

The Real Estate Roundtable

National Policy Challenges for Real Estate

Managing Political Risk in Washington

Clifton E. (Chip) Rodgers, Jr.
Senior Vice President, The Real Estate Roundtable
Washington, DC
www.rer.org



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View From Washington

- The Real Estate Roundtable
 - *Who we are*
 - *What we do*
 - *Why we exist*
- Major policy issues addressed by Roundtable
- Key issues outlook

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- Roundtable founded in late 1990s
- Goal: Change perception of real estate among national policymakers
- Former view of real estate:
 - No sense of “industry”
 - Collection of wealthy individuals focused on tax avoidance
 - Developers just wanted to “pave over paradise”
 - No environmental sensitivity

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- Goal: demonstrate that real estate is vital component of the overall economy
- Establish industry identity
 - U.S. CRE worth approximately \$5 trillion
 - 9 million jobs, one third U.S. GDP
 - Investment – an increasing number of Americans own investment real estate than ever before
 - Real estate taxes - support many essential services such as education, police/fire, roads, schools
 - 70% of these services funded by real estate taxes

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- Develop a more coordinated message about our industry's place in the overall economy
- Bring together a wide range of industry and economic perspectives to research, analyze and advocate national policy issues
- Interconnectivity of industry with other industries such as finance, energy, telecommunications and health care

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- Work to inform policymakers and public about today's vast and diverse real estate market
- Positive energy and environmental actions of our industry
- Paint real estate *GREEN*
- Continue to move real estate from an unfavorable to a much more preferred image

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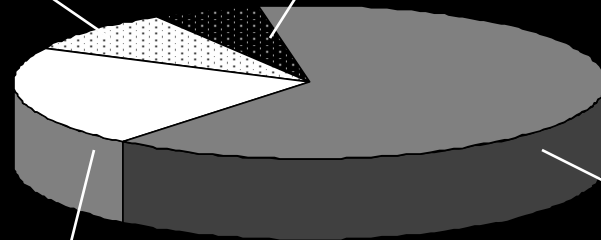
- Represent CEOs of nation's top private and publicly-held real estate entities - top owners and financiers of major hotels, office buildings, apartments, retail and industrial space
- Membership includes elected heads of the 16 major real estate trade associations
- Serve as a Roundtable for Nation's real estate industry on National Policy Issues
- Coordinate Policy Positions with Major National Real Estate Organizations

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12% – Real Estate Trade Organizations

- AHLA
- AFIRE
- ARDA
- BOMA
- CMSA
- ICSC
- MBA
- NAHB
- NAIOP
- NAR
- NAREIM
- NAREIT
- NMHC
- NAA
- PREA
- ULI

3% – Asset Managers



21% – Financial Services

- Investment Bank 44%
- Commercial Bank 4%
- Insurance 24%
- Credit Company 4%
- Mortgage Banker 24%

- 52%
- 14%
- 10%
- 12%
- 4%
- 8%

64% - Owners
Public – 50%
Private – 50%

- Mixed
- Office
- Retail
- Apartments
- Hotel
- Industrial

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Real Estate Regulation

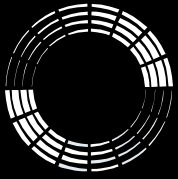
- State and Local
 - Planning, zoning, building codes, environment
 - Tax, licensing
- Federal
 - Executive and Legislative
 - Interplay of lawmaking and regulation
 - No Real Estate “Committee” or “Department”
 - HUD more about housing than urban development

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- Policy focus –
 - Credit and capital markets
 - Energy and environment
 - Homeland security
 - Tax
- Implement policy positions by working with lawmakers and building coalitions
- Manage industry's political risk in Washington

Real Estate Lawmaking & Regulation

- Executive Branch
 - Treasury
 - Federal Reserve
 - OCC, FDIC, OTS
 - Commerce
 - EPA/Energy
 - DHS
 - HUD
- Legislative
 - Banking/Fin Serv
 - Ways Means/ Fin
 - Energy
 - Commerce
 - Environment
 - Judiciary
 - Homeland Security



