The 5th Annual Kirkland & Ellis LLP Real Estate Private Equity Symposium

September 23, 2010
SUMMARY REPORT

KIRKLAND & ELLIS LLP

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Kirkland's 5th annual Real Estate Private Equity Symposium, featuring two highly animated panel discussions ("Anatomy of a Workout" and "State of the Real Estate Funds Business"), echoed the tension between the continuing uncertainty and emerging optimism in the industry.

Moderator **Steve Tomlinson**, Kirkland's New York-based senior real estate partner, opened the day's discussion with an overview of the themes for the past four conferences, which began in 2006, at a time when the fund environment was bullish ("If you ask, you will receive"). That, of course, was not to endure. Between then and the "world of distress" that marked the September 2009 conference (*Through the Looking Glass*), Tomlinson recalled the uncertainties of 2007, "when we were all wearing grey armbands," that year's Monopoly theme (*Pass Go, Free Parking or Chance?*), and the truly grim 2008, less than a month after Lehman Brothers had filed for bankruptcy, setting off a global financial chain reaction. The 2008 theme, *Discovering New Worlds*, chosen well in advance of the Lehman Brothers bankruptcy, proved prescient as, by conference time, the real estate world was certainly perched on the precipice.

(From left to right) Moderator: Stephen Tomlinson, Partner, Kirkland & Ellis LLP; Jay Weaver, Managing Director, Walton Street Capital; Paul Basta, Partner, Kirkland & Ellis LLP

As Tomlinson said at the conclusion of his opening remarks, it has been quite a ride.

Anatomy of a Workout

The first panel, "Anatomy of a Workout," focused on the financial woes of a hypothetical, if also highly realistic, "HotelCo," the owner, through its subsidiaries, of two "branded" hotels, one in Manhattan, the other in Fort Lauderdale. The problem, needless to say, was that HotelCo was over-leveraged, with $150 million in secured debt, but unable to keep up with the debt servicing, leading it to default. The good news, as **Jay Weaver** of Walton Street Capital put it, was that the default "forced an event." In his view, "The old equity is just gone." Any further investment into HotelCo would essentially be a new investment.

Kirkland's New York-based senior restructuring partner **Paul Basta** looked at the fiduciary duties inherent in a real estate bankruptcy. Basta warned that, as opposed to most bankruptcies, those in real estate — with their numerous covenants, those "totally tortured documents" — are apt to be "tied-up like a pretzel." Of course, it helps if you have all the papers to properly assess things.

> The good thing about bankruptcy: "It forces you to stop, look and listen."

But that is not always the case. Indeed, as Tomlinson noted, "Often, it's well into a case when we actually find all the original pertinent papers," especially in deals with CMBS debt where borrowers seldom have a complete view. The bottom line: Make sure you have the facts you need and the documents to support the facts.

Matt Lustig of Lazard Frères — a frequent panelist at Kirkland real estate conferences — also found good news in the seemingly dire situation presented by HotelCo. "Jay still has money in his fund to invest," he said. "More often, they don't." Like Basta and Tomlinson before him, Lustig focused on getting the facts: "What do you know? What's the value? What's the cash flow? Where can you get cash?" And perhaps most important of all: "When will you absolutely be out of cash?" Again, like Basta and Tomlinson, Lustig stressed the "document-specific" nature of hotel deals. The good thing about bankruptcy: "It forces you to stop, look and listen."

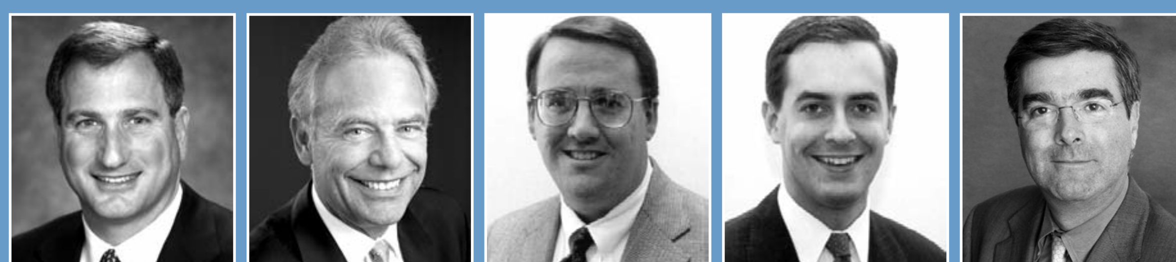
Hugh Hilton of A&M Capital Real Estate, LLC, taking the part of the lender, compared his role to being "in the passenger's seat, but trying to get into the driver's seat." His strategy: "I'd try to break assets apart. I'd try to get control of something I can really control." As for bankruptcy, Hilton cautioned that it could be "the kiss of death!" He warned, "You don't want to file if you have a big convention business." Do, and it will "destroy the asset for everyone. You'll never get the convention business back."

Kirkland's Chicago-based senior tax attorney **Todd Maynes** noted that "tax law has changed a lot — and *is* changing a lot." He cautioned, "You want to make sure you don't send 40 percent to the IRS." Maynes observed that it would be better — by far — if HotelCo were a corporation rather than a partnership, as the options for avoiding cancellation of debt income are far better for corporations. "It's just not practical to ask partners themselves to file for bankruptcy," he said, whereas, "if you're a corporation, that's as far as you have to look." So why not convert to a corporation in advance of a bankruptcy? *That*, Maynes warned, "does not go over well with the IRS!"

State of the Real Estate Funds Business

The day's second panel, "State of the Real Estate Funds Business," was moderated by Kirkland's Chicago-based real estate partner **Nat Marrs**. Marrs opened by asking each of the panelists for a quick, personal overview of the industry today.

