

Good afternoon, and thank you for allowing me to participate as a speaker at this Conference.

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My topic is Distressed Property and the Opportunities Presented, which is an interesting topic within the context of a REIT Conference.

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One of the reasons I was asked to speak on this topic is my background in the distressed real estate markets and my related credentials.

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As a quick background, I spent the first 10 years of my career at Lehman Brothers and then spent the past 7 years effectively investing my capital firstly alongside Lone Star and for the past 5 years as a founder and managing partner of Patron Capital. We now manage on a discretionary basis approximately €600 million of equity or over €3 billion in assets across 3 funds. We have investments throughout Europe including Germany, Italy, Spain, England, Switzerland, Check Republic and Slovakia

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A large part of my experience has been in the acquisition, management and exit of distressed assets in multiple jurisdictions.

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I have had the benefit of being involved with and leading many of the earlier landmark transactions which established the precedents for the current environment.

Some examples include being involved in Texas in the late 80's before the RTC was formed and helping Ron Perlman acquire First Gibraltar Savings which was rumoured to make over \$1.5 billion,

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I led the acquisition of over \$15 billion of distressed assets in the U.S. and Europe

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establishing and being one of the early players in buying distressed mortgage assets and companies in the United Kingdom, followed on by doing the first large transaction in France in 1994 and

owning and operating various servicing companies and banks throughout Europe.

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As a starting point it is important to define "What is Distressed?".

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From our mutual investor perspective I am considering primarily distressed loans and direct assets which are secured by property either commercial, residential or other forms of property product.

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Most of the activity that involves third party buyers, typically refers to secured product although there are large markets in the consumer unsecured industry.

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From a historical perspective there are several major trends, which need to be understood within the context of this business.

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First is a classic credit cycle in which the economy moves into recession, loans default and may never recover, property prices significantly fall until the economy stabilises.

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After which, more ambitious lenders return lending to these troubled customers followed by a general increase in underlying asset values.

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This credit cycle in its rawest form dates back to biblical times with Joseph and the seven-year cycle of feast or famine.

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However, in our sophisticated markets there have been quite a significant number of variations that have been developed. For example, after buying distressed assets in the early 90's, we led the largest management buy-out of a sub-prime mortgage lender in the United Kingdom in 1999, in which its basic business was

lending to customers with general poor credit quality and bad histories in relation to the prior recession.

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The delinquency levels remained at approx 20% but we received close to 90% of what was due on a monthly basis. The spreads in the business were so significant it more than covered any problems. The business was sold to GE in 2001 and is now generating over €600 million in monthly production.

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As most people in the audience either know about the distressed property markets or have read quite a bit of information on them I thought it would be helpful to share some specific perspectives that are not normally considered.

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With respect to the sellers, there appears to be from the newspapers a general area of distressed real estate assets in which various people participate depending on the risk appetite.

In reality, what we have actually seen is that unless there are significant government incentives to address a non-performing loan problem, the distressed loan and related distressed property are primarily sold by

financial institutions who do not consider this lending a core business,

independent finance companies that were established in the boom times to target aggressive lending or

domestic lending institutions owned by foreign banks.

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It is very rare that core lenders will sell or address their non-performing loan problem. Usually what they try to do is to bury their problems and hope they can survive the cycle.

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If you look at the history of distressed assets in Europe and what has happened you find both the credit cycle I refer to as well as the impact of the different types of lenders.

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For example the UK which in 1992 was the first big distressed market, most of the portfolios that were sold were from independent finance companies or foreign owned entities.

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Very little assets if any were ever sold by the Building Societies, which were the primary lenders in these markets.

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This same trend continued into France into which here also the number of assets sold by local lenders were relatively minor in comparison to the foreign owned entities, the insurance companies and the independent finance companies, examples are Barclays, UIC Sofal and Creditsuez.

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The various economic cycles within Europe allowed this trend to continue into Italy into mid 90s and then Switzerland, Central Europe and now Germany.

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To the extent sellers do not fall within this group it seems that the drivers of these markets as I refer to are really linked to government incentives to help address the problems.