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Roundtable Agenda

Election Year and Beyond

- What lies ahead?
 - *Election*
 - *Card Check*
 - *Carried Interest*
 - Green Buildings
 - Credit Crisis

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Next President Faces Significant Challenges

- Economy – Credit Crisis - Recession
- Global Security –
 - Rise of Asia – China, India
 - Terrorism – Iran, Iraq, Afghanistan, Pakistan
- Trade challenges
- Sovereign Wealth Funds
- Sustainability and the carbon footprint
- Rational energy strategy

Domestic Challenges

- Economy/Housing/Credit Markets
- Massive deficit with entitlements swelling
- Baby boom retirees
- Tax challenges – 2009 pivotal year
- Education
- Infrastructure
- Labor and immigration

Election Outlook

- **Historically high negatives of POTUS and Congress**
- **Financial crisis propelling Obama into lead nationally and in key states**
- **Obama within 10 Electoral votes of the 270 needed to elect (est. 264 – 163)**
- **Within range to get well over 300**

Card Check

Coalition for a Democratic Workplace

<http://www.myprivateballot.com/>

- NLRB ensures fair election free of employer and union coercion
- Employee Free Choice Act – “Card Check”
- Unions claim Act would provide freedom to workers to decide whether to form unions
- Denies workers right to secret ballot
- Places new burdens on employers
- Paves way for union coercion

Tax Policy

Carried Interest

Taxation of Carried Interest

- Raise tax revenue to pay for AMT relief, etc.
- Interest in partnership profits in excess of equity contribution
- Current law: carried interest taxed as investment in partnership (capital gain – 15%)
- Proposal: Tax carried interest as compensation for services (ordinary income - 35%)
- Represents a 133% tax increase

Carried Interest

Expected Impact of Proposal:

- Stifle entrepreneurial activity
- Virtually all real estate ventures use partnerships with carried interest – matches expertise with risk capital
- Will disrupt investment relationship between partners resulting in diminished returns, less capital flow and fewer deals

Carried Interest Impact

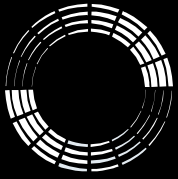
- Private equity managers targeted
- Real estate impact enormous – of est. \$4.5 trillion CRE market, at least \$1.3 trillion in partnerships affected
- By contrast, REIT market cap @ \$300 billion
- W&M Chair Rangel (D-NY) led House efforts
- Measure stopped in 2007 - 2008
- 2009 a critical year for tax policy

The Greening of Real Estate

- U.S. CRE today accounts for
 - 40% of energy consumption
 - 70% of electrical energy consumption
 - 30% GHG emissions (*indirectly*)
- EPA's Energy Star Program has
 - Reduced CO2 emissions by equivalent of taking 8-12 million cars off the road annually
- LEED and energy-related tax incentives

Cap and Trade

- Incentivize “green” investments by
 - CRE should own and trade CO2 reductions instead of allocating 100% carbon-trading energy efficiency benefit to utilities
 - Energy end users –building owners – should participate in this emerging market
 - Monetizing CO2 reductions created through energy efficiency investments by *users* of energy such as buildings



The Credit Crisis

- Real estate faces most challenging credit market environment in decades
- Credit market turmoil has spread from subprime mortgages to other sectors
- Subprime defaults triggered residential market declines
- Over \$700 billion in asset write downs
- Systemic risks have visibly slowed economy

Credit Crisis

- To date, residential declines tracking separately from CRE market fundamentals
- CMBS performance remains positive – outperforming corporate bonds, defaults remain low
- CMBS securitization volume dropped from \$230 billion in 2007 to \$12 billion in 2008
- How to fill credit shortfall?

Emergency Economic Stabilization Act of 2008

- Creates mechanism to remove illiquid assets weighing down financial institutions
- Make equity investments in banks
- Break impasse in credit markets
- Restore confidence in certain assets
- Provide necessary liquidity to financial institutions, enabling them to lend again

Banking and Credit Markets

- U.S. credit demand exceeds capacity of nation's banking system
- Failed credit markets reveal systemic shortfall, lack of banking capacity
- RMBS crisis stalled CMBS markets
- Necessary to have functional "secondary" market mechanism

The Great Depression - *Lessons Learned*

One of every five banks in America fails

[T]he Federal Reserve System had been set up ...to prevent the worst consequences of bank failures...It was all a question of reassuring the public that they could get their money...by supplying cash to the banks... [I]n 1929 to 1930... If the Federal Reserve had stepped in, bought government securities on a large scale, provided the cash, the depositors would have found that they could've got their money and they would have stopped asking for it.

