

*Confidential* Presentation to:

Standard & Poor's

Real Estate Update

*October 2007*

LEHMAN BROTHERS

# Summary

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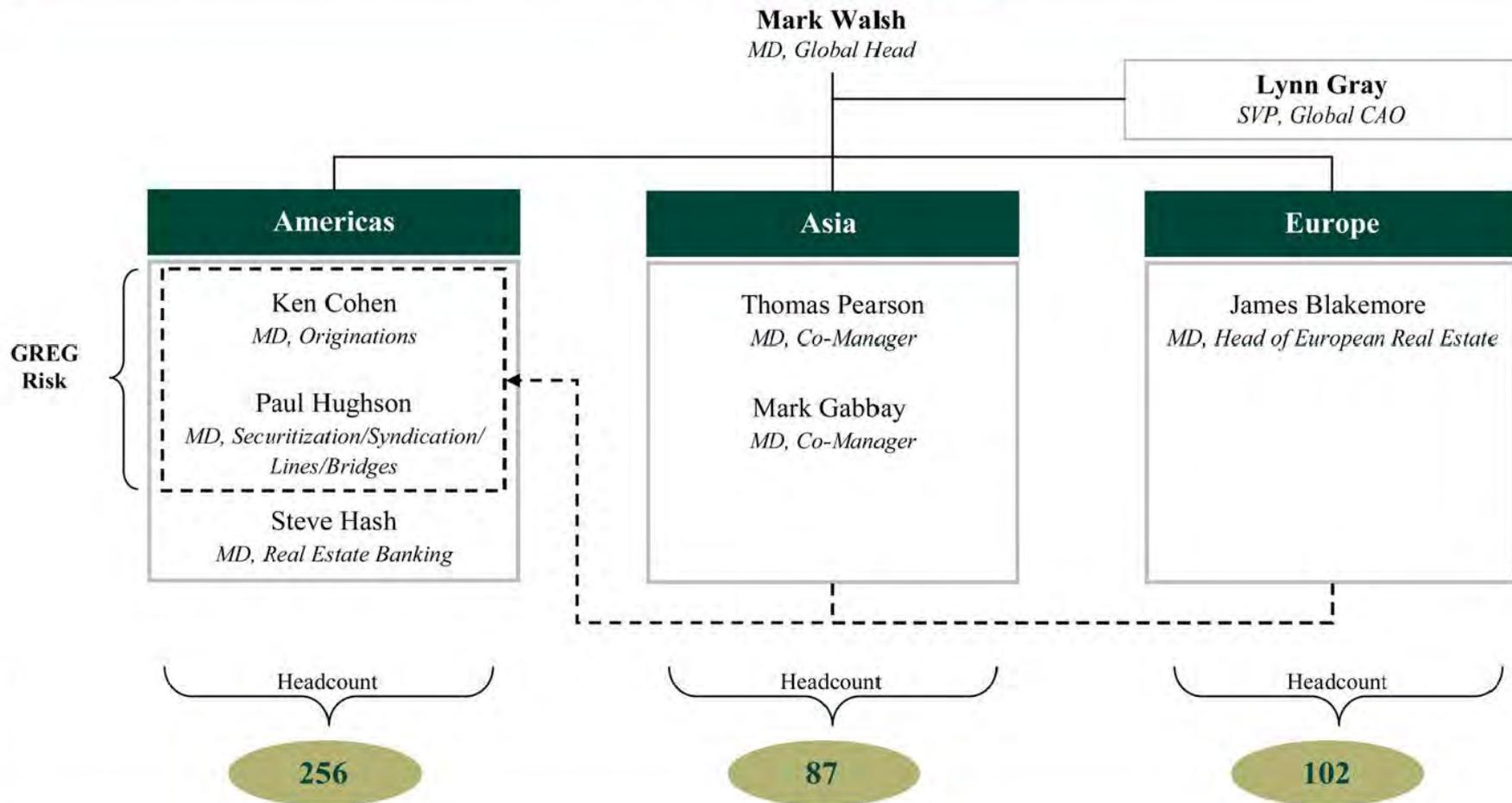
- ◆ Real Estate business consists of three components: Commercial Mortgage loan origination and securitization (CMBS), Principal Transactions Group (PTG), and Real Estate Advisory
  - Since 2003, the Firm's investment strategy has shifted more towards CMBS
  - In combination, the Real Estate business accounts for approximately 10% of the Firm's revenues and 13% of the balance sheet
- ◆ The risks in securitization business are linked to deterioration in whole loans ahead of securitizations and distribution in the CMBS markets
  - We manage these risks through careful underwriting, high volume of securitization and high asset turnover, an established, diversified client base, and spread hedging
  - Well diversified pool of investors, and tremendous distribution capabilities
  - Loans are predominately floating-rate and are well-diversified across regions and products
  - Effective hedging program
- ◆ The risks in the principal business, where exposures tend to be longer-term, are associated with the quality of the investment selection process and our ability to enhance the value of the property
  - We mitigate these risks by careful selection of the investments and partners, limiting the size of our exposures, and seeking geographic and segment diversification
  - Distribution of exposure includes more capacity within our own funds

# Overview

# Lehman Brothers Real Estate Group

The Lehman Brothers' Global Real Estate Group (GREG) is a team of experienced Real Estate professionals offering a complete set of services for the Firm's clients globally. The senior management team has an average of 20 years of industry experience

