COMMENTARY – *Bob Knakal*

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TARP, TALF, FSP, The Stimulus Plan and How They Will Affect the Investment Property Sales Market

The alphabet soup of government intervention is enough to make your head spin. The magnitudes of the programs are enormous. What I will do today is look at each of these initiatives and try to determine how they might collectively affect our New York City investment property sales market. We will examine three areas which have a significant impact on our real estate market: 1) Employment, 2) Credit Availability, and 3) Interest Rates. First, let's review these programs:

The Troubled Asset Relief Fund (TARP) (aka Bailout #1) was originally a $700 billion program handed to Congress by the Federal Reserve in September of 2008 with the intention of unfreezing the credit markets. This was to be done in the form of removing toxic mortgage-backed securities from the balance sheets of banks. Within one month, the plan for buying these toxic assets was abandoned because determining the value and, hence, the fair price of these securities was nearly impossible due to the continual decline in housing prices. If the collateral for the securities keeps falling and the expectation is that the reduction in value will continue, it is not possible to value the assets. The result was that the Fed deployed about half of the TARP funds in the form of cash injections into banks hoping that this injection would stimulate lending. Because there were almost no strings attached or guidelines with respect to the use of these funds, most of the TARP money was hoarded by the banks or, in a few cases, the funds were used to purchase other banks. The result was that credit availability was not enhanced.

Enter the Term Asset-Backed Securities Loan Facility (TALF) (aka Bailout #2). This program will not be financed with taxpayer dollars (directly) but rather by the printing of more money. This consumer bailout was anticipated to have a positive effect on credit availability as it would stimulate the secondary markets. The asset backed securities supported by this program initially were to include auto loans, credit card debt and student loans. The program was to allocate $200 billion by the Fed to security holders of consumer backed debt. Essentially, doing this would have insured the debt if a borrower defaulted. Additionally, backing the backers, the Treasury department was to provide $20 billion from the TARP funds to safeguard losses that the Fed might incur.

As the scale of the crisis became more apparent, the Stimulus Plan that had been discussed for months included a provision to increase the scope of the TALF in conjunction with the deployment of the balance of the TARP money. This initiative, which was laid out by Treasury Secretary Timothy Geithner, is dubbed the Financial Stabilization Plan (FSP) (aka Bailout #3) This program's primary objective also revolves around unfreezing credit. In order to unfreeze credit banks need to be supported and this plan addresses two of the three main issues facing banks; "troubled" assets and undercapitalization. **Importantly, the plan also addresses securitized lending and mortgage modifications. The**

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plan expands the TALF from $200 billion to $1 trillion in capacit and would allow AAA CMBS as collateral, in addition to AA consumer related ABS. The CMBS program will likely differ fror the consumer focused facility but should follow the same genera guidelines. Since refinanced CMBS appear to be eligible under thi program, it could address a large portion of existing issuance a it is refinanced. There is also an initiative to form a Public Privat Investment Fund on a scale of about $500 billion to purchase mortgag backed securities from banks. **Securitization volumes have evaporate in recent months; therefore, a revived securitization market woul be an important supplement to bank credit.** Additionally, the FDI(has suggested that it may extend its bank debt guarantee program to 1 years and allow guarantees of secured debt, which could also addres this issue. It is estimated that between $170 billion and $400 billio of commercial mortgages will mature in 2009 which will need to b refinanced.

The unprecedented $787 billion Stimulus Plan was signed by th President yesterday. While anything that will help our economy woul appear to be worthwhile, we must consider the long term costs associate with this stimulus. Unfortunately, what started as an economic initiativ became a political spending program with allocations for man things that make you scratch your head about the resultant long terr stimulus. 38% of the funds are in the form of tax cuts, the majorit

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of which is in the form of $400 credits for most taxpayers and exemptior from the alternative minimum tax. 24% is in the form of spending includin infrastructure construction and modernization and 38% is in the form of ai That is an enormous stimulus plan. But is this really "stimulus" at all? Ye there is a lot of spending but the Wall Street Journal estimates that only 12 of the funds will be spent on initiatives which could be considered growt stimulus. These are dollars spent which will produce a multiplier effect an the projection of only 12%, is disheartening to say the least.

So let's look at how all of this intervention will affect employment. I January, US companies slashed nearly 600,000 jobs. We currently hav an unemployment rate of 7.6% and it is projected, by most economists, t approach 9% at its peak. If we hit this threshold, another 3.6 million job will be lost. Initially, the projection for job growth from the stimulus pla was 4 million jobs. This estimate has been revised down to 3.5 million by th government while many economists believe the number will be significantl lower. Regardless of your assumptions, the unemployment rate will continu to rise; the only question is by how much. This will have a negative impact o real estate fundamentals and will have a negative effect on value.

The credit markets have started to loosen, albeit at a slow rate. The securitizatio enhancement aspects of the TALF and FSP should provide relief to th commercial mortgage market. The sheer volume of necessary refinancing i not possible without access to public capital and the new programs shoul make this possible. The TARP, TALF and FSP have had effects on the credi markets, in general. The US Treasury securities market has rallied based upo disappointments with the results of bank bailouts as funds sought comfo in low risk government securities. Two-year swap spreads, a major gauge o credit risks, have widened. Negative sentiment due to the lack of detail on th FSP has boosted interest in recent Treasury auctions. The bid-to-cover ratio, major gauge of demand, has been as high as 2.67, well above the 2.4 averag over the last 10 auctions. Notwithstanding these facts, the programs shoul have a positive effect on commercial mortgage availability which will have positive impact on property values.

Interest rates are a major concern. With all of these government program the need to raise cash is enormous. This means that the government will b flooding the market with Treasuries, greatly increasing the supply. When th supply goes up, the price goes down and as the price goes down, the yield go up. This is not a good thing for real estate, particularly because existin floating rate debt is often tied to treasuries and the cost of new borrowin will increase. China and Japan have been significant buyers of our debt an we should not expect Treasuries to appeal to foreigners as near record lo yields are limiting future capital gains from price appreciation. The low o negative carry of treasuries over sovereign debt elsewhere plus the long terr downward trend of the dollar erodes the relative appeal and total return o treasuries to foreign holders. Notwithstanding this fact, treasury yields hav been growing since November of 2008 based upon the fear of excess supply The yield curve is steepening and there are concerns that congress has alread raised the ceiling on the national debt to $12 trillion. This could bring ou government debt to GDP ratio to about 85% in late 2009 / early 2010. Th oversupply of treasuries is concerning given the downside risks to growth further bank losses, yet another stimulus package and additional funds fo bank recapitalization. We expect upward pressure on interest rates due to thes factors which will have a negative effect on real estate values.

While all of this information can be disquieting, we should keep in mind th following fact: History has shown us that coming out of a deflationary perio with low interest rates; we are likely to see above trend inflation and increase interest rates. In that type of environment, investors want to own hard asset and real estate is a great hard asset to own.

Bob