

A real job for  
Joe the  
Plumber?

Dealing with the Credit Mess  
CRE Panel Discussion – Boston, MA  
November 2, 2008  
Program initiated by CRE Ethics Committee

# Panel Participants

- **Charles Citro, CRE.** Vice President, Chief Credit Officer, Goldman Sachs & Company
- **Neil Madsen, CRE.** Senior Vice President, Head of Private Equity, AEGON USA Realty Advisors
- **Martha Peyton, CRE.** Managing Director, TIAA-CREF
- **Timothy Riddiough, PhD., CRE.** Graaskamp Center Director, University of Wisconsin-Madison

# How Do We Deal With the Mess?



Toilet Snorkel

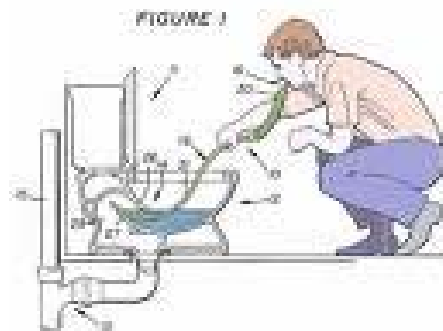
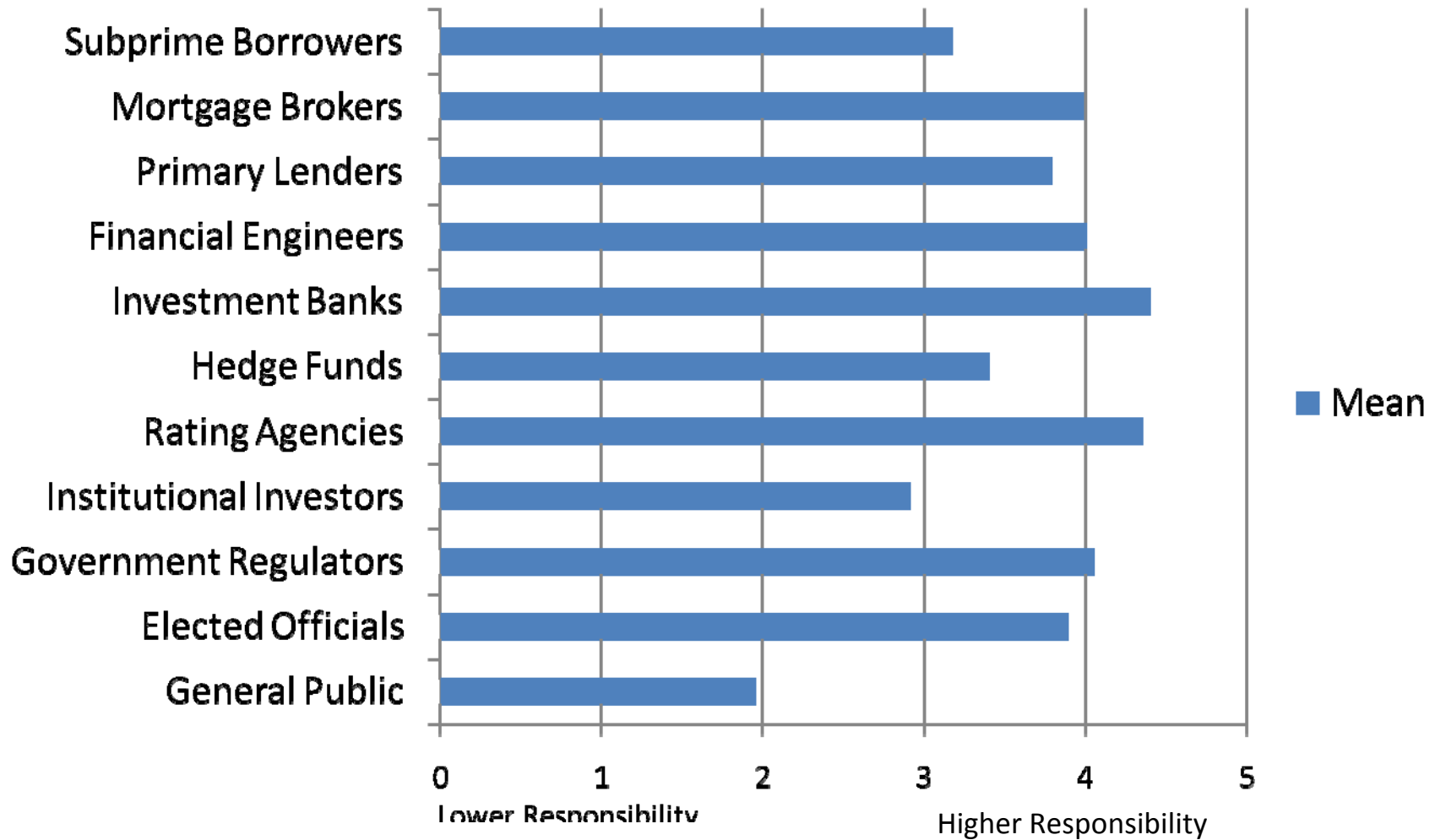