## GREG Organizational Chart

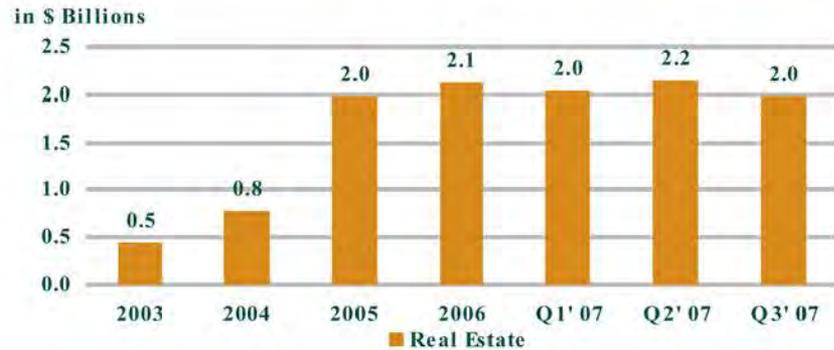


# An Important But Not Disproportionate Part Of The Firm

Overview

Since 2003, GREG has grown considerably in absolute terms, yet its role in the Firm's portfolio has remained relatively stable

### Real Estate Net Revenue<sup>1</sup>



### Real Estate Revenue as a % of Net Revenue



### Real Estate Net Assets<sup>2</sup> as a % of Total Net Assets



### Real Estate Risk Equity as a % of Adj. Equity<sup>3</sup>



1. Quarterly 2007 Revenue figures are annualized  
 2. Real Estate Assets net of Gross-ups  
 3. Risk Equity for Q3 is June 2007

# Business Mix

Overview

**The Global Real Estate Group is made up of three businesses: Commercial Mortgage-Backed Securities business (CMBS), Principal Transaction Group (PTG), and Real Estate Advisory**

## Commercial Mortgage Backed Securities Business (CMBS)

- ◆ Makes loans, aggregates them until they create a sufficient principal amount (\$2-3 billion) to be securitized
- ◆ The mortgages in the pool are secured by a variety of commercial properties, including office, retail stores, multi-family apartment buildings and complexes, industrial facilities and hotels
- ◆ Loans that do not fit well in a securitized pool are syndicated or seasoned until they are securitized

## Principal Transaction Group (PTG)

- ◆ Originates short-term loans (average duration 2.5 years) which are secured by first or second mortgages or ownership interests in properties. These short term loans have a defined exit strategy
- ◆ Makes strategic equity investments in markets that the Firm believes it can bring a competitive advantage or that has significant barriers to entry due to complexity of the situation
- ◆ Purchases non-performing and sub-performing loans or loan portfolios from lenders and government agencies (HUD, FHA)

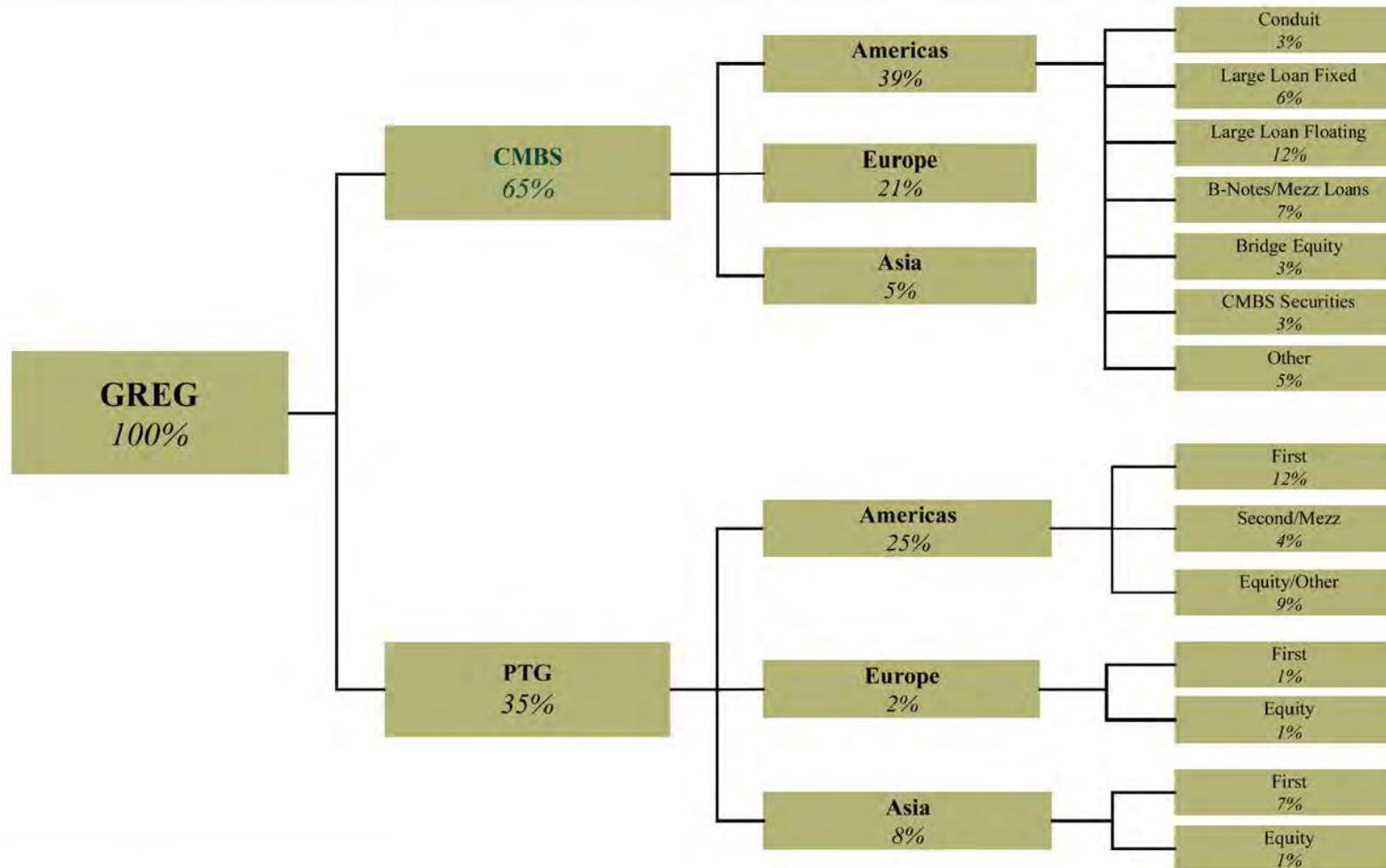
## Real Estate Advisory

- ◆ Provides comprehensive advisory and capital raising services, including general business and financial analysis, transaction feasibility analysis and pricing in a prospective acquisition for a large number of corporations, REITs, property companies, governments and financial institutions so that they can achieve their varied real estate objectives
- ◆ Does not utilize balance sheet

