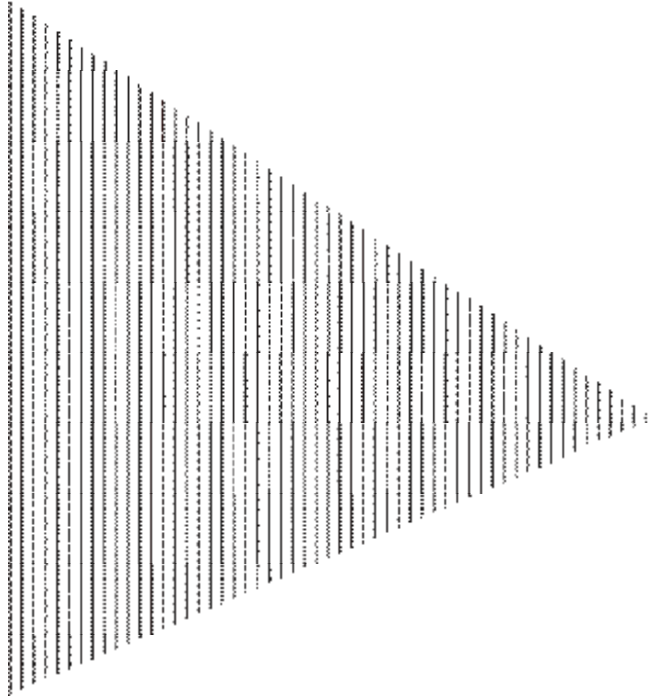


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# Insights into today's real estate market

11 December 2008

 **ERNST & YOUNG**  
*Quality In Everything We Do*

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# Today's Moderator

**Mark Grinis**

*Partner, Ernst & Young LLP*

# 2008 Timeline: Unprecedented Events

	Jan. - Aug	September	October	November	
<b>Government Actions</b>	<ul style="list-style-type: none"> <li>▶ US Rate Cut (75bp)</li> <li>▶ US Rate Cut (50bp)</li> <li>▶ US Fed Cash Loan (200)</li> <li>▶ US Treasury Security &amp; Cash Loans (236)</li> </ul>	<ul style="list-style-type: none"> <li>▶ Goldman &amp; Morgan Stanley: "Bank Holding Cos."</li> <li>▶ Loosened PE-Bank Investment rules</li> <li>▶ SEC ban on short selling</li> <li>▶ FBI Fraud investigation</li> </ul>	<ul style="list-style-type: none"> <li>▶ SEC / IASB clarification on fair value accounting</li> <li>▶ US Comm'l Paper funding facility</li> <li>▶ Ireland guarantees deposits at 6 banks</li> <li>▶ Germany guarantees all private bank accounts (~800)</li> <li>▶ Simultaneous Central bank rate cuts: US-50bp; BoE-50bp; ECB-50bp; China-27bp; Swz-25bp</li> </ul>	<ul style="list-style-type: none"> <li>▶ China announces stimulus plan (586)</li> <li>▶ Paulson: Chooses CPP over TARP for first (350) stimulus</li> <li>▶ Fed. Reserve to buy Fannie, Freddie &amp; Ginnie MBS (500)</li> <li>▶ Central bank rate cuts: AUS-100bp; BoE-150bp; ECB-50bp; China-100bp; Swz-150bp</li> </ul>	
<b>Government Bailouts</b>	<ul style="list-style-type: none"> <li>▶ Bear Stearns (29)</li> </ul>	<ul style="list-style-type: none"> <li>▶ Fannie &amp; Freddie (200)</li> <li>▶ AIG (85)</li> <li>▶ WaMu seized</li> <li>▶ US Guaranty program for MM funds (50)</li> </ul>	<ul style="list-style-type: none"> <li>▶ Troubled Asset Relief Program (TARP – 700)</li> <li>▶ Glintner</li> <li>▶ B&amp;B (78)</li> <li>▶ Dexia (9)</li> </ul>	<ul style="list-style-type: none"> <li>▶ Fortis (NL) (~24)</li> <li>▶ AIG (38)</li> <li>▶ Hypo Real Estate (69)</li> <li>▶ Landsbanki (Iceland)</li> <li>▶ Russian state banks (37)</li> <li>▶ CITI (25)</li> </ul>	
<b>Acquisitions (buyer / seller) &amp; Bankruptcies</b>	<ul style="list-style-type: none"> <li>▶ BoA / Countrywide</li> <li>▶ JPMorgan / Bear Stearns</li> <li>▶ IndyMac (bankrupt)</li> </ul>	<ul style="list-style-type: none"> <li>▶ Lehman (bankrupt)</li> <li>▶ Nomura / Lehman (Europe, Asia, ME)</li> <li>▶ Barclays / Lehman (NA)</li> </ul>	<ul style="list-style-type: none"> <li>▶ BoA / Merrill</li> <li>▶ Lloyds / HBOS</li> <li>▶ Berkshire / Goldman</li> <li>▶ JPMorgan / WaMu</li> <li>▶ Santander / B&amp;B</li> </ul>	<ul style="list-style-type: none"> <li>▶ BNPP / Fortis (BL,LX)</li> <li>▶ Wells Fargo / Wachovia</li> </ul>	<ul style="list-style-type: none"> <li>▶ Itao Holdings Finaceira /Unibanco Brazil</li> <li>▶ Allco Finance (bankrupt)</li> <li>▶ US Bancorp/Downey S&amp;L</li> <li>▶ Aegon/FSA</li> </ul>
<b>CEO / Chair Changes</b>	<ul style="list-style-type: none"> <li>▶ UBS</li> <li>▶ Wachovia</li> </ul>	<ul style="list-style-type: none"> <li>▶ Fannie &amp; Freddie</li> <li>▶ AIG</li> </ul>			

