

SHEARMAN & STERLING_{LLP}

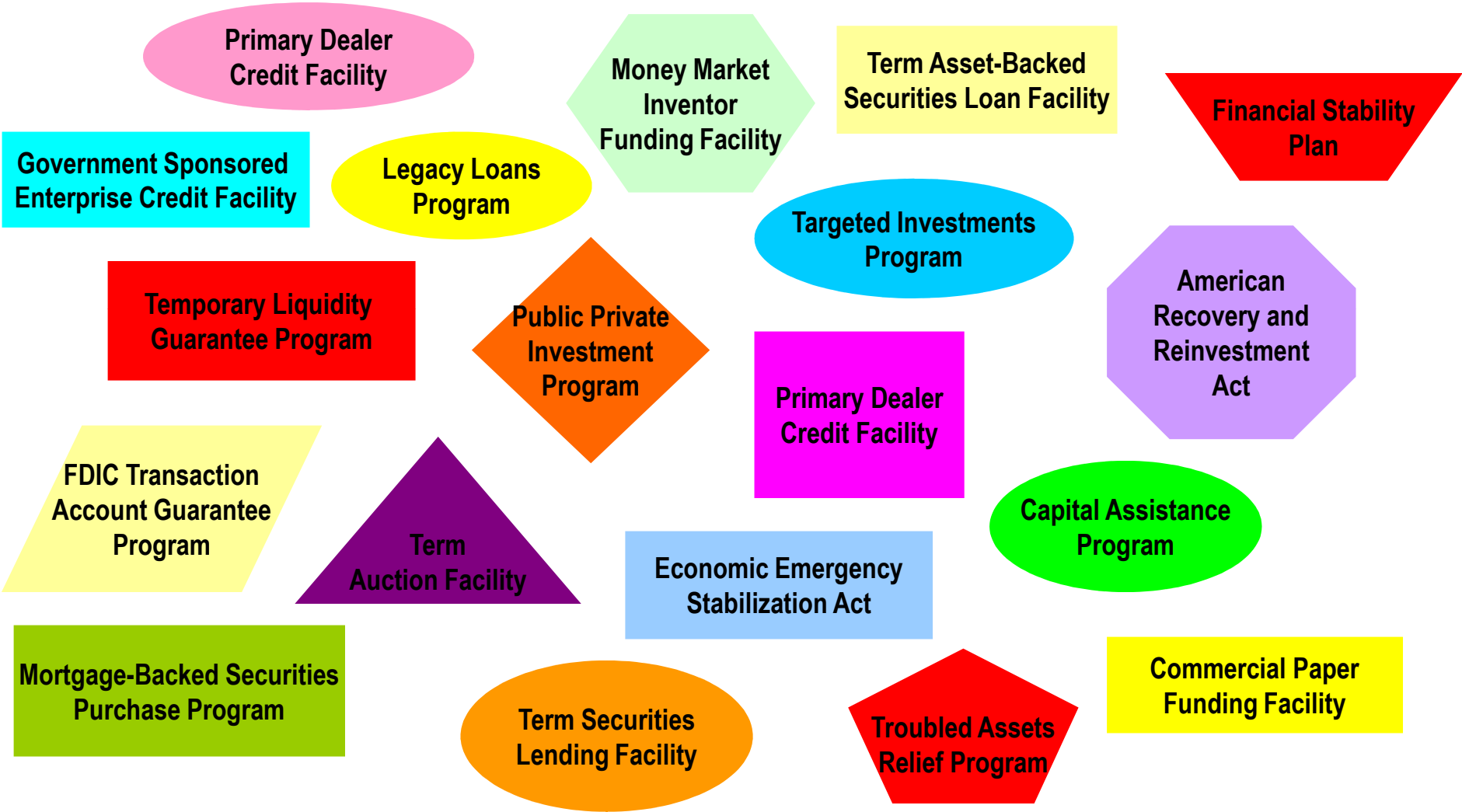
Government to the Rescue Dream or Nightmare?

ULI Europe Annual Conference

3 February 2010, Paris

CLARE BREEZE

US Government Initiatives



Troubled Asset Relief Program

Troubled Asset Relief Program ("TARP")

- TARP was intended to improve the liquidity of "troubled assets"
- In practice, TARP funds have been used almost exclusively to recapitalize financial institutions

Term Asset-Backed Securities Facility

Term Asset-Backed Securities Facility ("TALF")

- Federal Reserve Bank of New York ("FRBNY") extends credit to holders of eligible asset-backed securities ("ABS") offered as collateral for TALF funding
- As of 30 December 2009¹:
 - \$10 billion of TALF loans are backed by CRE loans of which less than \$500 million are legacy loans (pre 01/01/09)
 - Only one issuer has offered new CMBS as collateral for TALF loans
 - Most of the notable financial institutions have offered legacy CMBS as collateral for TALF loans (inc. Bear Stearns, Citigroup, Credit Suisse, GE, GMAC, JP Morgan Chase, UBS, Merrill Lynch, Morgan Stanley, Wachovia)

¹ Federal Reserve System Monthly Report on Credit and Liquidity Programs and the Balance Sheet (January 2010)

Term Asset Backed Securities Facility cont.

- Increasing appetite for non-TALF structured vehicles
 - CMBS - 2 of the 3 CMBS issued in 2009 did not use TALF funding. Many Investors feared that by investing in TALF structured vehicles, they might in some way be caught by the restrictions imposed on financial institutions utilising Government funding (eg. employee compensation curbs)
 - CRE loans - in December 2009, JP Morgan Chase raised \$625m for Inland Western, a real estate investment trust of which \$500m was in the form of securities backed by commercial real estate assets²
- Current uncertainty as to TALF availability for downgraded legacy CMBS

² Henry Sender (10 January 2010), FT.com

REMIC Regulations

September 2009: Real Estate Mortgage Investment Conduit ("REMIC") Regulations

- Borrowers now have the ability to speak to Servicers about restructuring in the event of impending default (previously only post-default)
- Servicers now have greater flexibility to restructure loans (by reducing interest rates, substituting collateral, amortising interest and extending terms)
- Servicers' increased flexibility may exacerbate tensions between Servicers and different tranches of CMBS Investors. Internal servicing disputes will slow down the loan modification process
- Servicers' ability to modify loans is generally restricted by the related CMBS pooling and servicing agreements ("**PSAs**") so what statute permits, contracts prohibit
- DELAY AND PRAY

Policy Statement on Prudent Workouts

October 2009: Policy Statement on Prudent Commercial Real Estate Loan Workouts

- Policy Statement is a roadmap for financial institutions to:
 - implement prudent CRE loan workout arrangements (rather than foreclose)
 - reduce adverse regulatory treatment of restructured loans
- Washington's approach is easy to understand:
 - forcing lenders to write down multiple non or barely performing loans could trigger unprecedented bank failures
 - it reduces the impact of the maturing CRE loans for which there does not appear to be an alternative capital source to refinance (approx \$1,500 billion of CRE loans are due to mature by 2012)
- EXTEND AND PRETEND
- Critics claim the restructuring and workouts approach retards the rate of recovery, prevents the pricing system from working effectively and extends and enhances the period of uncertainty

The Crystal Ball

- How do you measure the success of the US Government's intervention?
- Is the banking system sound enough to absorb the distressed commercial real estate assets and value write downs over mark-to-market?
- DELAY AND PRAY that asset values return to some semblance of their former lofty levels
- EXTEND AND PRETEND that banks can take write-downs when their balance sheets are stronger
- Is a second crash around the corner?
- Will this be the USA's "lost decade"?