# Diversified Product/Region Portfolio

**GREG is well-diversified from a regional/portfolio perspective. None of the products within the regions account for more than 15% of the group's balance sheet**

Balance Sheet Contribution by Business Segment Q2 2007



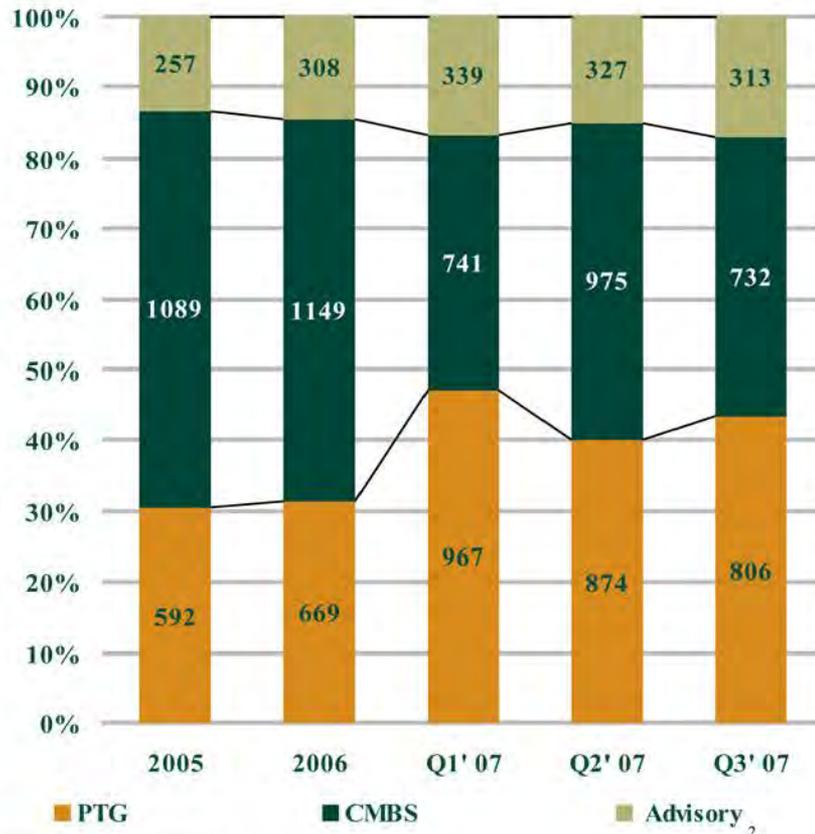
# Moving vs. Storage Business Evolution

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Overview

In the last few years, GREG has shifted its focus from predominantly less-liquid PTG to more fluid CMBS. The rapid development of the Advisory Business has further reduced GREG's asset intensity