All figures in \$bn unless otherwise noted

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# Today's Presenters

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## Tom Horton

Executive Director, Structured Finance Advisory Services,  
Ernst & Young LLP

## Bill Seidman

Economist and Chief Commentator, CNBC

## Mike Straneva

Americas Director of Transaction Real Estate, Ernst & Young LLP

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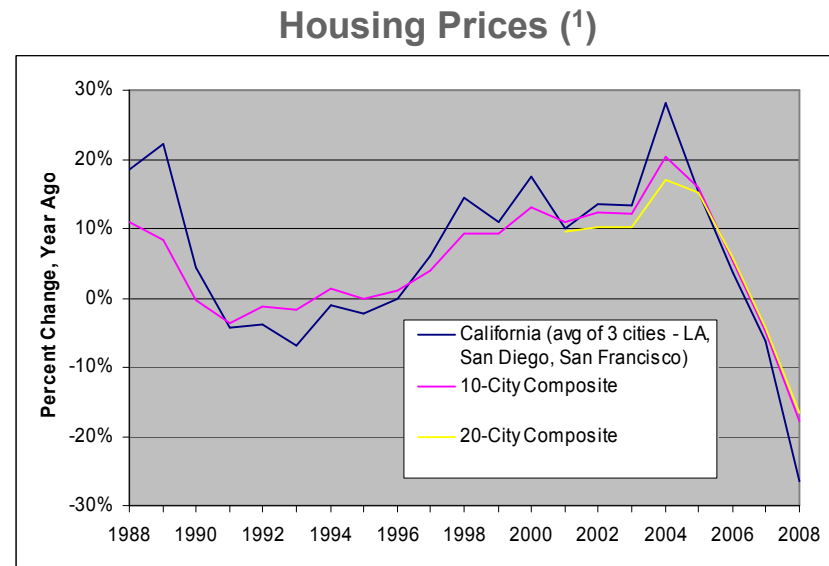
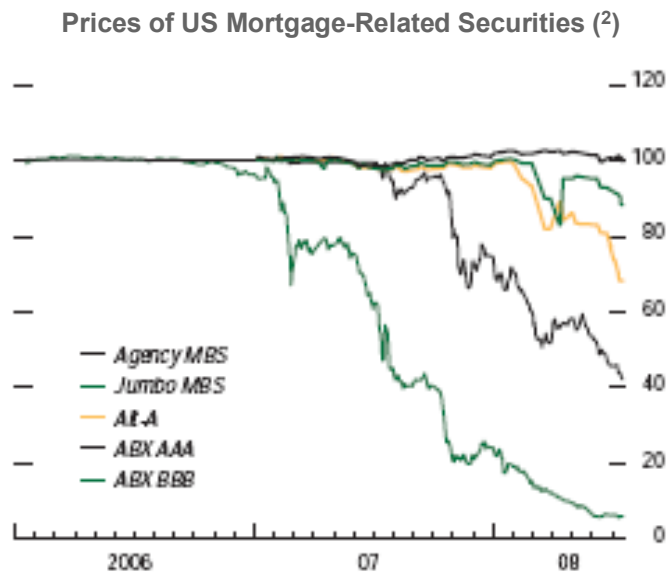
# Today's agenda