For example, in the Italian market, the introduction in 1999 of a 2 year window to spread the accounting losses over a 5 year period combined with new legal framework for securitisation created a massive exit of non-performing loans both on a portfolio sale basis and through securitisation.

Since then there have been over 30 non-performing loan transactions that have been securitised in that period. Regardless of this activity it is still generally believed that there is over Euros 46 billion of non-performing loans on the balance sheets of Italian Banks.

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In terms of buyers for these assets, many of the people that you hear about today, experience stems from the originally big transactions that happened in the US. For example, if you go back to Texas in the late 80s the people at Lone Star, Fortress, Whitehall, Morgan Stanley, JER and ourselves have all worked together in some capacity.

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With respect to buyers the general trend is where you have the first transactions done by pioneers which is then followed by what I call the Titans or funds with over \$1 billion of equity

which then helps create a cottage industry of smaller players who will buy single assets either from the Titans or directly from the sellers.

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This is clearly being played out right now in Germany with Lone Star being the most public, acquiring several portfolios from several leading commercial banks that are focused on cleaning up their assets. In the meantime, Patron as a small player has acquired various office buildings throughout the German market which would generally be considered distressed.

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What is the experience of NPLs and distressed asset buyers and why did they do it? A friend of mine in Germany said that he and his colleagues now feel after seeing the press that they are standing on the Autobahn facing the wrong way.

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The general strategy, contrary to the press is not to kick out the borrower nor go into liquidation BUT to buy a portfolio of distressed non-performing loans and assume or hope that a large percentage of these assets will be resolved through discounted pay offs within the 1st year.

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To explain better, if we were to buy a portfolio for say 40% of face value an individual buyer within the portfolio may be prepared to acquire his own asset at say 60% of his original loan.

He would be very happy since he is able to realise a 40% discount to his original investment and we would be happy as we

would make 20 points, or effectively 50% return on the gross asset.

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In addition, we, as opportunistic buyers are prepared to take risks that traditional real estate buyers do not like to assume. For example, we have acquired buildings in Berlin in which the underlying vacancy is relatively high in the market as well as in our building.

Our pricing assume that we can rent these properties out with some tenant improvements at some future date, say in 5 years at rents below current levels. We believe and we hope that this would be sufficiently conservative in pricing these assets. Clearly if the German market continues to get much worse or/and stagnate over the next 5 years then we will probably look ridiculous.

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Where this strategy seems not to have worked is that most buyers have underestimated the collection time and the costs associated in dealing with these assets. In a transaction in Italy, for almost 6 months the various courts in a given region were closed due to internal fraud problems and as a result foreclosure proceedings in that jurisdiction were relatively low during that year.

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In our own portfolio in Italy, it took 2-3 years to get our paperwork in order.

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The good news is that even though collections and workouts for non-performing assets have taken from 1-3 years longer than expected, underlying real property values have dramatically increased which has more than offset the delay in payments. This was my direct experience in France in 1995 as well as in Italy

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There are certain issues to highlight in considering these transactions which I believe are the 3 biggest questions that you need to consider.

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The first is information. Most distressed loans and distressed assets have very little information available to determine appropriate pricing, we have seen this in every market we have looked at. The larger funds therefore make an early investment in staff to ensure they can resolve these issues. It is generally believed that Lone Star has over 100 people in their German office.

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Information also includes understanding the process and ensuring that buyers are confident that a process is transparent, is fair and is followed through. There are many many examples of sale processes in which we were involved in which simply never followed the original rules and created serious questions on our interest.

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Secondly, there are certain regulatory issues in different markets which affect the ability to buy assets as well as the resolution of any Individual loan.

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Lastly and most importantly is price, as buyers of non-performing assets assume a discount rate to simply account for the time value of money and banks generally hold their assets on a future value basis, there is a natural disconnect between the buyers and the sellers. This is one of the key reasons why we tend to focus in more difficult markets on asset acquisition as opposed to loans which may require a longer period of time to realise an asset.

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I am sure you have noticed I have avoided speaking about the specific opportunities but the distressed markets of focus are Germany, Switzerland, Central Europe and to some degree Italy and perhaps in 2-3 years we will all be back focusing on consumer residential distressed debt in England.

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Thanks you very much and if you have any questions please do not hesitate to ask.

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