COMMENTARY – *Bob Knakal*

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The Prospects of Bank Nationalization and Potential Affects on Commercial Real Estate

Nationalization of our banks has been a popular topic in newspapers and on business television for the past few months which should be no surprise. **Thus far in this economic cycle, 43 banks have failed and there are an additional 200 on the FDIC's watchlist of troubled banks.** The failures are primarily being driven by insolvencies as bad loans rise, mark-to-market write downs kick in and equity is depleted leading to negative levels of bank capital. Banks with significant exposure to residential mortgages and construction loans have been subject to rising defaults and mounting losses from nonperforming loans. In nearly all of the cases of bank failures, the FDIC already had buyers lined up for the failed institutions by the time they were taken over. Insolvent banks are generally taken over on a Friday and transferred to the new owners over the weekend so they can be reopened under a new name on Monday. The one exception to this process, in this cycle, was the takeover of IndyMac, the California bank which had become the poster child of all that is bad about subprime mortgages, Alt-a mortgages and ninja loans. The FDIC decided to nationalize IndyMac rather than sell it off immediately.

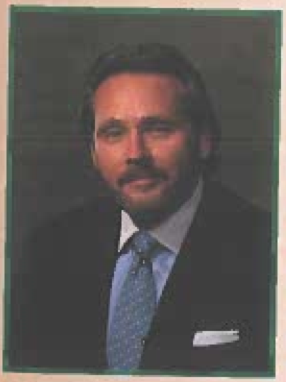
Seizing control of large industries, ie nationalizing them, is often among the first acts of a leftist government. Clement Attlee and Hugo Chavez did it, and so did Lenin. Even the less extreme Francois Mitterrand made the nationalization of some banks and heavy industry the focus of his agenda when he became the president of France in 1981. Presently, the United States is finding its capitalistic principles being challenged at every turn. Surprisingly, calls for bank nationalization have been emanating from decidedly nonleftist quarters. Conservative Republican senator Lindsey Graham, from South Carolina, has an opened mind on the subject and, more remarkably, the free market ideologist, Alan Greenspan, has endorsed this approach. The White House has aggressively deflected such calls for nationalization although the rhetoric from Washington is often quite contradictory.

So what is "nationalization". It can mean different things depending on your definition. There are two different forms of nationalization. **The first stems from the belief that the government can run large enterprises more efficiently and effectively than self-interested capitalists can.** This is the nationalization of Lenin, Chavez and Mitterrand, and the record here is abysmal. France's economy stumbled through the 1980s as government run banks backed political pet projects that produced disappointing results. **The second version of nationalization is the one that today's advocates are suggesting. It is a temporary takeover born out of crisis.** Sweden successfully implemented this kind of strategy in the early 1990s to strengthen its banking system. Even advocates of this form of nationalization agree that no one in their right mind wants the government to be in the banking business any longer than it needs to be. Let's look at the arguments for and against the government taking this step.

This article, and all other Commentaries by Bob Knakal, can be found on The Massey Knakal Reel – a blog for breaking sales, listing and neighborhood real estate news – at www.masseyknakal.com/blog

We have some pretty sick banks in America at the moment, some of whic may not be viable in the long run. But putting a bank through bankruptc ala Lehman, is unthinkable. Instead the government would declare the ban insolvent, wipe out its shareholders, terminate its top executives and inje enough money to keep it operating. It is argued that these cash injection without nationalization, are akin to water torture which is keepin zombie banks alive resulting in a process which is both expensive an dangerous. Aggregating guarantees, liquidity support, and capitalizatio the government has already provided between $7 trillion and $9 trillic of help to the financial system. On a de facto basis, the government already controlling a substantial portion of the banking system. Supporte of nationalization believe that the idea that government will continue t fork over trillions of dollars in the hope of rescuing financial institutior by throwing good dollars after bad money is not appealing as the fiscal co is likely to be significantly larger.

