax Provisions

The Stimulus Bill also contained a series of changes in federal tax law designed to encourage the growth of small and medium businesses. For example, the Stimulus Bill changed the carryback loss rules for the 2008 tax year, permitting five years of prior losses to be considered.

In addition, the Stimulus Bill renewed the temporary increase in the maximum amount of equipment lease costs that a business can write-off in a single tax year. Early in 2008, the Section 179 limit was increased to $250,000 for the 2008 tax year, and the Stimulus Bill has extended this increased limit for the 2009 tax year.

The Stimulus Bill also contains a variety of Work Opportunity Tax Credits for businesses that hire new employees from certain target groups.

Finally, the Stimulus Bill contains a more generous individual capital gains treatment for stock purchased in small businesses and held for at least five years. These purchases must be of stock issued after the date of the Stimulus Bill. This provision will permit the owner of qualifying small business stock to exclude from income up to 75% of the capital gains from this stock.

Stimulus Bill and the SBA

Another key area of the Stimulus Bill targeted at the credit needs of small and medium-sized businesses is a series of provisions liberalizing and enhancing the ability of the Small Business Administration ("SBA") to make loans to qualifying businesses.

The Stimulus Bill authorized the SBA to temporarily eliminate or reduce fees for participation in its loan guarantee programs, that insure banks against default by small business borrowers. In addition, the Stimulus Bill increased to 90% the percentage of qualifying loans that the SBA can guarantee.

The Stimulus Bill also created a new "small business stabilizing financing" program to permit qualifying businesses to borrow up to $35,000 from the SBA to make six months of payments on existing loans. These stabilizing loans have very attractive terms, and are designed to help small businesses through the current liquidity crunch.

Finally, the Stimulus Bill significantly increased the size and scope of the SBA microloan program that makes loans up to $35,000.

Recent Developments

On Monday, March 16, 2009, President Obama announced that, in addition to the changes in the SBA program outlined in the Stimulus Bill, the Treasury Department would allocate $15 billion in TARP funds to a new program designed to buy small business loans from community banks and other lenders. This newly announced program is designed to work with the Stimulus Bill measures and the TALF to unlock the credit markets for small and medium-sized businesses.

Conclusion

Over one year ago, the current economic crisis began, in large part with a failure in the asset-based securities credit market exemplified by the collapse of Bear Stearns. Despite the efforts of the federal government, the underlying problems that triggered the credit crisis remain largely unchanged. Hopefully, the new measures by the federal government combined with the ongoing efforts of the Federal Reserve will finally thaw the credit markets.

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