



## Plan Objectives

In order to fix many of these problems, we quite simply need to find ways to increase the value of the Company and improve its liquidity. We can do this by allocating more capital to higher returning development and value-added investments, while paring the portfolio of core assets. Over time, this should allow the Company to pay down the Term Loan and syndicate the remaining bridge equity.

By selling the underperforming, low yielding assets we can begin the process of de-leveraging the Company. However, we should all recognize that selling the lower quality assets at acceptable prices will be a challenge in today's market. Archstone has been out in the market with several lower quality deals and has received mixed feedback from the market, both in terms of pricing and the depth and quality of the potential buyer pool. Plus, as we all saw with the two Crystal City assets and the Werner portfolio, buyers today are much more likely to re-trade deals than they were several months ago.

We will also look to form JV's where possible around some of the more strategic, high quality assets with long term upside. If we are successful in doing so, this should allow us to circumvent the drawn out marketing process described above. We also hope to get better pricing for these assets, since cap rates have not moved as much for the best quality assets in the best locations. In many cases, we may also be able to rollover existing financing when these assets are contributed to newly formed JV's, which should help us get these deals closed despite today's challenging financing environment. As we expand the Company's pool of JV investments, we will also prove out the Asset Management part of the business plan and capture additional fee streams and promotes for the Company.

We will also endeavor to raise new equity capital to form a value-added development JV, which will enable the Company to take advantage of new investment opportunities until its liquidity situation improves. This is in addition to the mezzanine fund that M3 is currently raising for the Company. If we are unable to find a strategic partner who is willing to form a value-added development JV with the Company, we recommend hiring someone to help us raise this capital for the Company. We believe it is critical to keep the Archstone "deal guys" motivated to find new deals with higher returns to increase the value of the Company and the investor returns. Otherwise, we risk losing key employees and diminishing the value of the Archstone platform.

It will be challenging to achieve all of these goals in the near term, but if we are successful in doing so, we will take the first step toward de-leveraging the Company, while also providing capital for it to grow, and making the equity and debt much more saleable.

## The Plan

Over the last few weeks we have worked with the Company to clean up the business plan, and have been specifically focused on finalizing the disposition and refinancing strategy that will enable the Company to de-leverage its balance sheet and pay down the Term Loan and Development Loan more quickly.

The base case of the Plan, which also matches the Company's 2008 budget, includes \$4.3 billion of real estate sales and \$646 million of refinancing proceeds that could generate up to \$2.3 billion of cash to pay down the Term Loan and refresh the Company's Revolver capacity and up to \$402 million of cash from asset sales to pay down the Development Loan. While we are optimistic that the Company will be successful selling enough assets to meet these targets, we are also realistic about the challenge of doing so in today's environment. Nevertheless, we feel that focusing the Company's efforts on trying to execute the Plan is in the best interest of both the equity holders and lenders, and in order for the Plan to be effective we need to be patient and give the Company the opportunity to execute the Plan.



A summary of the base case Plan is shown below:

Asset Grouping	Potential Timing	Gross Sales Price	Core Property Cap Rate	Net Sales and Refinancing Proceeds	Notes
Assets Already Sold	Complete	\$505,000,000	Misc	\$348,000,000	Includes the two Crystal City assets, German Syndication Proceeds and other miscellaneous sales
Werner Portfolio	Q3	\$311,000,000		\$307,000,000	If we are unsuccessful selling these assets we will refinance them, we are also trying to capture Werner's \$13.3 million deposit since he defaulted on the sales contract
Assets Under Contract	Q1 - Q2	\$145,000,000	5.21%	\$100,000,000	Includes the Wharf ground leased property in SF, the Garage in Boston, one Seattle asset, one San Diego asset and a small land parcel
Assets Currently Being Marketed	Q2 - Q4	\$798,000,000	3.85%	\$347,000,000	A 4.35% blended cap rate on <u>stabilized</u> NOI for the core assets after adjusting for Warner Center, this group also includes the three encumbered ground leases, Monterey Grove, Terracina, Gaithersburg and others
Other Single Assets to be Sold	Q2 - Q4	\$1,679,000,000	4.36%	\$621,000,000	Includes Presidio View, Rincon Hill, four Crystal Assets, two Long Beach assets, Clinton, Laurel Crossing, Newport Village and others
Miscellaneous Asset Proceeds	Q1 - Q4	\$106,000,000		\$105,000,000	Failed 1031 exchange proceeds, sale of tax credits, Clinton condos and payoffs from certain mezz loans
Refinancing Proceeds	Q1	n/a		\$646,000,000	New financing for unencumbered assets, NY seconds, and development loan proceeds
New York ADIA JV	Q2	\$777,000,000	4.25%	\$259,000,000	101 West End, Chelsea and West 54 <sup>th</sup>
<b>Total Base Case</b>		<b>\$4,320,000,000</b>	<b>4.27%</b>	<b>\$2,733,000,000</b>	<b>Potential cash available to pay down the Term Loan, refresh Revolver Capacity and pay down the Development Loan</b>