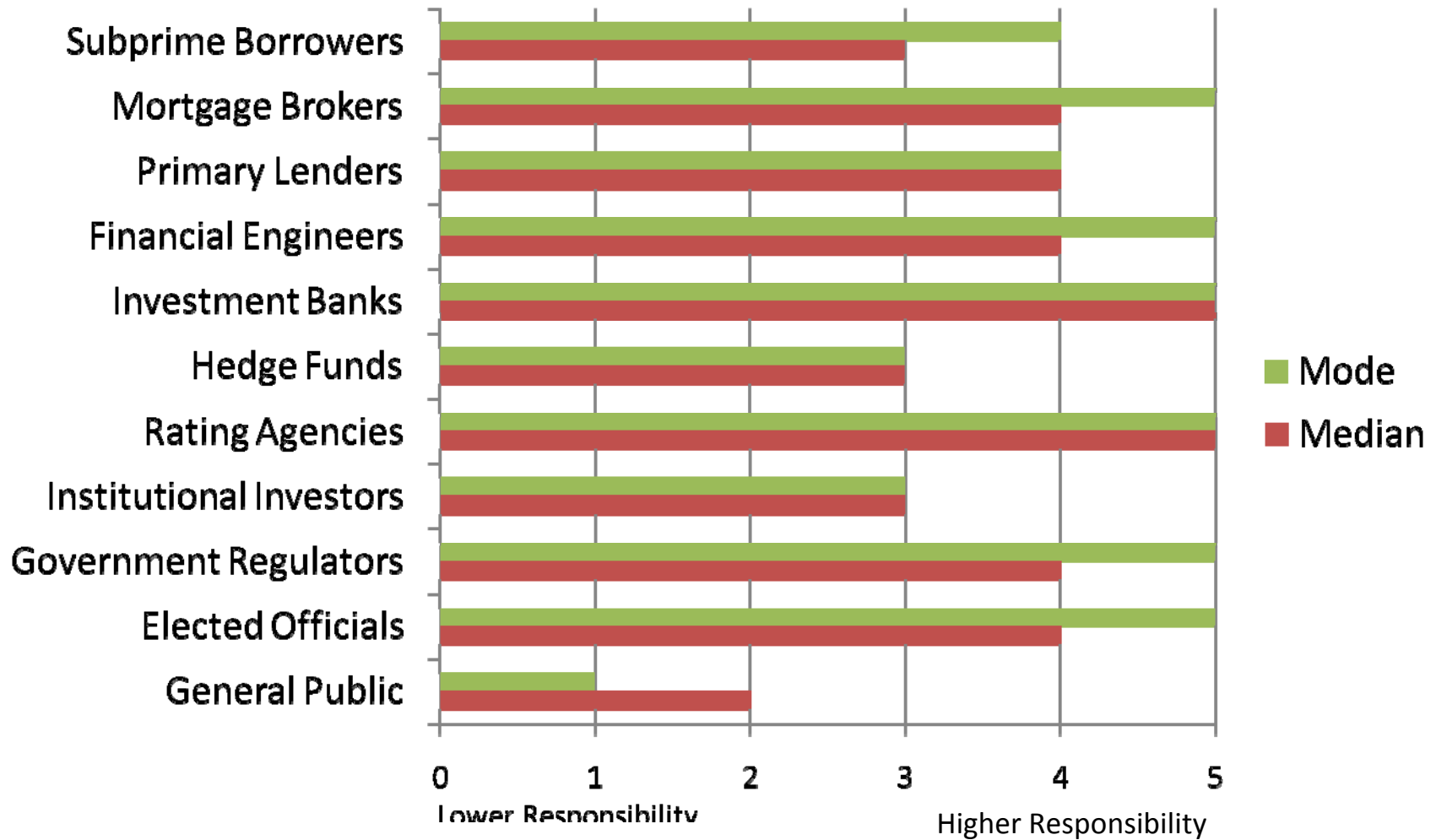
FIGURE 1

- **Diagnostic question still remains – how much of the blame stems from poor decisions, and how much from systemic flaws?**
- **Prescriptive issues are very hard, requiring**
  - **Financial industry restructuring**
