RCLCO
ROBERT CHARLES LESSER & CO.

THE ADVISORY

APRIL 2008

the big idea

HAVE WE HIT BOTTOM? OUR EXPERIENCE TELLS US NO!

Centex transaction sets a precedent and lowers the bar on land values for the foreseeable future.

Recently, Centex Homes sold 8,500 residential lots in 11 states for $161 million. The sale, which occurred on the last day of its fiscal year, would net Centex a $294 million tax benefit, generating a total of $455 million of potential liquidity. The purchaser, RSF Partners, Inc., is a real estate private equity fund managed by Farallon Capital Management, LLC, and Greenfield, LLC. Centex will retain a 5% interest in the JV and could receive a greater share if pre-established financial targets are met. The portfolio sale represented lots in various stages of development, and it was spread among 27 communities in 11 states. Further research described the portfolio as being predominately located in Nevada and California. Prior to this transaction, Centex had a cash position of only $62 million. Analysts view this transaction as positive for Centex, despite the disappointing impairment charges. This transaction helps Centex reduce their land position in assets that are unimportant to them over the next three to five years, and they can instead focus on rationally priced land on an as-needed basis.

The Centex bulk lot sale has many similarities to the Lennar bulk sale of 11,000 lots to Morgan Stanley that occurred on November 30, 2007. The tax benefits to Lennar were approximately $265 million, and the deal closed on the last day of their corporate year. The lots were sold at 40% of Lennar's stated book value. Most sellers view the Lennar transaction to be an aberration, and not necessarily one that reflected true market value—Lennar was able to obtain some upside potential, and the deal contained certain land re-purchasing options for Lennar that may ultimately yield significant value to the seller. However, since that transaction occurred, many Land Opportunity funds have been set up with the goal of underwriting transactions with a 20 to 25 unleveraged Internal Rate of Return. Very few deals have been transacted on that basis because sellers are: 1) reluctant to give up these types of returns, and 2) not at the point of desperation. Lennar and Centex could sell on that basis because they both had huge tax incentives to justify such a discount in order make the transaction palatable.

These transactions are not an aberration in our opinion, and further study would reveal an alarming trend. If we were to analyze the Centex transaction where they were paid $161 million for 8,500 lots, the average lot sale would approximate $20,000 per lot. Centex claims to have a book value of $565 million, or $66,500 per lot. But in order to have a tax benefit of $294 million, you need to reflect a loss of $750 million in the 39% top corporate tax bracket. That places the original and carry costs at about $911 million (sales price of $161M plus loss of $750M), or $107,000 per lot, representing a sales price just under 19% of the original cost. Some would argue that this transaction is also an aberration. On the contrary, it is a reality that we should prepare for through the remainder of 2008.

IN THIS ISSUE

This transaction has many potential benefits to both the buyer and seller. For Centex, even though they generated only $455 million from the transaction ($161 million from the sale plus $294 million in tax recapture), which represents approximately 50% of their cost, the transaction still makes economic sense for them. The sale creates short-term liquidity and/or reduction of debt that is sorely needed in order to enhance their balance sheet, although it gives up potentially long-term gains. They are able to monetize inventory now, whereas the process could have taken three to five years to complete if the lots had been held. Centex further benefits because they have given up some development risk on the lots sold, which also would have required the use of future cash. Instead, this cash can be put towards buying finished lots and building houses. If Centex had not made this transaction or had waited, they would have lost the tax benefit for at least a year, or perhaps permanently. Alternatively, the buyers of this transaction have a large potential upside that could gain returns above 30%. The transaction is not without many risks. First, the buyers will now take some development and market risk that the lots purchased can be finished and absorbed within three to five years at a stabilized price. The purchaser takes on the function of developer and the cost of carry, real estate taxes, insurance, maintenance, keeping permits active, entitlements, and some HOA responsibilities. If you take the position that this purchaser will pay $20,000 per lot and spend $1,500 on maintenance per year per lot (with a hurdle rate of return of 30%), after five years (2013) the lots would need to sell for just under $92,000 per lot in their current state to generate those returns, or $76,500 for a 25% return. This equates to the investor assuming that property values will increase 30% per year and that values will be back to their 2006 peak value around 2014, where Centex had a lot carry cost of approximately $107,000.

We have now reached a new low.