Revenue Mix by Business<sup>1</sup>



Balance Sheet Mix by Business<sup>3</sup>

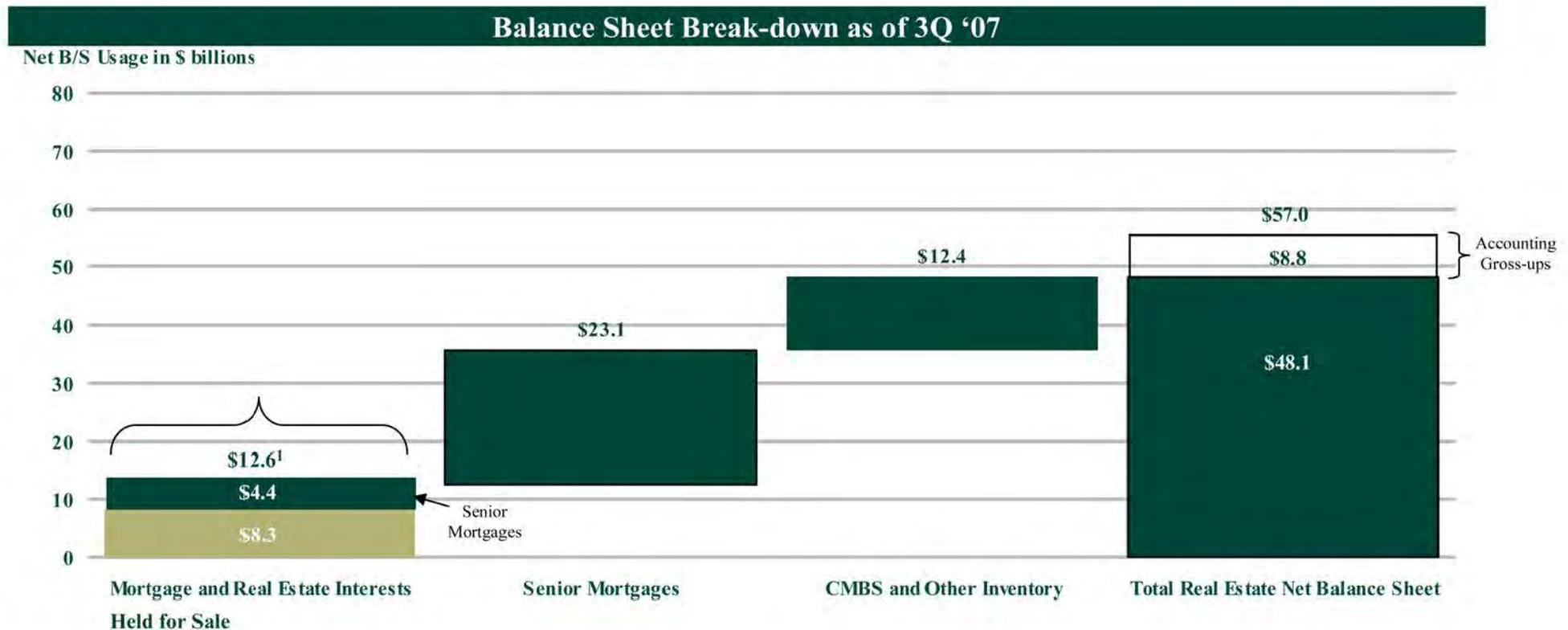


1. 2007 Revenue figures are annualized  
 2. Advisory Business does not utilize balance sheet  
 3. Net of Accounting Gross-ups

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# Asset Composition

Net balance sheet usage by the Real Estate business can be broken down into three component parts. Of the inventory, Senior Commercial Whole Loans (split between Real Estate Available for Sale \$4.4 billion and Senior Mortgages \$23.1 billion) makes up 48% of the “at risk balance sheet”



1. Represents the disclosure for 'Real Estate Available for Sale' net of non-recourse financing

# Managing Liquidity

## **Commercial mortgages and equity assets are difficult to fund in a stress environment. We do not rely on any short-term financing (secured or unsecured) to fund the Real Estate balance sheet**

- ◆ The Firm uses its three bank entities to fund a portion of its Real Estate assets. These regulated bank entities operate in a deposit protected environment and are able to source reliable term unsecured funds from a completely different investor base than that of Lehman debt. They are generally insulated from a Company specific or market liquidity event thus providing a reliable and diversified funding source at a cost effective level
  - Approximately \$6 billion in Real Estate assets are funded through Lehman's three banking entities (LBB, LB Bankhaus, LBCB)
  
- ◆ The Firm funds all assets based on their liquidity characteristics and does not rely on asset sales for liquidity. Cash capital sources, cash with remaining life of more than one year, are used to fund the Firm's less liquid assets including real estate
  - Long-term debt and Equity capital are used to fund Real Estate assets
  
- ◆ Additionally, the Firm is utilizing its private equity funds as an alternative outlet for both mezzanine and equity investments. As a result, PTG's relative share of net assets is decreasing
  - PTG as a share of total net assets has declined from 9% in 2004 to 5% in 2007 YTD

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## Risks and Risk Mitigation in CMBS Business

# Risks And Risk Mitigation

To mitigate risks specific to CMBS and PTG, the Firm deploys a comprehensive suite of different tools and approaches

Business	Activity	Risk	Risk Mitigation
◆ CMBS	◆ Origination of whole loans	<ul style="list-style-type: none"> <li>◆ Underwriting risk</li> <li>◆ Market risk</li> </ul>	<ul style="list-style-type: none"> <li>◆ Strong underwriting discipline</li> <li>◆ Predominantly floating rate loans</li> <li>◆ Shortened time between origination and securitization</li> <li>◆ Geographic/segment diversification</li> <li>◆ Hedge CMBS spread with derivatives</li> </ul>
	◆ Securitization	<ul style="list-style-type: none"> <li>◆ Inability to distribute securities, particularly non-investment grade tranches</li> <li>◆ Reputational, legal risks if securities under-perform</li> </ul>	<ul style="list-style-type: none"> <li>◆ Established customer base for both senior tranches and residual interest</li> <li>◆ High quality process with feedback to underwriting</li> </ul>
◆ PTG	<ul style="list-style-type: none"> <li>◆ Property selection and valuation</li> <li>◆ Development</li> </ul>	<ul style="list-style-type: none"> <li>◆ Underwriting risk</li> <li>◆ Market risk</li> <li>◆ Execution risk</li> </ul>	<ul style="list-style-type: none"> <li>◆ Disciplined due diligence process and committee approval</li> <li>◆ Established developer partners</li> <li>◆ Migration of investment into private equity funds</li> <li>◆ Geographic/segment diversification</li> </ul>

# Strong Securitization Performance

Risks and Risk Mitigation in CMBS Business

## Lehman's loans are performing better than those securitized by any of the top 10 issuers

- ◆ Credit indicator is a seasoning adjusted measure of cumulative credit performance
  - More seasoned pool is expected to have experienced greater credit issues than less seasoned pool
- ◆ On a seasoning adjusted basis, Lehman Brothers has the strongest cumulative credit performance

### Fixed Rate Conduit/Fusion Credit Performance by Issuer

Contributor	Closing Balance (\$bn)	Current Balance	Age (yrs)	Credit Indicator <sup>(1)</sup>
Lehman Brothers	45.8	37.1	4.7	-1.15
Bear Stearns	24.5	21.8	3.0	-0.79
Morgan Stanley	38.4	32.9	3.6	-0.66
Greenwich Capital	26.1	24.9	2.6	-0.11
Bank of America	48.8	42.6	3.5	-0.50
Wachovia	67.4	60.5	2.9	-0.40
JP Morgan Chase	47.8	42.1	3.6	-0.19
Deutsche	32.9	30.0	3.3	-0.14
Credit Suisse	60.2	49.6	4.5	-0.10
Merrill Lynch	26.8	21.8	3.9	0.32
<b>Total / Wtd. Ave (Top 10)</b>	<b>418.7</b>	<b>363.3</b>	<b>3.6</b>	<b>-0.39</b>
Others	272.7	236.8	3.5	-0.34
<b>Total / Wtd. Ave</b>	<b>691.4</b>	<b>600.1</b>	<b>3.6</b>	<b>-0.37</b>

Source: Trepp, LLC; Age adjusted by Lehman Brothers Surveillance Database. Data as of 8/31/07.