In addition to the Base Case Plan outlined above, the detailed Plan spreadsheet (see attachments) shows \$2.3 billion of additional potential sales and JV transactions, including the potential Irvine West LA JV, that are not included as part of the Company's 2008 budget. These sales and JV's could generate up to \$614 million of cash to pay down the Term Loan and the Development Loan. The same spreadsheet also shows another \$1.3 billion of assets that are financed with floating rate or easily prepayable debt and have minimal tax protection. These assets could also be sold to generate \$369 million of additional cash proceeds or could be used as loan substitution collateral to facilitate the sale of assets that are financed with fixed rate debt. While it is certainly possible that some or all of these sales could pay down incremental Term Loan beyond what is assumed in the Plan, it's much more reasonable to assume that these potential transactions will help us meet the objectives outlined in the Plan and will take the place of any sales assumed in the Plan that are not completed.

### Pricing Expectations

All of the sales pricing in the Plan above and the budget was based on feedback from the Company. In addition, the Company solicited feedback from local brokers wherever possible to supplement their own analysis and opinion of value. Although we believe the pricing proposed above and in the Plan is reasonable, there have been very few trades in most markets since the fall, so it is hard to precisely estimate value in most of these markets. On average, the pricing for the core operating assets in the Plan above represents a 10.3% discount to the appraisals prepared by CB at closing and a 9.3% discount to our underwriting.



While we would prefer to sell all these assets at prices closer to our historical cost basis, we believe it is very important to de-leverage the Company and pay down the Term Loan quickly, and in order to do so, we need to be prepared to accept sales prices that are in-line with the Plan pricing above, if it is the right real estate decision to make. The alternative would be much worse – holding on to low yielding, core assets, continuing to operate with limited liquidity and potentially incurring additional OID upon Term Loan syndication.

### **Archstone General Market Strategy**

**New York:** Sell or JV the two assets that in the Company's opinion are the least desirable for the long term (Midtown West and West 54<sup>th</sup>) and those assets which have 421a tax benefits that burn off and cause below average NOI growth going forward (Chelsea, 180 Montague, 101 West End and East 39<sup>th</sup>). Keep the remaining assets which offer good long term upside (Murray Hill, Key West, Westmont, Camargue and Hoboken). Three of these assets are being marketed to ADIA as we speak and if that deal is not successful we will seek an alternative JV partner or prepare to bring these buildings to market in an orderly fashion. In addition, the Company will bring Clinton Green to market once the asset is stabilized and with our partner's consent. The Company is also in the process of adding second mortgage and/or mezz debt to the underleveraged assets.

**Washington DC Metro:** The Company would like to hold their assets in the Ballston corridor and two assets in Crystal City, but sell the other assets in Crystal City. They have received a preliminary bid to buy four of the Crystal City assets and some development rights for \$775 million. The Company is also preparing to market a portfolio of four Washington D.C. properties if they can get comfort from a title insurance company that TOPA will not apply for the proposed transaction. The Company would also like to sell their older garden style communities, but keep those that are exceptionally well located (Columbia Crossing, Tyson's Corner).

**Los Angeles:** We have been speaking to the Irvine Company about potentially forming a JV that would include 5 of the more desirable assets in West LA and Pasadena. If we are not able to reach an agreement with the Irvine Company, we would then approach groups like MSD Capital or AEW as other potential JV partners. In either case, this would require some help from Fannie since all of these assets are financed with longer term fixed rate Fannie debt. The Company would also like to sell or JV some of its non-strategic assets (Long Beach, City Place, Bradbury Park, Vanoni Ranch and Warner Center).