Financial institutions and borrowers have been working diligently together to keep development loans from being written down and/or foreclosed. They have been buying time in hopes that the market will recover. But history is beginning to repeat itself; the market sounds a lot like what it was in the early nineties. We are now deep enough into this down cycle that most builder/developers are being required to re-evaluate their properties. The Centex transaction sets a new standard and lowers the bar on land values for the foreseeable future. The original loan-to-value criteria is gone, additional equity will be required to maintain the current loan status, and most builders are running out of cash. Centex is a prime example of a builder just trying to hang on and then dumping properties to firm up their cash position. Financial institutions are claiming that their borrowers just don't get it. Most financial institutions don't want property back on their balance sheet, and builders don't want to sell at distressed prices. The market has withstood many cracks over the past two years, but this new Centex precedent is arguably the straw that will break the camel's back. Banks are now going to have to force the builder/developers' hands to guarantee debt or place additional equity in project in lieu of having to dump property or be foreclosed. This will cause many properties to be marketed within a short period of time, creating an even greater downward spiral in the market value for land and a flood of bankruptcies and workouts.

It's time to think strategically.

Our 40 years of experience tells us that the market has not yet hit bottom and that now is the most prudent time to be thinking strategically, both on a short- and long-term basis, regarding repositioning of your company and its assets. RCLCO is currently working on over 275 distressed projects worth over $2 billion—they represent some of the largest and most challenging real estate workouts presently in the United States. Our firm has been engaged by developers, homebuilders, creditor committees, and financial institutions to help them value, acquire, reposition, manage, or dispose of distressed real estate assets in jeopardy of non-compliance or already in bankruptcy. We have a talented and seasoned team of developers, capital market specialists, market analysts, and strategic planning experts to provide objective and insightful recommendations that are analytically based and action oriented. For more information on our Real Estate Workout Practice, please contact Scott Price, Managing Director, at 240-644-0989 (sprice@rclco.com).

RCLCO- REAL ESTATE WORKOUT SERVICES

VALUATION SERVICES AND ANALYSIS OF ASSET AND/OR MARKET

- Monetary default resolution
- Non-monetary default resolutions
- Market feasibility studies to project realistic loan exit strategy
- Develop and implement workout plans
- Evaluate borrowers overall position within the market
- Analysis of financial trends and ratios to identify risks of potential issues
- Independent verification of key financial information
- Assess management adequacy
- Loan sale/acquisitions
- Portfolio analysis of distressed assets co-mingled or cross-collateralized with performing assets
- Evaluate and make recommendations on lender/borrower proposed structures

TURNKEY SERVICES FOR BANK OWNED REAL ESTATE (REO) AND DISTRESSED ASSETS

- Analyze, resolve and full implementation of alternative strategies
- Refinance Alternatives—make recommendations and coordinate loan restructure and/or forbearance agreement. Identify alternative financial institution as loan exit strategy
- Raise additional equity for borrowers to meet lenders current LTV requirements and/or for asset capital requirements
- Bank Trustee—Act on behalf of financial institutions to facilitate the asset management function of a bank owned, bank controlled or bankrupt asset
- Third Party Sale—posture asset for sale, identification and coordination of third party buyouts (accelerated and orderly sales)

VALUE ADDED SERVICES

- Asset management
- Bankruptcy workouts
- Advisors to creditor committees
- Consensual workouts pre-bankruptcy
- Preparation of operating budgets
- Oversight of marketing, tenant relations and property management
- Oversight and implementation of capital improvement programs
- Update financial underwriting models
- Develop annual business plan
- Summarize current asset/portfolio performance
- Coordinate compliance with loan agreements

SCOTT PRICE

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RCLCO Foundation

GRANT AWARDEES PROVIDE PROGRESS REPORTS

In 2007, the RCLCO Foundation awarded grants to 3 organizations focused on providing affordable housing solutions to families in need. *Reynoldstown Revitalization Corporation (RRC), Fusion International, and Behrend Builders have been putting their awards to productive use. Following are two progress reports stemming from this admirable work.*

PROGRESS REPORT ON RCLCO HOUSING PROJECT IN COLOMBIA

To: RCLCO and David McCarty

From: Matt Alexander, President, Fusion International

Date: February 19, 2008

Project Location: Soacha, Colombia (Los Altos de Florida)

Brief Project Update:

After further conversations with our local implementing partner for housing projects, the Tejaditos Foundation, we have determined that we will be able to build three houses with the RCLCO grant instead of the two that we had originally promised in our grant application. This means that RCLCO's generous contribution will support yet another family living amidst severe violence and poverty in Colombia.

The houses will be given to the most vulnerable families that take part in our income generation program, as determined by the participants themselves. The three houses will be built during the months of April, June and August. Upon completion of each home, Fusion International will send RCLCO a progress report including the beneficiary's profile and photos from construction.

For questions related to this project, feel free to contact Matt Alexander at malexander@fusion-international.com

Thank you again for your generosity and commitment to the wellbeing of some of the world's most vulnerable families.

