NO Market, NO Staff –
Be ready for the New World

The daily news brutalizes the markets, sometimes like a steamroller, sometimes like a sharp stick in the eye. We have been frozen with fear – fear that if you set a price today a bigger loss will result tomorrow, fear that the worst is yet to come. The hurt happens continuously so that no healing can begin…until recently.

The rapid collapse of confidence in Bear Stearns and the negotiated takeover by JPMorgan Chase ranks as the biggest single casualty of the expanded mortgage crisis. It may also have been the dramatic event that changed the market psychology. We are no longer all splashing in the deep end of the pool with no lifeguard. Someone is watching. The panic has begun to ease even though we cannot quite feel the bottom and the shore is still far away. Where are we?

Opportunistic money and vultures have gathered in isolated pockets to be ready when the markets start to move. However, for big money to be made, big money must be lost. Many of the institutional deep pockets have become well drained due to write-downs for real estate financing vehicles such as CDOs, SIVs, RMBS, CMBS, commercial mortgages, and leveraged-loan commitments. UBS has reported write-downs on the value of loans and securities of $40B from mid-2007 through the first quarter of this year - the largest of any institutional mortgage lender, but with Citigroup and Merrill Lynch not far behind with $32B and more than $20B, respectively. According to Lehman Brothers analysts as reported by Bloomberg, the global reach of the financial crisis has led to $300B in write-downs by the financial industry throughout this same period with the likelihood of another $100B by the end of 2008.

To counter this value decline and remain in business certain domestic and international financial institutions have raised over $180B in new capital. The capital has come from many sources including rights issues, preferred equities, and numerous large cash infusions by foreign government-owned investment funds, the sovereign wealth funds.

Bank or Security Firm	$/share ~mid '07	$/share April '08	Mkt Val Decline %	Mkt Val Decline $MM
Citigroup	55.55	24.02	-56.8%	165,378.01
Lehman Brothers	82.05	44.07	-46.3%	20,942.17
Bank of America	52.96	40.30	-23.9%	56,410.05
Morgan Stanley	75.50	49.09	-35.0%	29,190.90

Washington Mutual	44.66	11.76	-73.7%	29,031.91
Merrill Lynch	95.00	45.34	-52.3%	48,746.61
Bear Stearns	159.36	10.87	-93.2%	21,626.02
UBS	66.26	32.61	-50.8%	64,454.49
Goldman Sachs	250.70	176.87	-29.4%	29,170.78
National City	38.32	9.22	-75.9%	18,860.91
Credit Suisse	78.88	56.55	-28.3%	22,790.79
Wachovia	56.90	28.61	-49.7%	56,059.21
Deutsche Bank	159.76	118.78	-25.7%	20,534.40
IndyMac Bancorp	37.50	4.90	-86.9%	2,690.81

With a frozen market and no income producing activity, businesses have been forced to quickly cut expenses, meaning large numbers of highly paid employees, contract workers and brokers have been let go. In late March, Bloomberg tallied over 34,400 jobs lost among just a small list of less than a couple dozen financial companies. This does not include the hundreds of small mortgage brokers and lenders who backed away from the disappearing market. Nor does the total include to-be-announced layoffs from these and other players, including Bear Stearns that some have projected will lose half of its 14,000 employees in the acquisition by JPMorgan Chase.

More recent additional cuts from these same companies total another 24,000 jobs. The Independent Budget Office of New York City expects further job losses in the financial sector of New York City alone will be 20,200 by the end of next year.

Firm	Positions Cut by 3/24/08	Recent & Future Cuts
Citigroup	6,200	
Lehman Brothers	4,990	
Bank of America	3,650	
Morgan Stanley	2,940	1,000
Washington Mutual	2,600	
Merrill Lynch	2,220	
HSBC	1,650	
Bear Stearns	1,550	7,000
WestLB	1,530	1,500

UBS	1,500	8,000
Goldman Sachs	1,500	
National City	900	
Credit Suisse	820	
Royal Bank of Canada	500	
Fortis	500	
Wells Fargo	500	
Wachovia	443	
Deutsche Bank	370	
JPMorgan Chase	100	
Aurora Loan Services		1,600
First National Mortgage		1,000
First Franklin Financial		1,650
IndyMac Bancorp		2,400
Total	34,463	24,150

We know much pain has been felt and more will come. Even so, the financial jockeying for survival must be accompanied by an eye to the future. The markets will return in a form ready to respond to changes in the lending environment. Mortgage lending including securitization will again be a viable and predictable business. The excesses will be rung out of this cycle. We should expect and plan to get back to business as it "used to be" – before the easy money, before the unfettered greed, speculation, fraud and just plain old "pushing the envelope" of lending standards.