**Northern California:** The Company is still very bullish on Northern California and would like to hold on to as many assets as possible to take advantage of the strong projected rental growth, but is nevertheless looking to sell some of the lower quality, non-strategic assets in this market (Fox Plaza, Monterey Grove, Rincon Hill).

**Ground Leases:** The Company is prepared to sell the three ground leases that were financed at closing. All three assets are currently being marketed for sale and interest to date has been encouraging. In addition, the Company is scheduled to close on the sale of the San Francisco Wharf ground lease, which is currently unencumbered, on Thursday, January 31<sup>st</sup>.



## Impact to the Balance Sheet and Liquidity

As the Company executes the Plan and generates cash, we will need to balance our desire to pay down the Term Loan with our need to provide the Company with ample liquidity to invest in higher-yielding deals and to run the business day-to-day. In the short term, the Revolver can be drawn to cover the initial equity requirements for development deals and cash flow shortfalls from the operating business (which are approximately \$120 million per quarter and can also be partially funded from the interest reserve); however, the Revolver will need to be refreshed periodically with cash generated from asset sales and refinancings. Otherwise, the Company is likely to face a liquidity crunch by mid-2008, even without significant additional new investments.

Most of the transactions included in the base case of the Plan are projected to close in the 1<sup>st</sup>, 2<sup>nd</sup> or 3<sup>rd</sup> quarters of 2008. If we are successful in executing the Plan, this will mean \$2.3 billion of cash available to pay down the Term Loan and refresh Revolver capacity and \$402 million of cash from asset sales to pay down the Development Loan. This cash will allow us to pay down the Term Loan A balance to \$150 million by the end of the 3<sup>rd</sup> quarter and pay off the Development Acquisition loan entirely, and Term Loan A would be paid off almost entirely by the end of the year. Executing the Plan would also provide sufficient capital to refresh the Revolver capacity, based on the current Term Loan sweeps. And, if the OID on Term Loan A is avoided, it will also improve the equity returns of the overall deal and improve the Company's liquidity.

Despite the fact that we will be selling assets and primarily paying off debt with the net sales proceeds, the Company's leverage ratio, as defined in the Credit Agreement, does not decrease significantly as we sell assets throughout the year. By the end of the year the Company's leverage ratio is projected to be 75.4% vs. 75.9% at year-end 2007, assuming a static valuation for the assets that are not sold. This is largely a function of asset sales that are, on average, projected to occur at prices that represent a 10.3% discount to the current CB appraisals. In addition, there are on-going development expenditures, additional transaction costs (including OID) and operating cash flow shortfalls that are included in the liquidity analysis and need to be funded with debt, which somewhat offsets the benefit from repaying debt outstanding. Nevertheless, the Company's leverage and liquidity at year-end 2008 will be much improved from executing the Plan vs. maintaining the status quo.

## Plan Summary

To summarize, we strongly believe that executing the Plan should be the Company's top priority and it is in the best interests of all parties involved. We believe that we need to give the Company ample time to execute the Plan outlined above, and in order for the Plan to be truly successful, we will also need the cooperation of the lenders to delay marketing the Term Loan. This will give us the best chance possible to build some positive momentum for the deal as a whole and should be in the best interest of all parties involved:

1. The lenders will get Term Loan A repaid relatively soon, which will help to de-leverage the Company and make Term Loan B more marketable.
2. The equity will become more marketable because we will be able to show higher returns and lower leverage as the Term Loan is paid down and OID is avoided.
3. The Company should have a more flexible balance sheet with more liquidity which over time will allow it to invest in higher-yielding deals, leading to an increased value of the Company, all of which will help to make the equity more saleable.

## Current Deal Returns and Impact of the 2008 Budget

The current deal model shows a gross IRR of 13.9% and a net leveraged IRR to the investor of 12.2% today vs. a 13.6% net leveraged IRR in November. The drop in IRR is mostly a result of incorporating



the Company's 2008 budget assumptions into the model, which generally were more conservative than our acquisition underwriting.