After the government takes control, the worst assets could be siphone off into a so-called "bad bank", pooling them with toxic assets from oth nationalized banks. The healthy parts of the banks could then be sold bac to the private sector. The promise of nationalization is that it, and onl it, can halt a self-reinforcing cycle in which banks continue to take hug risks in an effort to dig themselves out of a hole. In the months before the collapsed, both Wamu and Lehman made the financial equivalent of th Hail Mary pass by making investments that had little chance of paying o



During Mr. Knakal's almost 25-year career, he has sold over 1,000 buildings having an aggregate market value of over $5.8 billion. He was the top salesman, with partner Paul Massey, at Coldwell Banker Commercial (now CB Richard Ellis) in New York in 1986, 1987, and 1988 prior to forming Massey Knakal. In 1990, he was awarded Crain's New York Business "40 Under 40" awarded annually to 40 business people under forty years of age for outstanding achievement in the New York business community. In 2001, Mr. Knakal was named one of "The Top Dealmakers" by Real Estate New York Magazine. He has twice been the recipient of the Robert T. Lawrence Award in the Real Estate Board of New York's Most Ingenious Deal of the Year Contest. First in 2002, for the assemblage of the easterly blockfront of Second Avenue between 54th and 55th Streets. Then again in 2004 for the sale of the historic Gotham Book Mart at 41 West 47th Street.

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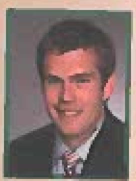

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but at least had the potential to put them back in the black. These additional los cost the taxpayers even more money. Nationalization ends the game.

It is unlikely nationalization will be implemented in a way other than o case by case basis. Yes, it worked in Sweden, but we are not Sweden. The Swed government had to deal with only a handful of banks; we have more than 8,3 Once you start, where do you draw the line? **The most obvious problem w nationalization is the risk of contagion.** Certainly, no one wants to national all of the banks, thousands of which are healthy. But where do you stop, or you start? If a few banks are nationalized, the next bank in line would find its at a significant disadvantage competing for funds with the government back banks. They would be forced to pay higher interest rates to attract deposit and other creditors, negatively impacting profitability. Worse yet, even talk abo nationalization can be harmful as it puts bank stocks under selling pressure. the government wipes out equity holders at some banks, why would invest want to put money into healthier but still marginal institutions? If some ban were nationalized, contemplation of this happening at subsequent banks wou cause their share price to tank and short-sellers might consign the companies an early grave.

The process of nationalization and reprivatization went amazingly well Sweden partly because it was remarkably free of political interference. Cou our politicians exhibit such constraint? I think not. The government should n be in the banking business. Treasury Secretary, Timothy Geithner, has repeated stated that governments are ill suited to manage businesses.

Finally, because nationalization runs counter to deeply ingrained America traditions and attitudes, there is a danger that it might undermine rathe than bolster confidence. Additionally, the government already owns positions i many banks, and supervisors have immense powers to influence banks withou owning them. Look at recent changes in the composition Citigroup's board for a illustration of this influence.

The stress test for banks, which is a component of TALF 2.0, is likely to b inconclusive. Bank's toxic assets are difficult to value, making it impossibl to know how much capital they need and probably very expensive to provid it. Nationalization doesn't make this problem disappear. It will not be until th public/private investment initiative component of TALF 2.0 has been establishe and is functioning, that the value of these assets be determinable and it will onl be at this time that conclusions will be able to be drawn from the stress tests. Th vagaries of mark-to-market accounting for assets in a nonfunctioning market als could benefit from this public/private initiative. I fully expect the mark-to-marke rules to be modified as they are a significant contributing factor to the meage levels of bank capital today.

How would nationalization of banks affect commercial real estate? If we look at the banking industry, we see thousands of retail stores occupied by bank branches and million of square feet of office space occupied by these institutions in New York City alone. **In a nationalization scenario, the government could terminate leases at will. In addition to terminated leases, the conservators could use the threat of termination to renegotiate leases.** For strong landlords, this tactic would be frustrating but probably acceptable as vacant office space is not something on anyone's wish list today. For landlords with excessive leverage, the results could be devastating. Consider the potential impact this could have on the cash flows of the properties banks occupy. This dynamic will add even more pressure to rising capitalization rates which serve to reduce property values. Consolidation would be a likely scenario under any form of nationalization. Consolidation in the industry will continue to happen even if nationalization is not implemented, but it is much more likely to be orderly without government intervention. Let's hope it doesn't happen.