Sincerely,
Matt Alexander
President
Fusion International

FUSION

The RCLCO Foundation was formed in 2006 as a means to positively influence the availability and development of affordable housing. Funding to the RCLCO Foundation is provided by RCLCO, which annually contributes a share of its profits, along with contributions and grants provided by RCLCO team members, alumni, clients, and other organizations who are interested in advancing the cause of affordable housing. The RCLCO Foundation's mission is: *"Changing lives through initiatives that provide affordable housing where people live with dignity."*

PROGRESS REPORT ON GRANT TO REYNOLDSTOWN REVITALIZATION CORP.

DATE: April 7, 2008

TO: RCLCO Foundation

FROM: Jay Perlmutter

SUBJECT: Report on Grant to Reynoldstown Revitalization Corp., Inc.

The funds awarded to RRC to benefit families facing foreclosure have made a huge impact in two local families and, upon the repayment of the loan, to future families. Since the fall, RRC has been providing foreclosure prevention counseling through multiple public events and private one-on-one sessions. Before any monetary support was issued for these homeowners, RRC's staff worked with them to determine the cause of the hardship and the ability to remain solvent in the future. The ideal candidate is someone who is facing foreclosure due to job loss, illness or other catastrophic event, cannot catch up on what is past due, but has the ability to make current payments.

The first loan that RRC awarded funds to using RCLCO Foundation's grant was to an individual for $1,850 for a 6 month period to a resident of DeKalb County, GA. The person lost their job and was denied unemployment benefits, but obtained a new job in October 2007. During the unemployment period, he could not pay his bills and became three months behind on his mortgage. He had never previously been delinquent on his mortgage in 14 years of owning the home. Although he has enough income to make the current payments, he could not make up the gap quickly enough. He has agreed to continue credit counseling with RRC during the loan period.

The second loan issued by RRC was to a woman who was seven months behind on her loan. She had been communicating with her lender, but was unable to get a modification of the loan, and the home was headed for foreclosure. The woman is a single parent, with 2 children, living in Clayton County, GA. She has been employed with the Department of Revenue since 1987.

A series of events led to her falling behind on her mortgage, including a change in child support payments, a broken air conditioner and several car repair bills. She was in a good mortgage with a reasonable fixed rate. RRC's counselor was able to work out the situation between the lender and the homeowner, and also assist the homeowner with improving her budget. The lender wanted a $1,480 up front payment in order to modify the loan. RRC made a loan for $1,000, and the homeowner was able to provide $480. The lender modified the loan to slightly reduce the monthly payments and rolled the 7 months arrearage onto the end of the loan, as long as the homeowner keeps up steady payments. To help prevent future problems, her young adult daughter move back into the home and is assisting by paying $350 a month in rent. Additionally, the homeowner was able to pay off her car note, which not only allows her to avoid monthly interest & principal payments on the car, but also allows her to focus on the mortgage.

For both of these homeowners, the RCLCO Foundation grant has helped them work through difficult financial situations and keep their homes. Within a year, RRC will have been paid back these funds and will re-use them on new families who are facing similar financial hardships. Due in part to RCLCO's support in providing two success stories, RRC has successfully solicited additional funds from banks and other local sources to support other families in need.

minding your strategy

CHARLIE HEWLETT AND GADI KAUFMANN RELEASE TIMELY BOOK FOR INDUSTRY LEADERS AND ENTREPRENEURS

STRATEGY FOR REAL ESTATE COMPANIES
APRIL 2008
ULI - THE URBAN LAND INSTITUTE

Ensure that your company will survive and thrive in today's--and tomorrow's--more competitive, complex market. RCLCO's practical guide to strategic planning addresses the most important issues real estate leaders face: how to set the direction of the firm and implement an action plan to ensure that the strategy is pursued. Discover how to gain a competitive edge in a crowded field and how to maximize your profits by anticipating and responding market cycles, determine how and where to grow your business, identify and fully use the appropriate tools to target customers, and apply best practices from other fields and areas in your market. An essential tool for all types of real estate companies, both large and small, private and public, those that are focused on a narrow set of geographies or products and those that are fully diversified, multidisciplinary concerns. To order, go to http://www.uli.org/AM/Template.cfm?Section=Bookstore&Template=Ecommerce/ProductDisplay.cfm&Productid=1709
ULI Member Price - $59.95
Retail Price - $74.95