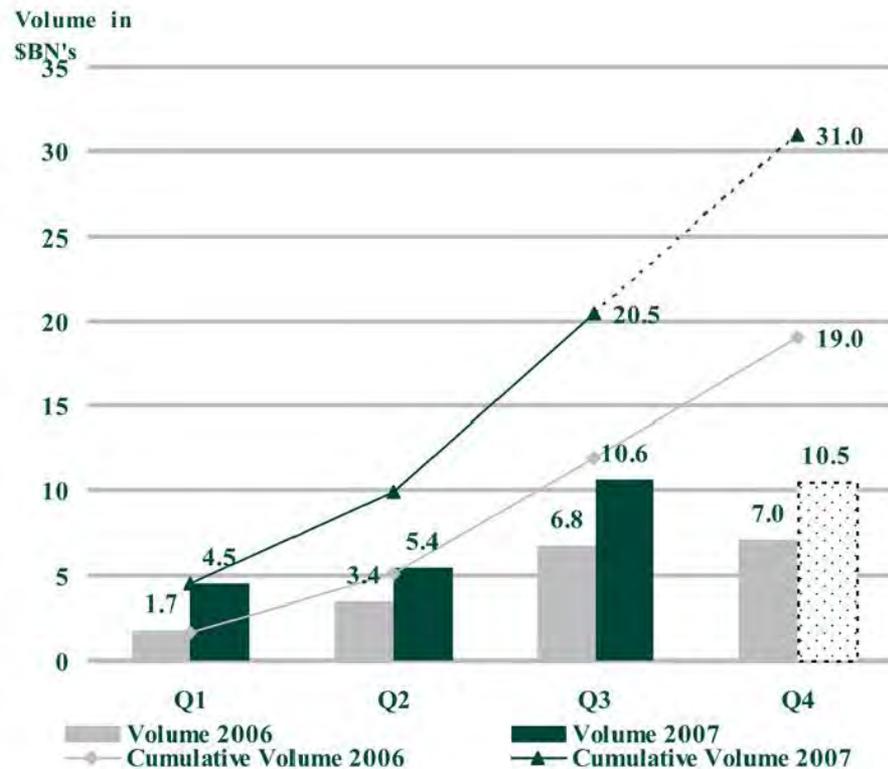
(1) Excess of 60+ day delinquencies and cumulative liquidations over age implied rate.

# Effective Securitization Engine

Risks and Risk Mitigation in CMBS Business

Year to date, we have completed 12 securitizations for a total of \$20.5 billion, which is 8% higher than the total volume of issuances in 2006. Our business model is to sell all of the subordinated tranches. As of August 31, 2007, we had a de-minimis \$78 million in below investment grade retained pieces of commercial mortgage securitizations -- primarily due to the Firm making a market in these securities. In Q4, we have a significant amount of securitizations planned globally

CMBS Securitization Volumes – 2006 vs 2007



Commercial Mortgage-Backed Securities: FY 2007 YTD

	Total Deal Size (\$bn)	Lehman's Contribution (\$bn)	Lehman's Exposure as of 3Q 2007 (\$bn)	Lehman's Exposure as of 10/09/07 (\$bn)	Lehman Non-investment grade residuals (\$bn)
<b>U.S. Issuance</b>					
LBUBS07-C1	3.0	2.0	0.2	0.0	0.0
LBUBS06-C7	3.7	2.5	0.2	0.0	0.0
LBUBS07-C2	3.6	2.4	0.3	0.1	0.0
LBCMT07-C3	3.2	3.2	0.1	0.0	0.0
LBFR07-C5	2.3	2.3	1.2	1.1	0.0
LBUBS07-C6	3.0	1.9	0.2	0.1	0.0
<b>U.S. SUBTOTAL</b>	<b>18.8</b>	<b>14.3</b>	<b>2.2</b>	<b>1.3</b>	<b>0.0</b>
<b>NON-U.S. Issuance</b>					
WINX	2.0	2.0	0.0	0.0	0.0
WINXI	1.4	1.4	0.5	0.3	0.0
WINXII	2.1	1.1	1.0	0.6	0.0
DTC 8	0.4	0.4	0.0	0.0	0.0
LJAC 4	0.7	0.7	0.0	0.0	0.0
LJAC 5	0.6	0.6	0.0	0.0	0.0
<b>NON-U.S. SUBTOTAL</b>	<b>6.2</b>	<b>6.2</b>	<b>1.5</b>	<b>0.9</b>	<b>0.0</b>
<b>GLOBAL TOTAL</b>	<b>25.0</b>	<b>20.5</b>	<b>3.7</b>	<b>2.2</b>	<b>0.0</b>

# Profitability on Recent Securitizations

Even during this tumultuous market, Lehman has continued to securitize commercial mortgages in a profitable manner by utilizing different regions and structures

