From: Bernard, Clement [clement.bernard@lehman.com]
Sent: Monday, March 3, 2008 5:55 PM (GMT)
To: Morton, Andrew J [amorton@lehman.com]
Subject: bridge equity

Andy

Find below a summary of what we do with bridge equity.

Two components in the valuation of the asset
* the estimate of the expected cash flow on the transaction and what falls into the Equity tranch and
* market yield that people are expecting on this type asset.

> ____
> From: Cohen, Jonathan
> Sent: Monday, March 03, 2008 11:13 AM
> To: Bernard, Clement
> Subject: bridge equity
>
> The methodology on pricing bridge equity is generally based on the
> initial capitalization structure on day 1, which also includes
> assumptions of the projected entity level cash flows and estimated
> yields that we would sell the bridge equity to investors. We mark our
> investments at 96 (par less the 4 point fee we charge to the ultimate
> investors). We also do these deals with the intention of collecting
> accrued preferred returns from investors (usually 11%-13%). To be
> conservative, we do not recognize this accrued preferred return until
> collected.
>
> Since it was always expected to be carried short-term, there was never
> a robust analysis put in place at the independent servicer to value
> the equity. Over the past few months, Anthony Barsanti and Trimont,
> our servicer, are putting in a valuation framework and cash flow
> monitoring procedures. That said, these investments are actively
> monitored from the business side (Paul Hughson) to see if there is any
> yield impairment to the ultimate equity investor). For one of the
> large investments (ProLogis), we had a legal balance of $575mm (marked
> at 96 day 1). Due to the capital markets, the assumptions for debt
> financing needed to be negatively adjusted and the corresponding
> equity was impacted. Thus, in order to sell the equity at the yield
> investors would require for this asset type (net levered yield of
> 11%), we marked the asset down $55mm over the past 2 quarters.
>
> For Archstone, all fees days one 1 ($233mm) went to reduce the debt
> positions ($33mm) and bridge equity ($200mm). We have also taken any

> excess coupon over carry cost and applied it to the bridge equity
> mark. The mark is now approx 89.6. Even when the term loan or other
> debt is paid down, we do not record positive p&l.
> Based on a failed syndication (i.e. not able to syndicate equity in
> 9-12 months), we would be able to sell equity without sponsor asset
> mgmt fees or promote. The current assumption is that we are carrying
> the equity assuming a failed syndication and we can sell to investors
> at a 15% yield. As the entity level cash flows are updated, which
> occurs often, this yield will be reevaluated.
>
> Jonathan Cohen
> Senior Vice President
> Real Estate Finance
> Lehman Brothers
> 399 Park Avenue, 5th floor
> New York, NY 10022
> Tel. (212) 526-2469
> Fax (646) 758-1570
> jonathan.cohen@lehman.com
>