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- ▶ Real estate and credit market perspectives
- ▶ Government initiatives and the TARP
- ▶ Commercial and residential market update
- ▶ FAS 157 and valuation challenges
- ▶ Distressed investment opportunities and timing the market

# Real estate and credit market perspectives

- ▶ 1995-2005 home prices nearly double
- ▶ 2006 housing bubble bursts with Florida, California, Nevada & Arizona experiencing the largest declines



- ▶ The collapse in home prices impacts securitized loan pools
- ▶ Sharp Decline in Value of Mortgage-Related Securities; AAA ABS (-55%) & BBB ABS (-95%)

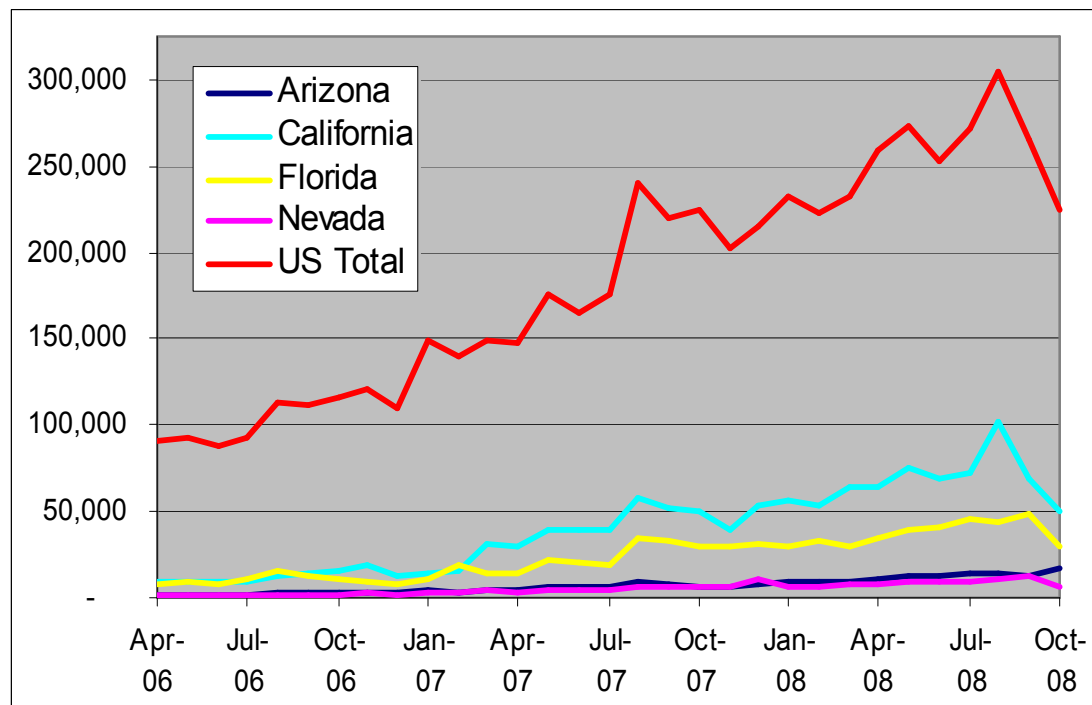
(1) Compiled from the August 2008 S&P/Case-Shiller Home Price Indices