## Recent Lehman Commercial Securitizations

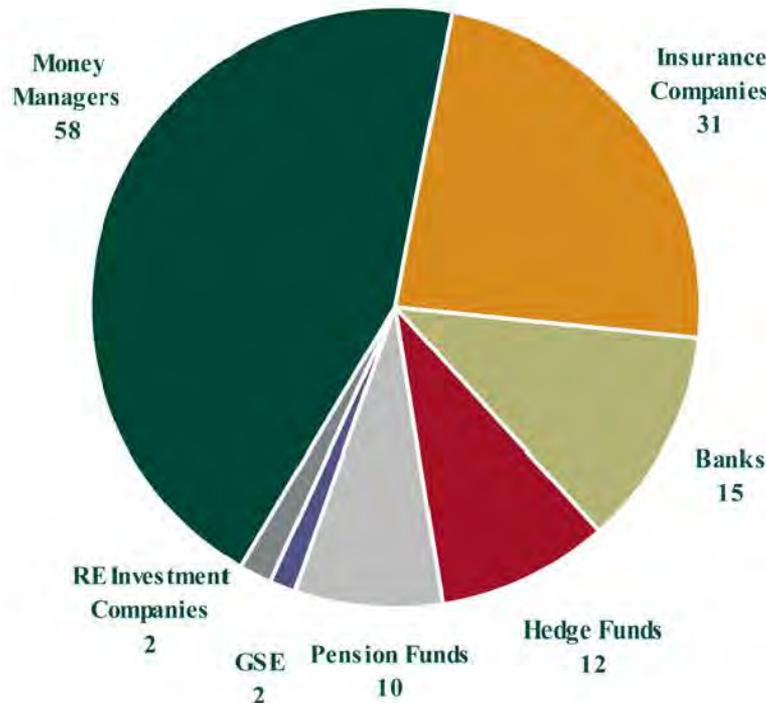
Month	Region	Securitization	Fixed vs. Floating	Securitization in \$ Billions	Profit in bps
April	Americas	LBUBS07-C2	Fixed Rate	2.4	200
July	Americas	LBCMT07-C3	Fixed Rate	3.2	125
July	Europe	WINX1	Floating Rate	1.4	30
August	Americas	LBFR07-C5	Floating Rate	2.3	30
August	Americas	LBUBS07-C6	Fixed Rate	1.9	75
August	Asia	LJAC 5	Floating Rate	0.6	125

# Well-Established Distribution Capabilities

The high volume of CMBS securitizations is supported by strong distribution capabilities. Most senior tranches are bought by traditional long-only investors

## Buyers of Senior Tranches

Composition of Securitization Investors



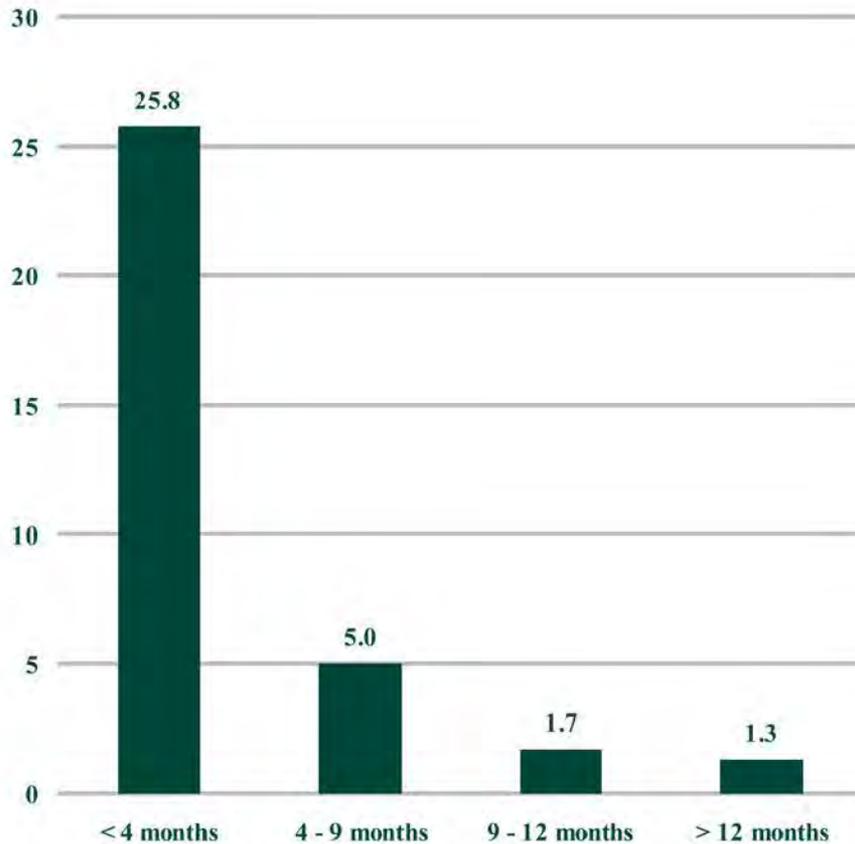
## Distribution of Subordinate Tranches

- ◆ Lehman has an established B-Note and mezzanine distribution program which accompanies every large loan floating rate transaction and most fixed rate transactions. As insurance companies, pension plans and money managers look to leverage off established real estate infrastructures in search of yield, the ranks of participants continues to expand
- ◆ Lehman has capitalized on market appetite for B-Note and mezzanine risk by distributing those positions. This has allowed Lehman to offer investors a broader range of products as well as expand the investor base
- ◆ Major investors who have bought these subordinated tranches recently include
  - HIMCO
  - Sorin Capital
  - AIG
  - Aegon
  - NY Life
  - Capital Trust
  - TIAA
  - Helaba
  - Prima Capital
  - Northstar
  - Allied Irish Bank
  - CW Capital
- ◆ Our competitors often provide financing through repo arrangements. Lehman does not offer such a service

# Rapid Inventory Turnover

The average age of the Firm's commercial whole loan inventory is just over 3 months with 76% of the portfolio aged 4 months or below. This inventory is spread over 2,000 positions with average balance of \$16 million

Commercial B/S Aging 8/31/2007



Distribution of B/S by Size \$ million

Investment Size	# of Positions	Average Investment Size
<25	1,824	3
25-50	99	30
50-100	84	61
>100	83	231
<b>Total</b>	<b>2,090</b>	<b>16</b>