The Company believes that they have been reasonably aggressive in their budgeting for 2008 and are concerned about meeting the budget targets in the face of a potential recession in 2008. Historically the Company has underperformed their budgets by approximately 1%.

### *Net Operating Income*

The budget shows an NOI variance (deal underwriting vs. budget) for the "same store" population of negative 6.1% or \$38.3 million (see attachments for more detail). \$11.8 million of the negative variance (31% of the total) is a direct result of the Company underperforming relative to budget in 2007, which was largely concentrated in the Washington DC metro region (\$8.8 million) including Virginia and Maryland. Same store NOI for 2007 as a whole is projected to be 2.5% below the Company's 2007 budget due to underperformance on both the revenue and expense side.

By market, the Washington DC metro region is responsible for \$21.9 million of the negative variance (including the \$8.8 million mentioned above) vs. the deal underwriting and Los Angeles (including Ventura County) is responsible for another \$7.0 million of negative variance.

Looking forward to 2008, our deal underwriting assumed blended top line revenue growth of 7.1% from 2007 to 2008 while the Company's 2008 budget assumes rent growth of only 5.5% (which may prove to be too aggressive in light of current economic conditions). The budgeted rental growth differential causes another \$8.9 million of variance (23% of the total). Last, the company is also budgeting occupancy that is 69 basis points lower than our deal underwriting (94.9% vs. 95.6%), which causes \$5.7 million of negative NOI variance (15% of the total).

On the expense side, the Company is budgeting expense growth (excluding RE taxes) of 6.5%, as compared to our deal underwriting assumption of 4.0%, which is a function of larger than normal year-over-year increases in personnel, contracts and utilities. In addition, real estate taxes are budgeted to be \$4.2 million higher than our pro forma, with most of the variance occurring in the Washington DC metro region (\$4.1 million) where the company is budgeting a 16% year-over-year increase in real estate taxes. Our deal underwriting in DC had minimal real estate tax growth in 2008 but significantly larger bumps in 2009 and 2010, so looking out a few years this potential "miss" should become smaller.

For the "non-same store" population of 33 core assets, the overall NOI variance (deal underwriting to budget) is \$16.2 million. The assets in this category are generally either new acquisitions, in lease-up, or have other irregularities. Archstone Westbury accounts for \$8.7 million of this variance, with the Company projecting a \$5.3 million operating loss in 2008. The majority of the remaining variance is due to occupancy assumptions on lease-up.

### *Capital Expenditures*

Capital expenditures in the 2008 calendar year budget total \$194.6 million as compared to \$134.8 million in the deal underwriting. This \$59.8 million variance is a function of higher than projected capital costs including \$17.2 million of unanticipated redevelopment at Westbury that will be required to fix the widespread water intrusion problem. The budget assumes \$23.8 million of capital will be spent on Revenue Enhancing & Expense Reducing projects that were not in our deal underwriting. These expenditures are expected to generate a return on investment for the Company over time, which should help support the budget growth assumptions and future NOI growth. The remaining \$19.8 million variance will largely be spent on additional capital improvement projects that were not assumed in the deal underwriting. These projects include the conversion of retail space to thirteen additional rental units at 101 West End in New York and major renovations and structural improvements at Crystal House, Crystal Towers and Water Park Towers in Northern Virginia.



It should be noted that the total budget of \$194.6 million could be reduced by approximately \$30 million as the Plan is implemented and assets are sold. As an example, an optional renovation project at Crystal House, which is carried at approximately \$9 million in the budget, is currently on hold.

#### ***G&A Costs***

The Company's budgeted G&A costs for 2008 total \$63.2 million as compared to \$54.4 million in our deal underwriting. The \$8.8 million variance comes from:

1. Netherlands G&A costs (the costs of administering the German operations), were assumed to be part of the European G&A, but were not included in the final deal underwriting. In 2008 these costs are expected to be \$5.0 million.
2. Merit increases, which were not in the deal underwriting, were \$1.9 million.
3. The Company is budgeting \$1.8 million of recruiting fees to help it bulk up its development staff and fill some open development positions and searches for a new CFO and General Counsel. This should be a one-time variance.