Park Hill Real Estate Group's **Chuck Purse** — a longtime panelist at Kirkland



(left to right) Matthew Lustig, Managing Director, Lazard Frères & Co. LLC; Hugh Hilton, CEO & Co-Founder, A&M Capital Real Estate, LLC; Todd Maynes, Partner, Kirkland & Ellis LLP; Moderator: Nat Marrs, Partner, Kirkland & Ellis LLP; Chuck Purse, Managing Principal, Park Hill Real Estate Group real estate events — began on an upbeat note: “We are seeing people coming back to our space.” Purse pointed especially to Brazil (“the poster-child,” given the lack of debt there) and Asia (“very strong, but with well-placed concerns about a possible bubble in China”). Domestically, Purse noted that while “distress is still the focus, there is also strong evidence that the dam is about to burst.”

Going forward, the biggest LP demands will be governance and transparency.

Steve Hason of APG Asset Management felt that while the private equity model “is not dead,” it will have to be “better deployed and more transparent” going forward. At APG, Hason noted, “We prefer regional strategies rather than global mandates.” It was a point also picked up on by Purse, who pronounced himself “a longtime believer in the operator model,” in which, “the decision-making process should be as close to the real estate as possible.”

Steven Hason, Managing Director, APG Asset Management

Given this emphasis on the operator model, Hason stressed the importance of evaluating managers, especially in hard times. “All the track records coming out of this cycle will be pretty bad, ... so we try to look at how they behaved, how they handled themselves — and their transparency. How did they deal with negative developments?”



(left to right) Jennifer Morgan, Partner, Kirkland & Ellis LLP; Alan Bear, Managing Director, A&M Capital Real Estate, LLC; Jim Hime, Principal, The Lionstone Group

Hason noted that at APG today, “We are really focused on scenario analysis. Investors often think: ‘It will never happen.’ Well, we focus on ‘never’ now. We have pages and pages of ‘lessons learned.’”

Purse returned to the issue of rating managerial performance: “If they saw the tea leaves — and adjusted — that is something we like. Did the team hang together? That’s something we like.”

Kirkland’s New York-based real estate partner **Jennifer Morgan** addressed the issue of new federal regulation: “For sponsors, new rules mean a lot of work — expensive, time-consuming work.” That might well also mean hiring a chief compliance officer.

Alan Bear noted that in recent months at A&M Capital Real Estate, LLC, “We focused on large investors — separate accounts — or club-type deals.”

The Lionstone Group’s **Jim Hime** — a former tax partner at an Am Law 100 firm, longtime real estate executive, and author of three published mystery novels — provoked much laughter when he recalled how, “In 2008, the market was such that I wrote a novel. In 2009, the market was such that I rewrote my novel.”

Going forward, Hason said, some of the biggest LP demands will be governance and transparency, as well as a big focus on the mechanics. “How do you exercise your rights? Am I getting the information I need?”

Asked for their predictions for the future, Purse pointed to consolidation in the industry (“it’s a good thing”), better managers, and lessons learned. Bear predicted that there would be a different metrics for compensation. And Morgan predicted there would be "a lot more separate account deals rather than commingled."

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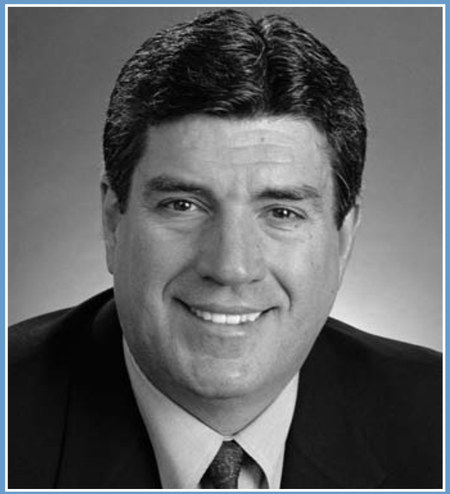
Keynote Address

Keynote speaker **Bryan Marsal**, Co-CEO of Alvarez & Marsal and currently also CEO of Lehman Brothers, was introduced by **David Snow**, Editor in Chief of PEI Media. Marsal offered a brief, spirited inside account of the fall — and resurrection through restructuring — of Lehman Brothers.



Keynote speaker: Bryan Marsal, Co-CEO of Alvarez & Marsal, CEO of Lehman Brothers Holdings, Inc.

Marsal began by recalling how on September 14, 2008, he grudgingly put aside his beloved Sunday night football game after his wife insisted that he take a call from the Lehman board. "They were going to file for bankruptcy in two hours, with $650 billion in assets — and $1.2 trillion in debt claims." And, oh, by the way, they wanted Marsal to come in as Chief Restructuring Officer. He later transitioned to CEO.

The Lehman Brothers that Marsal inherited was, he found, "driven by its trading and real estate desks." Together, the two desks dominated the bonus pool. They were where the action was, but also where the risk was. What Marsal discovered later was that at the two desks driving Lehman, "Nobody followed the risk management guidelines. Liquidity management was non-existent."

Yes, the SEC "lived on the premises," in Marsal's words, "but they had no idea what was going on" at Lehman in the months leading up to the crisis.

The lessons Marsal says he's learned from the Lehman experience and particularly those related to its real estate investments include:

- Value is based on intrinsic cash flow.
- Don't get swept away by cheap money.
- Understand your pipeline. If the music stops tomorrow, where am I? What do I own?
- Be careful of the guy who makes the gold. He's the one who will get you in trouble.
- The rules of the game need to be much more straightforward.
- Synthetic derivatives belong in a casino.

Finishing with a clarion call for better and more careful regulation, Marsal received an ovation — and brought the 2010 Kirkland Real Estate Private Equity Symposium to a successful conclusion.