  - **Addressing global coordination needs**
  - **Recognition that paying for the fix will require higher taxes, no matter what party is in office**

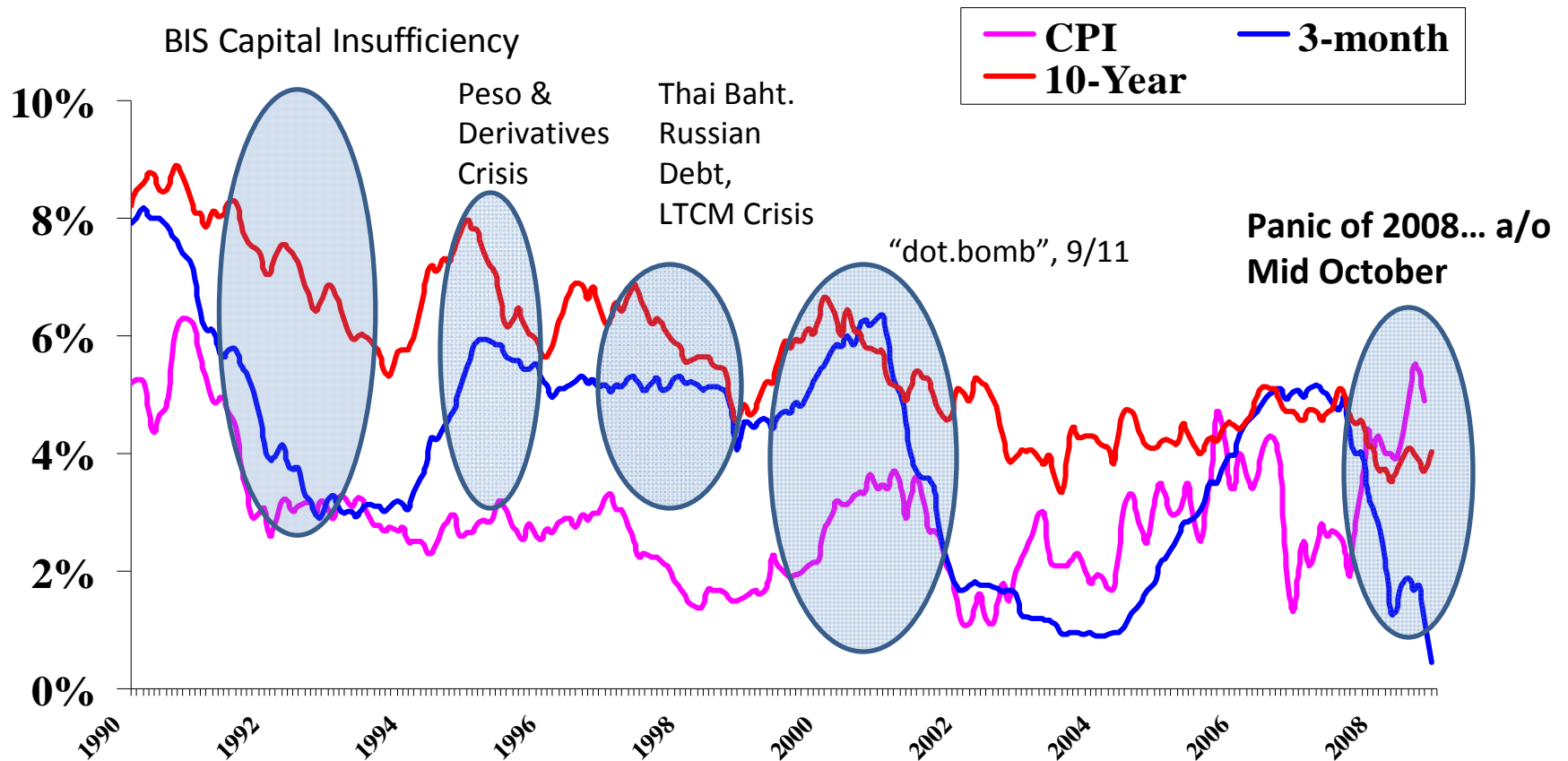
# CRE Survey Responses On Responsibility for Credit Crisis



