

News release

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It's Springtime for Some Investors in Commercial RE Debt, but Others Head into Hibernation

New York, NY (May 25, 2011) – After more than a year of dormancy, some investors in distressed debt are waking up to the opportunities afforded by a commercial real estate debt market that appears to have sprung into life, according to a recent survey conducted by the distressed services professionals of Ernst & Young LLP. But this year's survey also reveals a growing number of investors who appear to have given up on being able to buy distressed debt.

“This year's survey reveals a bifurcated market for distress where a growing number of investors appeared to have given up on getting the right deals and have exited the market. But, ironically, those investors staying the course seem to have access to a much more robust market and seem quite optimistic,” said Chris Seyfarth, partner in Ernst & Young LLP's Transactions Real Estate practice.

Ernst & Young estimates that sales of distressed commercial real estate (CRE) loans totaled approximately US\$18 billion in 2010 and Seyfarth expects 2011 to be similarly active. However, whereas FDIC sales are still likely to dominate transaction activity in 2011 (as they did in 2010), EY expects bank loan sales to

account for a much higher percentage of activity going forward. “Banks are warming up to the idea of selling problem loans and, although they may still have to sell for a loss, pricing is now much more attractive and is inducing more banks to bring loans to market,” says Seyfarth.

The prospect of more opportunities to purchase problem loans from regional banks is exciting some investors. In the last three years, the FDIC was by far the biggest seller of distressed debt with structured sales totaling US\$23 billion. Yet that appears ready to change although further complicating the data, according to Seyfarth, banks in 2010 set aside almost 50% lower loan loss reserves, suggesting that many banks feel they have their real estate loan losses under control. “There’s a shakeup coming in the market and something has to give,” says Seyfarth. “Either banks will fully clean up their balance sheets and release their problem loans or a lot of investors will go home empty handed,” he said.

From an investor’s point of view, this year’s survey revealed a significant change in sentiment. Nearly a third of those responding characterized the market for distress in 2010 as “active” compared with just 8% in 2009. Further indication that this is widely perceived to be the right time to buy distressed debt is apparent in the fact that 43% respondents believe that market conditions are favorable enough today for them to entertain distressed debt purchases. That’s double the number of respondents who felt similarly last year. What’s more, almost 40% of respondents see market opportunity stretching into the future, while only 5% believe the time to invest in distressed debt has passed.

At the same time, investors return expectations seem to have solidified in the high teens. The percentage of respondents who targeted returns in the low teens dropped 12% between this year’s survey and the one conducted by Ernst & Young in 2009. Investors shooting for 20% or greater returns also saw a drop

of 8% but the percentage of investors expecting returns in the high teens increased from 43% in 2009 to 62% this year. According to Seyfarth, this may point to the emergence of more opportunity funds in the market for distressed debt in 2010 since these funds typically have higher return requirements. It may also be indicative of a belief that the return of the financing market may offer investors the opportunity to benefit from positive leverage.

For a detailed analysis of this year's Ernst & Young survey of distressed debt, visit www.ey.com/realestate.

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