



REAL ESTATE INSIGHTS

Facing a Decision to Fund

Addressing Exposure and Uncertainty in Real Estate-Backed Lending



Our Credentials

- » Real Estate & Valuation Professionals
- » Certified Public Accountants
- » Cost Estimators
- » Licensed Architects
- » Professional Engineers
- » Construction Managers

From 2002 to 2007, unprecedented amounts of capital moved into real estate spurring stunning levels of development and construction activity. This exuberance was based largely on investor dissatisfaction with other asset classes and the belief that real estate could produce double-digit returns during a period of widely available, low-cost debt. Value-add opportunities were pursued by developers, private equity funds and public-REITs on behalf of their investors. Often these speculative developments were complex, mixed-use projects. Creative, multi-party arrangements were coupled with low-cost debt with aggressive leverage. Many of these debt instruments were subsequently sold or securitized in a very active commercial MBS and CDO marketplace.

The sudden shift in the pricing of real estate and seizure of the credit markets have significantly changed the assumptions of

these original loans, including revenue, cost, schedule, terms and availability of financing, and returns to investors. Most development projects, but particularly residential projects, that commenced or anticipated the start of construction prior to 2007 have the jeopardy of being unviable in the current market environment. Loan loss reserves may not be sufficient to cover the level of current project risk.

During the same time period, but in response to other economic drivers (such as growing demand for cleaner and more efficient power), lending to industrial projects and infrastructure in booming industries such as Energy and Transportation has demonstrated a sharp increase. Lenders must continue to make significant funding decisions on these projects even while being impacted by a turbulent commercial market.

Our Outlook

The exposure of U.S. lenders to this dynamic is extreme:

- » Borrowers will seek extensions of existing loans to wait out the uncertainty in the current market.
- » Funding decisions by a lender will be closely scrutinized by borrowers and their counsel; decisions to deny funding that lack adequate foundation will expose lenders to liability and claims for alleged lost profits by equity, subordinate debt and bank syndicates.
- » Lenders have a risk management priority to assess potential losses and take corrective action with borrowers.
- » Regulatory pressures will increase, and the ability to demonstrate systematic analysis and informed prudence will become a necessary standard.



Our Clients

- » Executive Leadership
- » Chief Risk & Credit Officers
- » General & Outside Counsel
- » Workout Teams

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Our Advantage

Navigant Consulting is an independent, comprehensive source for testing the expected financial performance of these types of projects against initial underwriting, recommending a course of action and supporting execution on an individual project or portfolio level. We have

unmatched diversity of experts that can be brought seamlessly together to address the most complex of real estate investments. We know all asset types and have current assignments in most major markets, and importantly our professionals draw from direct experience with the issues that lenders faced in prior downturns.

Our Approach

- » Documenting the structure of real estate-backed positions, including: debt, equity, mezzanine, joint venture, and option arrangements
- » Comprehensive review of controlling documents and review of any legal analysis
- » Identifying economic impact of changing market conditions by MSA and product type (both as of a date certain and over a relevant planning horizon)
- » Estimating the value of holdings and positions
 - › Site visits and related market analysis to validate projected revenue
 - › Thorough construction assessment, including schedule and cost to complete analyses
 - › Reevaluating the feasibility of the project under current and projected market circumstance
- » Performing risk analysis (including solvency testing) on partners and key vendors
- » Projecting severity of loss under alternative outcomes (including sensitivity analysis)
- » Identify points of leverage with a borrower to pursue restructuring or collateral enhancement
- » Conducting sophisticated alternatives analysis, such as selling distressed loans at a discount, foreclosure, or restructuring with borrowers, with a sensitivity to the financial performance and evolving standards of risk management
- » Documenting action plans for mitigation
- » Directing the execution of negotiations with borrowers and work out advisors
- » Providing continuous reporting and sophisticated project management