(2) Source: IMF Global Financial Stability Report, October 2008

# Real estate and credit market perspectives (cont.d)

- ▶ Unsold inventory is increasing (expected 2.5 million foreclosures in 2008)
- ▶ Almost one in ten home loans are in default or in foreclosure
- ▶ Home prices decline 19% from peak in top 20 markets

US Foreclosure Filings (1)



(1) Source: [www.Realtytrac.com](http://www.Realtytrac.com)  
Page 8

# Polling question

**Will the various mortgage modification programs currently underway:**

- A. Help establish a housing floor**
- B. Only delay the price correcting process**
- C. Create more foreclosures through moral hazard**

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# Polling question

**The bottom of the housing market is likely to occur:**

- A. Within 6 months**
- B. Within 12 months**
- C. Within 18 months**
- D. More than 24 months**

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# Government actions and the TARP

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## Spent

- ▶ \$335 billion already committed
- ▶ Capital distributed to financial institutions, including JPMorgan Chase & Co, Bank of America Corp., and Wells Fargo & Co. in exchange for preferred stock
- ▶ Not including special assistance provided to AIG and Citigroup
- ▶ Additional \$10 billion set aside for Merrill Lynch & Co., to be settled after its acquisition by Bank of America
- ▶ \$40 billion pledged to AIG

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# Government actions and the TARP (cont.d)

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## Recently unveiled

- ▶ Term Asset Backed Securities Loan Facility - \$200 billion targeting student, auto, credit card and small-business loans to be backed by a \$20 billion in credit protection from the TARP fund
- ▶ Purchase of \$100 billion in debt issued by the housing GSEs and \$500 billion in mortgage-backed securities issued by Fannie Mae, Freddie Mac and Ginny Mae

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# Government actions and the TARP (cont.d)

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## FDIC (proposed only)

- ▶ Plan to prevent about 1.5 million foreclosures by sharing any losses with mortgage companies that agree to refinance certain home loans
- ▶ Foreclosure prevention estimated at \$24.4 billion
- ▶ \$1.4 trillion to guarantee bank to bank loans

## Fed

- ▶ \$2.4 trillion in commercial paper program

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# Polling question

**Will there be significant distressed investment opportunities next year, and who will be the primary seller?**

- A. Banks**
- B. Government Agencies**
- C. Private Equity & Hedge Funds**
- D. Expect few sellers disposing of non-performing assets in the market**