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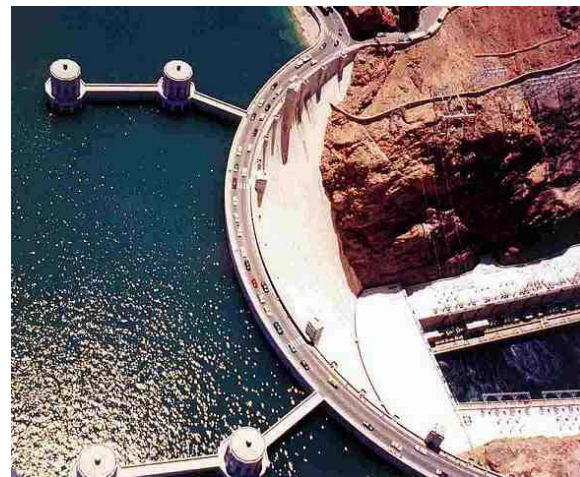


# Things Fall Apart...



Sources: U.S. Dept. of the Treasury; U.S. Census Bureau (data);  
H. Kelly, event characterization

# What's Happened to the Capital Flow?



# Where Will We Find Ourselves Along the Continuum?



**Slide 8**

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**HFK1**

Hugh Kelly, 10/31/2008

# Time to answer to a higher authority???



# Ten Commandments for the Future of Finance

- I. Write upon thy heart the law that 'reward' and 'risk' shalt always appear in the same sentence.
- II. Make neither markets nor regulators into idols, and follow not false prophets of simplistic bias.
- III. Be sober and watchful, lest the enemy of massive loss approach like a thief in the night.
- IV. Honor thy father and thy mother's ancient counsel: Keep It Simple, Stupid!
- V. If thou wilt not do thy own credit analysis, then vow to invest not at all.