# Additional Risk Mitigants

**Fixed rate inventory is hedged for both credit spread and interest rate movements, while floating rate inventory, which has been less susceptible to credit spread movements, is further buffered by characteristics of the deal and profit margins**

## Fixed Rate Commercial Inventory

- ◆ Fixed Rate inventory is hedged both from an interest and credit perspective
  - Interest Rate Risk
    - Swaps and Treasuries are used to hedge fixed rate loans
  - Credit Spread Risk
    - AAA – BBB– rated portion makes up 95% of the exposure
      - Hedged using a AAA CMBS Index
    - ‘< BBB- rated portion makes up 5%
      - Pre-sold prior to securitization
      - Excess spread between origination and the securitization absorbs some of the credit spread movement

## Floating Rate Commercial Inventory

- ◆ Floating Rate inventory due to the below factors is well insulated from increasing credit spreads
  - Short-term in nature
    - The average remaining duration on these loans is approximately 1.25 years
  - Securitization Spread
    - The excess spread and fees between origination and the securitization
    - Represents an additional buffer to protect from any spread widening
  - Flexible Pricing
    - The Firm is often able to reprice the loans based on any spread widening

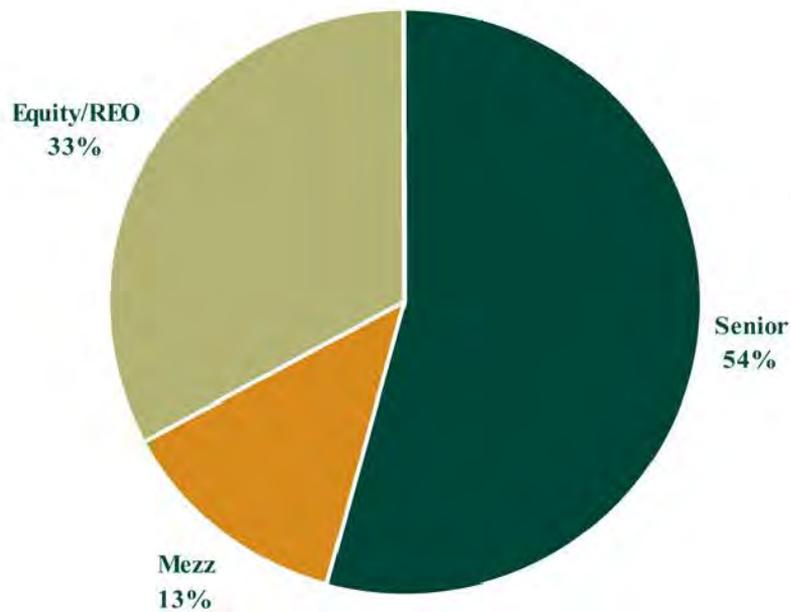
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## Risks and Risk Mitigation in PTG

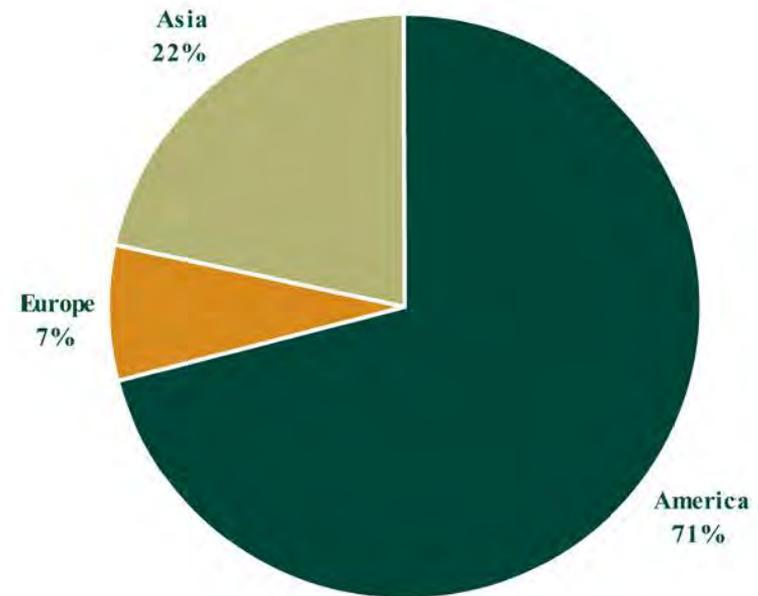
# PTG Investment Portfolio

The Firm's PTG portfolio is well diversified across investment types and geography. This should reduce the effects of a specific product/geographic slow down

PTG Balance Sheet by Type



PTG Balance Sheet by Region



# PTG Positions

Risks and Risk Mitigation in PTG

## Top 10 PTG Real Estate Positions as of August 31, 2007

Project	Type	Lien	Location	\$ MMs	Comments
Heritage Fields	Mixed Use/Land	Senior	CA	456	Construction loan for a newly planned community situated on 3,723 acres and will consist of 3,630 residential home sites, 3.1 million square feet of R&D / office space, 225,000 square feet of retail space and two golf courses. Equity sponsors include CALSTRS, NYSTS, and Oregon State Employees
Project Clover	Housing	Senior	Japan	390	6- month bridge loan collateralized by pledge of shares of Ryowa, a Tokyo based publicly traded condominium developer
Carillon	Multifamily	Senior/Mezz	FL	371	Ground up condo development in Miami. Expected completion and sell out of phase 1 in 4Q07
Knickerbocker	Hotel	Senior/Mezz	NY	263	Renovating and repositioning Time Square Hotel as five star hotel
Ritz Carlton Kapalua	Hotel	Senior/Mezz	HI	217	Construction loan to convert 548 room hotel into condo-hotel in Maui with 298 hotel rooms and 107 condos
LBS Holdings SARL	Hotel	Equity	Various	220	Originating from the recapitalization of the Meridien position. Secured by a portfolio of 31 hotels. Strategy is to maximize operations at the properties through management and renovations and position them for sale
Project Cowboy	Mixed Use	Senior	Japan	201	Origination of a 3-year senior secured floating rate loan to provide refinancing to K.K. Taurus Realty. The debt is secured by 1st mortgages on 16 properties located throughout Hokkaido, Miyagi, Niigata, and Osaka
Commons of Mclean	Multifamily	Senior	VA	173	Senior loan secured by 23 multifamily buildings that were constructed in 5 phases between 1966-1973. The development project is located in one of the most affluent locations in the DC area. A newly planned metro station should increase the value of the property through increased density and provide a competitive advantage over other comparable properties
Orlando Assets Acquisition	Multifamily	REO	FL	163	Foreclosed loan; Two condo conversion in Orlando, which is currently being marketed for sale by Jones, Lang, LaSalle
Daikoku Distribution Center TMK	Land	Senior	Japan	184	Purchase of TMK bond issued by Daitoku Distribution TMK. The bond is one year bridge financing collateralized by 1 land parcel. The initial LTV at deal closing is 77.7%.