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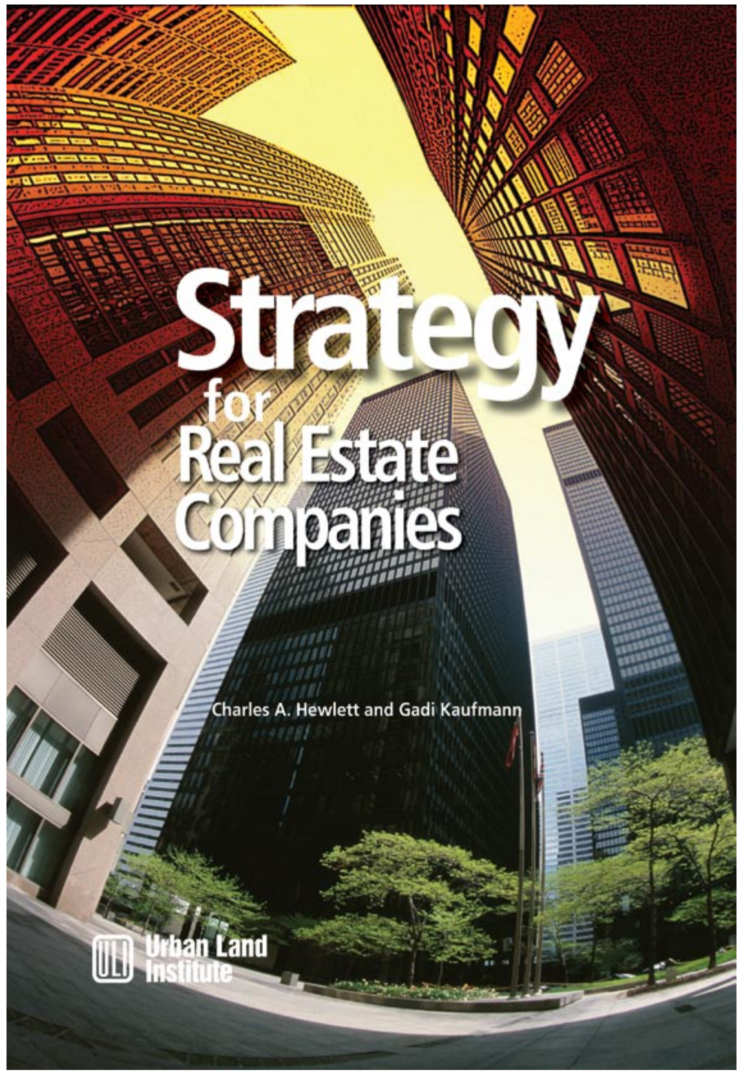

"Charlie Hewlett and Gadi Kaufmann offer readers a process and a mechanism for managing and introducing change in real estate organizations and introducing new ways of strategic thinking about the real estate business. They provide a process and a rigor that can be used to force engagement in collective thinking, which- for Crosland- ultimately was one of the most important things that we needed to change." *- Todd Mansfield- Chairman and CEO, Crosland, LLC*

upcoming events

April 2008

Gregg Logan
April 7-8, 2008
ULI: Developing & Investing Green
“Creating Value Through Sustainability”
Speaker
Charlotte, NC

May 2008

Gadi Kaufmann
May 8-9, 2008
ULI Spring Council Meeting
“To Do Something Or Not To do Something, That Is The Question.”
Speaker
Dallas, TX

Gadi Kaufmann
May 8-9, 2008
ULI Spring Council Meeting
“The Cycle – What’s Ahead and What Should You Do About It?”
Speaker
Dallas, TX

Gadi Kaufmann
May 8-9, 2008
ULI Spring Council Meeting
Overview of the Economy and What it Means for the Real Estate industry
Panelist
Dallas, TX

Gadi Kaufmann
May 8-9, 2008
ULI Spring Council Meeting
“Managing the Enterprise During Uncertain Times”
Moderator
Dallas, TX

Shyam Kannan
May 8-9, 2008
ULI Spring Council Meeting
“Measuring the Market for Green Residential Development”
Speaker
Dallas, TX

Shyam Kannan
May 11-13, 2008
NAHB’s Green Building Conference
“Building Green and Staying in the Black – The Demand for and Market Performance of Green Residential Development”
Speaker
New Orleans, LA

Gadi Kaufmann
May, 14 2008
WPOLA (World Presidents’ Organization Los Angeles)
WPOLA Breakfast Series – The State of Los Angeles Residential Real Estate
Moderator
Los Angeles, CA

about RCLCO

Since our founding in 1967, RCLCO has been at the leading edge of real estate trends and issues. Our impressive record of accomplishments has made us the “first call” for clients seeking strategic advice. We can help you with everything from market research to product programming; financial sourcing to deal structuring; conceptual design to development strategies. We set the highest industry standards by partnering with our clients to answer key questions and solve complex issues--offering strategic guidance that is always market driven, analytically based, and financially sound. Our real estate advisors help clients make the best decisions about property development, planning, and investment, so they can seize the right opportunities for tomorrow ... today. We are real estate consultants, analysts, financiers, developers, and designers--and we are dedicated to offering end-to-end solutions.

In 1985, RCLCO published its first Advisory Newsletter. Since then, subsequent issues have come to represent significant milestones in our intellectual history. Today, our e-newsletter provides over 5,000 real estate professionals with free research, tips, and original articles on various industry trends and issues.