

News Release

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Back to basics approach needed for real estate companies to emerge stronger from the economic crisis

NEW YORK, 24 MARCH 2009 – It is no surprise that the continuing economic uncertainty throughout world markets and the lingering impact of a global credit crunch are seen as the greatest risks faced by real estate companies.

“In this time of great economic uncertainty and lack of liquidity, many companies are proactively looking for ways to effectively manage risk, streamline operations, and enhance their business relationships so they can hit the ground running when markets begin to stabilize,” says Howard Roth, Global and Americas Real Estate Leader, Ernst & Young.

The *2009 Ernst & Young real estate business risk report*, produced in conjunction with strategy consultancy Oxford Analytica, itemizes the ten top business risks faced by the industry as ranked by leading sector analysts. The top ten risks this year in order are:

1. **Continued uncertainty and impact of the credit crunch** – tighter credit is just one threat to real estate from the crunch; the economic downturn is affecting commercial vacancy rates as well as property valuations.
2. **Global economic and market fluctuations** – due to capital flows and business expansion, the real estate industry has become a truly global industry and, as such, is increasingly susceptible to global market fluctuations.
3. **Impact of aging or inadequate infrastructure** – particularly in the US, but also in other markets around the world, a lack of key transit and utility infrastructure is a threat to economic and real estate growth.
4. **A global war for talent** – globalization of business has also created a worldwide talent pool with countries forced to compete for human capital.

5. **Changing demographics** – aging and urbanizing populations are changing competitive dynamics and creating new markets in real estate.
6. **Inability to find and exploit non-traditional global opportunities** – with competition increasing worldwide from sovereign wealth funds and others, many global investors face a tough time sourcing new deals that will meet return expectations.
7. **Pricing uncertainty** – with few transactions taking place in the real estate market, valuations are a problem for existing owners, as well as buyers and sellers.
8. **Green revolution, sustainability and climate change** – real estate is at the forefront of the green movement with pressures intensifying to build and operate in sustainable ways and minimize the carbon footprint throughout all types of real estate.
9. **Economic vulnerability and regulatory risks in developing markets** – developing markets are a key focus for global real estate firms but regulatory risk in these markets is constantly changing as authorities seek to jump start economies.
10. **Increasing energy costs** – few analysts expect more than a temporary respite from high oil prices as new supply will be unable to meet renewed demand.

Given the risks outlined by analysts in the report, it is time for owners, investors and users of real estate to use the time afforded by this lull in real estate activity to prepare their businesses for the next period of economic growth.

“There will be a fundamental shift back to traditional real estate underwriting principles, including comprehensive cash flow analysis and prudent levels of debt and equity in consummating real estate transactions. This ‘back to basics’ movement will lead to the greater transparency necessary to restore confidence between buyers and sellers.” says Roth.

The real estate sector has felt the tightening conditions in credit markets perhaps more than any other sector due to its heavy reliance on capital. Financial conditions for real estate projects are undoubtedly worsening and the current financial markets landscape is expected to persist for the next couple of years.

According to Mark Costello, America’s Leader of Ernst & Young's construction and real estate advisory services practice, "Real estate is typically the second highest cost item

on an income statement after payroll and so provides excellent opportunities for companies to unlock hidden value, particularly through a back to basics approach."

On the construction side of the industry, two out of three capital projects are currently over budget or behind schedule, according to Malcolm Bairstow, Ernst & Young's Global Advisory Services Leader for the real estate and construction sectors, which he adds is a statistic exacerbated by the uncertainty surrounding the economy and the availability of financing. "Yet, deploying risk mitigation or accelerated delivery methods after careful assessment of a project can also reduce risk and cost and bring in projects on time and on budget," Bairstow adds.

"The real estate industry as a whole is focused on simplicity, transparency and quality deals. However, when things are going really well it tends to mask organizational inefficiencies," says Costello. "Companies which address those issues now and solidify their businesses will be in a much better position to address future risk threats."

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