# Commercial real estate

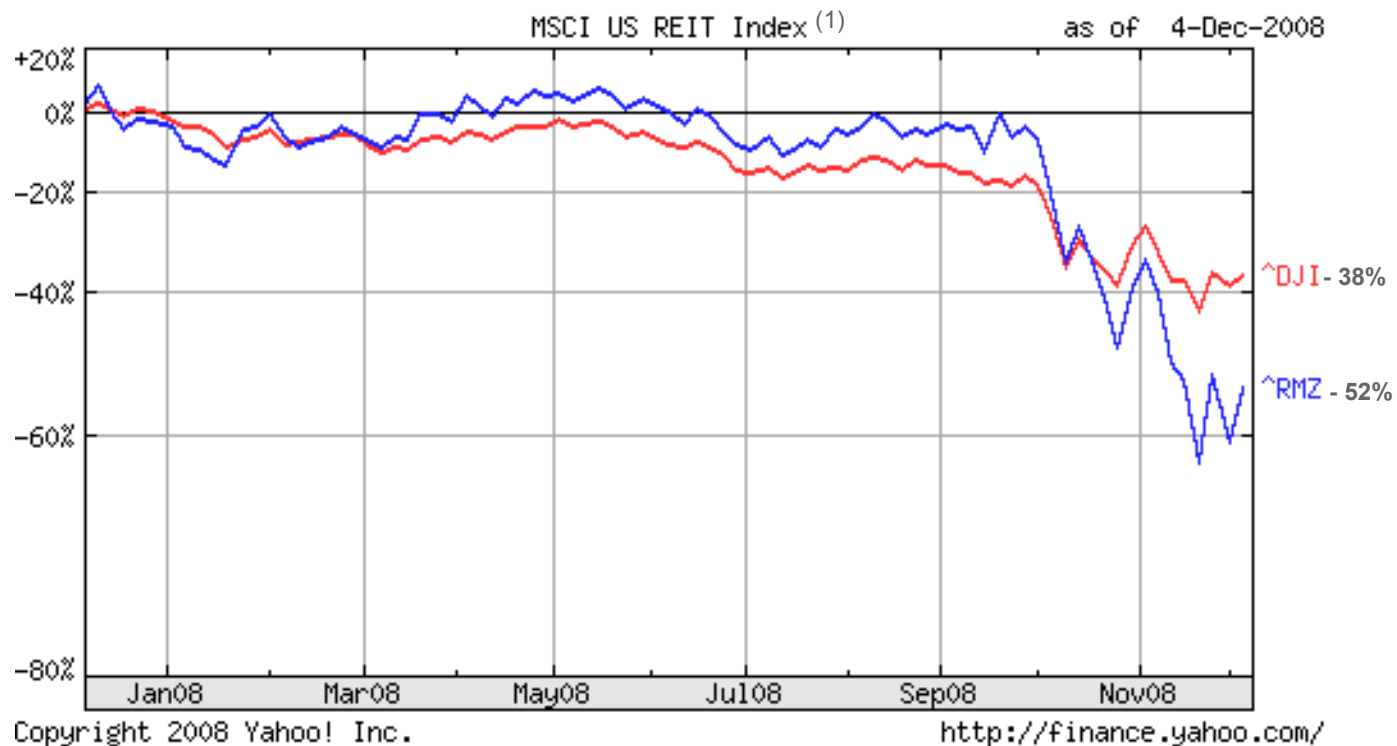
- ▶ Is commercial real estate next?



(1) Source: [www.Markit.com](http://www.Markit.com) Dec. 8, 2008 CMBX 04-1 AAA Index

# Commercial real estate (cont.d)

- ▶ The E&Y survey reports that 85% of respondents expect values to decrease by as much as 20% over the next 12 months<sup>(2)</sup>
- ▶ Office REITs are trading at a 25% discount to NAV



(1) Source: Yahoo Finance (2) EY/Globestreet.com Reality Check Survey 10/15/2008

# Polling question

The \$700 billion TARP program has reportedly yet to acquire any toxic assets from banks but has already distributed close to \$350 billion into financial institutions. How much additional funding do you think is needed to allow TARP to reasonably acquire toxic real estate assets from banks and other lending institutions?

- A. Less than \$500 billion
- B. Between \$500 billion and \$1 trillion
- C. More than \$1 trillion

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# Fair value measurements

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- ▶ What does FAS 157 do?
  - ▶ Establishes a singular definition of fair value
  - ▶ Provides a conceptual framework for measuring fair value
  - ▶ Expands disclosures about the use of fair value
- ▶ What does FAS 157 NOT do?
  - ▶ Require additional fair value measurements under US GAAP
  - ▶ Provide detailed “how to” guidance with respect to valuation
  - ▶ Address which items are to be measured at fair value or when this measurement should be used
  - ▶ Eliminate the practicability exceptions to fair value measurements that exist in other accounting pronouncements

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# Current application challenges

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- ▶ FAS 157 is principles based and can involve significant judgment
  - ▶ Interpretation of the principles may differ
- ▶ Differing approaches in application
  - ▶ Quantifying non-performance risk
  - ▶ Determining whether the market for an asset is active
- ▶ Changing fair value landscape
  - ▶ Significant standard setter activities and focus

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# Government infrastructure spending

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- ▶ Congress has been discussing a measure that they hope to have ready by the end of January which would earmark as much as \$700 billion over two years to be allocated to states for infrastructure spending (i.e. bridges, roads, rails....) and create 2.5 million jobs
- ▶ Measures expected to cut red tape would enhance the effectiveness of funds distributed.
- ▶ Spending is expected to ease rising unemployment
- ▶ The new White House administration is seen to favor a “new deal” approach to combating the current recession

# Polling question

**Do you think the \$700 billion of potential infrastructure spending coupled with the creation of 42 new infrastructure funds will benefit:**