# Ten Commandments (continued)

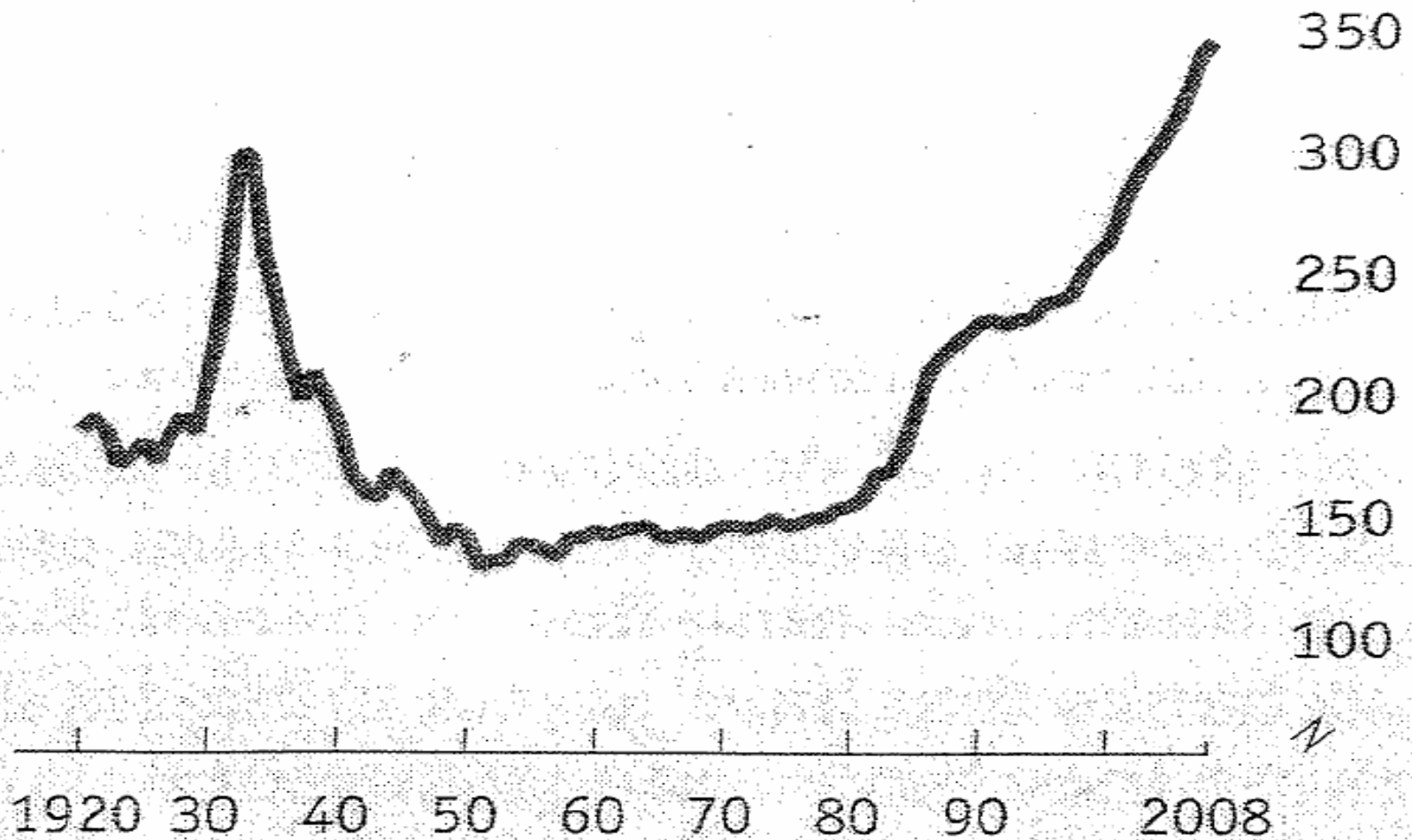
- VI. Thou shalt not adulterate thy portfolio with excessive leverage.
- VII. Thou shalt not bear the false witness of hidden assumptions in thy investment underwriting.
- VIII. Thou shalt not covet for the short term, yea, but shalt lay up thy treasures for length of days.
- IX. In all things, yield not to the tempter's snare of panic.
- X. Remember that, after thy exile in the wilderness, if thou heedest these commandments, thou shalt once again return to the land of milk and honey.