Does anyone remember business as it used to be? The days of cash flow in place and property values you could believe in?

Most important to each lender is HOW they will restart their business when the market comes back. If any staff remains it will likely be senior management, the rain makers who are well connected with counter-parties and customers. Middle management and the staffers who ground out the business and kept the wheels oiled will long be gone. The rain makers may also be gone if their compensation was too much to bear during this dormant period. Procedures and workflows will need to be dusted off using the few people who remember what they mean. Staff size will be slow to ramp up as business trickles in and management will be hesitant to commit to a market not yet established.

To shield from the uncertainties and the fits and starts of a new world the important element will be **Leverage**. Obviously, this is not the leverage of yesterday which involved lending on tomorrow's hopes using borrowed money. This is the operational leverage gained by employing bright, knowledgeable people who are cross-trained with multiple capabilities and aided by sophisticated, intuitive data systems tuned to their business. Operations of this nature are scalable for large increases in business capacity with limited increases in cost.

A key to the ramp up in productivity, as always, will be improved systems, analytics and data management.

In the past large scale lenders have run their businesses with a variety of computerized tools. These ranged from cobbled together, never-ending networks of Excel spreadsheets and Access databases (impossible to control the clutter) to complex, internal, IT-developed computer systems (expensive to develop, expensive to maintain and probably tied to older, legacy computer technology).

The lull in the market provides an opportunity, albeit unwelcome, to reassess personnel and system needs. The surge of recent past, 2005 through mid 2007, demanded a quick increase in staff to handle the workload. Training and staff development may have been overlooked. Support systems and work tools were developed on the fly. Then abruptly the phones stopped ringing; the cubicles were empty. What was delayed in order to make money is now unused in order to save money.

The future as we see it will be a significant nod to the past in several ways.

<u>#1 The lending excess of the last two years, as it was in the late 90's, is not a viable strategy for assembling a quality asset portfolio.</u> Important in the new era will be the old standards of:

- Underlying collateral quality,
- Borrower strength and commitment,
- Cash flow in place,
- Valuations and cap rates not as rarified as a hundred year storm,
- Risk adjusted sizing criteria for LTV and DSCR,
- Extensive data collection and management,
- Lengthy due diligence supportive of the final decisions,
- New and elevated scrutiny by regulatory agencies

<u>#2 Starting in the days of the RTC, the enormous volume of lending data had to be processed with the aid of computerized analytics and data management systems.</u> The latest generation of interactive, web-based tools is well beyond the earlier computer and dot com applications and offers:

- Data security and integrity to satisfy the closest regulatory inspection,
- Immediately functional, high speed data management systems,
- Strong analytics that adapt to changing markets and work habits,
- Reliable and detailed underwritten data needed for credit committees, rating agencies and high risk investors,
- Availability of data, analytics and supporting documents as, and when, needed in the global marketplace,
- All in deference to the new watchword in the marketplace - Transparency.

The best of the systems will have to be:

- Intuitive in use to provide a quick learning curve for both new and experienced staff,
- Comprehensive in scope to capture the changing products in the market,

- Intensely granular to satisfy the always increasing data requirements,
- Scalable to be prepared for the next big thing that runs away with the market,
- Customizable to what makes your company and products unique in the marketplace.

It is only with the help of such comprehensive and integrated data systems that a lender can hope to scale up quickly from the bleak environment of today.   With staff pared down to a few "placeholders", with procedures gathering rust or needing wholesale replacement, the ability to move quickly as the market returns will be a function of the operational leverage of your company's assets – the people and the support systems. If your people and systems can't handle change, you won't be part of it.

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