- A. Infrastructure funds only**
- B. Construction firms**
- C. Commercial property operators**
- D. All**

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# Increasing non-performing assets requires more aggressive disposition strategies

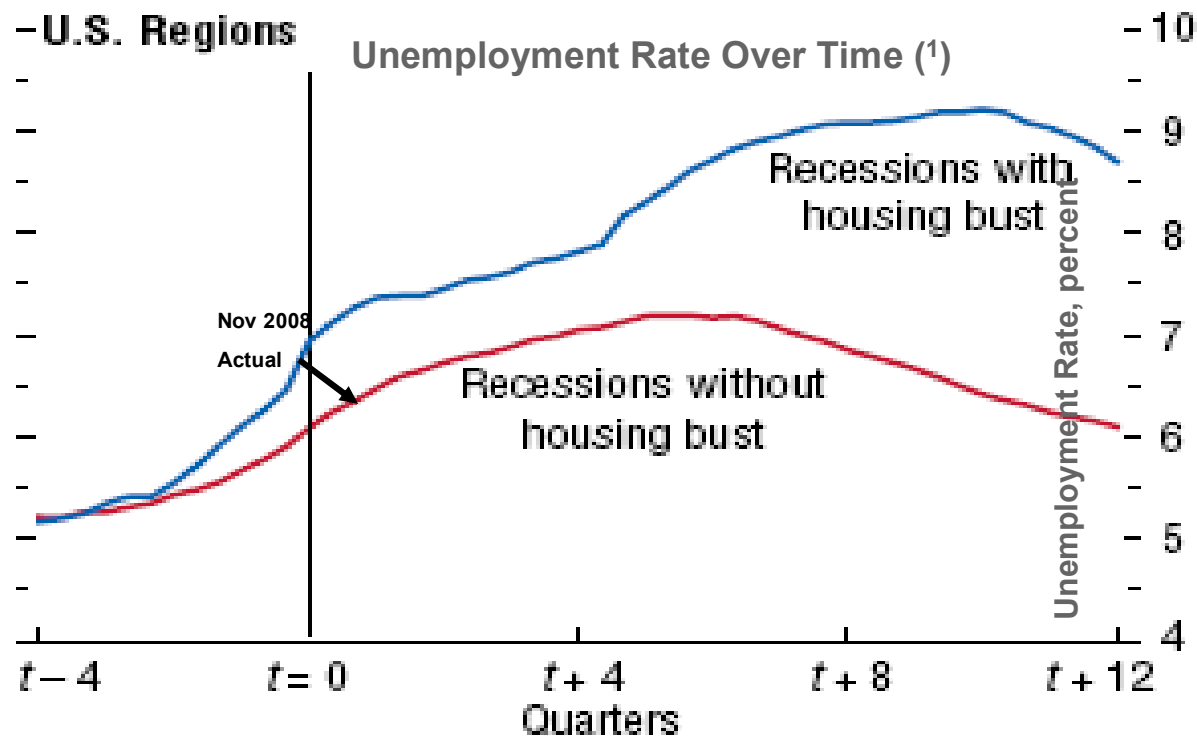
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- ▶ Foreclosed homes inventories estimated to be held by financial institutions rose to 871,000, up from 414,000 a year ago <sup>(1)</sup>
- ▶ Expected inventories to peak at 1.4 million by mid 2010. <sup>(1)</sup>
- ▶ As inventories of foreclosed homes increase the likelihood of dispositions through bulk sales will increase
- ▶ Recently an investor purchased 800 homes from Fannie Mae for a reported \$1.2 million, averaging \$1,500 per home <sup>(1)</sup>
- ▶ Small commercial portfolios are being marketed to test market demand and pricing

(1) Source: Wall Street Journal; Lenders Tiptoe Into Bulk Sales; Dec. 2<sup>nd</sup>, 2008

# Duration of recessions

- ▶ Recessions associated with housing busts and credit crunches are longer and deeper



(1) Source: IMF World Economic Outlook, October 2008

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# Recap

# One minute recap

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# Question from the audience

**Q&A**

# Thanks for participating!

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