- Milton Friedman

Central Banking: *The Panic of 1825*

...In wild periods of alarm, one failure makes many, and the best way to prevent the derivative failures is to arrest the primary failure which causes them. The way in which the panic of 1825 was stopped by advancing money ... by every possible means and in modes we had never adopted before; we took in stock on security, we purchased Exchequer bills, we made advances ...we not only discounted outright, but we made advances on the deposit of bills of exchange to an immense amount, in short, by every possible means consistent with the safety of the Bank ... Seeing the dreadful state in which the public were, we rendered every assistance in our power. After a day or two of this ... the entire panic subsided, and the 'City' was quite calm.

- Walter Bagehot, Lombard Street 1873

The Federal Reserve's *Mission*

- Charged with fostering sound banking system and healthy economy
- Fed design bank oriented
- 1999 GLB repeals Glass-Steagall
- Immense scale of credit markets – beyond reach of current regulatory mechanisms
- Reforms necessary

Principles of Central Banking

- Central banks calm panic by expanding liquidity – *lend into the panic.*
- Depression-era banking crisis could have been contained if Fed had purchased securities from banks to calm panic
- Another financial panic unfolding, centered in credit markets, outside banking system

What Has Been Done?

- Fed's giant steps –
 - *TSLF, PDCF, CP, Direct Lending Facilities*
- GSEs in conservatorship
- Wamu, Lehman, Wachovia
- Goldman, Morgan Stanley now banks
- EESA enacted - frees Fed to focus on banking system

EESA – TARP

“We knew how much of banking depended upon make-believe or, stated more conservatively, the vital part that public confidence had in assuring solvency.”

- Raymond Moley, a key presidential adviser to FDR

- Restore stability to our credit markets
- Increases FDIC insurance coverage
- Extends important tax provisions, and protects millions of Americans from the Alternative Minimum Tax
- Empowers SEC to suspend fair-value accounting (FAS 157) accounting rules

Still Unresolved

- GSE endgame – how do they evolve?
- Counter party trust at risk
- How is the credit shortfall absorbed?
- Do banks become primary capital source?
- What is new secondary market paradigm?
- Is there a future for MBS/CMBS?
- How to reform rating agencies?

Financial Services Reforms

“After all, there is an element in the readjustment of our financial system more important than currency, more important than gold, and that is the confidence of the people.”

- Franklin D. Roosevelt in his first “fireside chat” on March 12, 1933

- New Central Banking paradigm
 - Arrest financial market deterioration
 - Provide liquidity to credit markets
 - Mitigate market tension and safeguard systemic stability
- Should support entrepreneurs not speculators

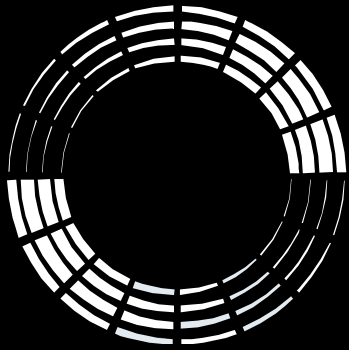
Credit Rating Agency Reform

How to restore integrity to the process?

- Reforms should focus on -
 - Objectivity
 - Independence
 - Access / Transparency/ Disclosure
 - Resources
 - Credibility
- Performance measure - default rates
- Re-affirmation of credible transparency

Going Forward

- Develop governmental and private sector initiatives that will restore demand
- Policymakers must articulate clear strategies to address contraction of credit
 - Wave of imprudent lending is past
 - Priority now to restore/maintain credit flows
 - Other new ideas necessary to aid debt restructuring
 - Comprehensive approach to maintaining real estate market demand
- Continue to pursue new ideas



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