# The TARP...



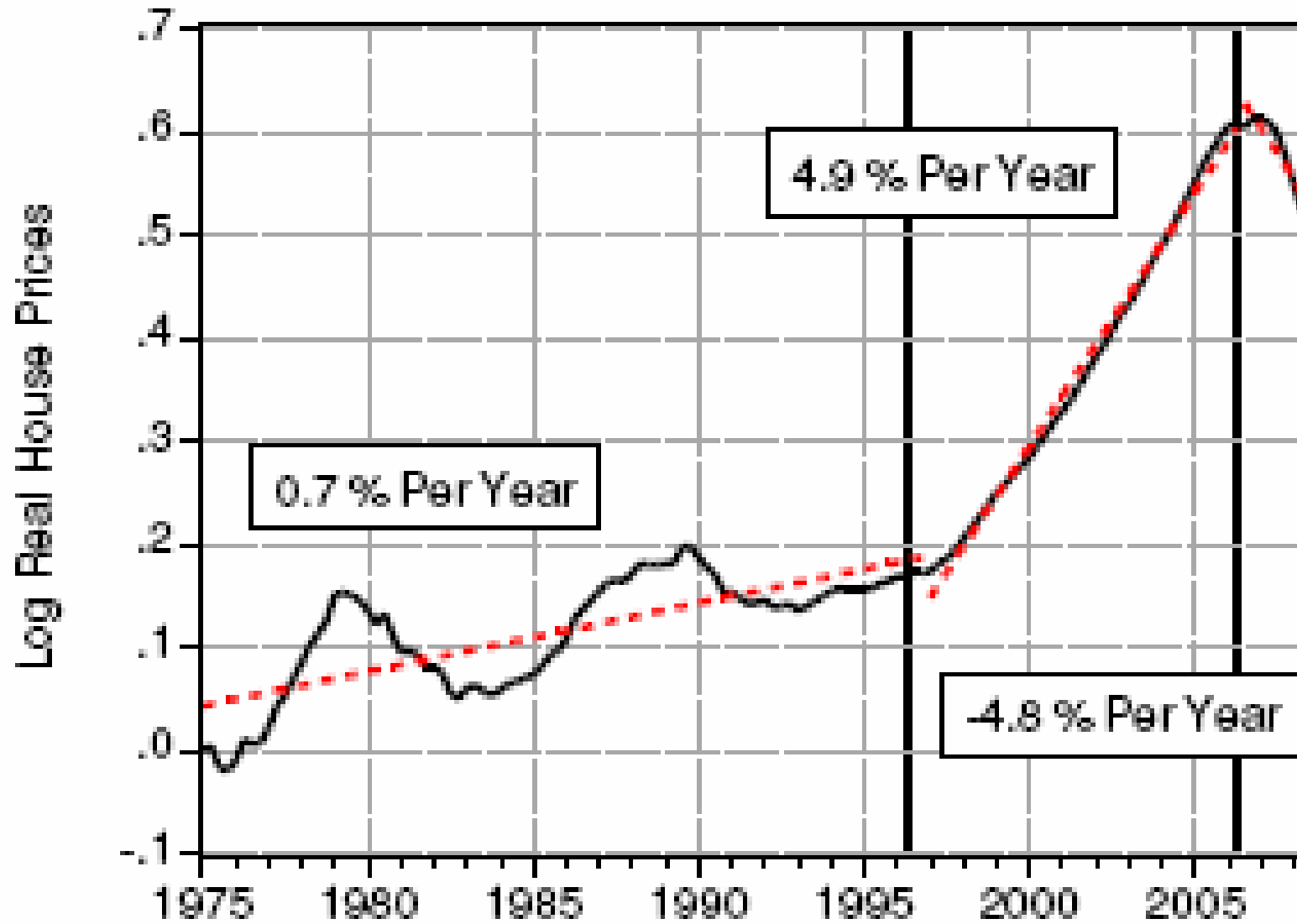
- \$700 billion!
  - Too much? Not enough?  
Just a downpayment?
  - Devil in the details: How  
is this supposed to  
work?
  - Will it help housing?  
How does it impact  
commercial property?

# ***U.S. Debt as a % of GDP***



Sources: Morgan Stanley; Federal Reserve; BEA

# *House Prices*



- *Market Failure: Likely Suspects*

- *Credit Channel Effects and Spillover Problems: Financial institutions matter to the real economy and are intimately interconnected, so chaos and failure creates domino effects that spill over to affect consumption and output*
- *Inability to trade assets at fundamental value: Information problems, resulting from adverse selection concerns*
- *Moral hazard: Let institutions fail to address “heads I win, tails you lose” conundrum*
- *Limits to arbitrage: Limited equity and lack of scale resulting in insufficient “staying power”, which creates deadweight costs associated with distressed asset pricing*
- *Madness of Crowds: Loss of confidence causes herding as investors panic and throw away their information*