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# PTG Deal Summary: The Post (Columbia Center)

Risks and Risk Mitigation in PTG

## Debt financing and equity participation in a ground up office project in Washington, D.C.

### Financial Summary

Start Date:	December-03
Property Type:	Office
Location:	Washington D.C.
Sponsor:	Monument Realty
Deal Type:	Development

### Deal Summary

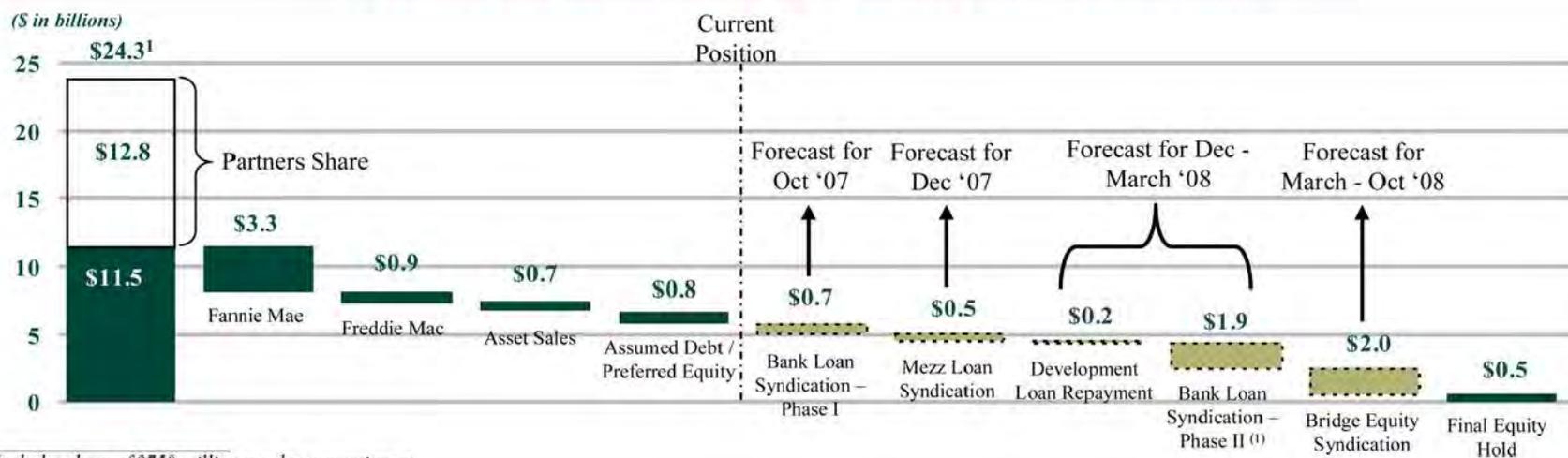
- ◆ **Business Plan:** Columbia Center will be a newly constructed, 394,500 SF trophy level office building constructed on a 35,464 SF parcel of land located on 15th Street in Washington, D.C. The building is expected to be completed in September 2007
- ◆ **LB Participation:** In 2003, LB funded a \$19.9MM mezzanine loan to fund the acquisition of the land and pre-development costs. In 2004, LB purchased the \$31MM outstanding senior loan on the deal from UBS. In December of 2005, LB committed construction financing of \$203MM, which paid off LB's existing senior and mezzanine loans generating \$12MM of P&L, and allowed LB to execute its option to convert the mezzanine loan into an equity position. In May of 2006, LB sold half of its equity position and senior loan position to UBS generating \$14MM of P&L. LB maintained an equity position of 20% and a senior construction loan balance of \$64.4MM
- ◆ **Sponsor:** Monument Realty is a full-service real estate company focused on the acquisition and development of commercial, residential and hotel properties in the Washington metropolitan area. Lehman has had a strong relationship with the sponsor having originated over \$1.4Bn in debt and equity across 35 investments resulting in realized profits to date of \$131MM on \$754MM of invested capital
- ◆ **Current Status:** In June of 2007, UBS bought-out the remaining 50% equity stake owned by LB (20%) and Monument (30%) and has paid off the remaining LB senior loan resulting in an additional \$12.5MM in P&L and total deal profit of \$38.5MM.

# Archstone-Smith Trust

**Lehman Brothers, along with its partners, acquired Archstone-Smith Trust, a large multi-family REIT in the fourth quarter of 2007. The Firm has commitments in place from outside parties and existing non-recourse financing to reduce its total exposure by \$5.8 billion**

- ◆ Over 50% of Lehman's exposure to the acquisition was syndicated prior to the completion of the commitment
- ◆ Lehman's original exposure was \$11.5 billion, which was comprised of \$9.1 billion of debt<sup>1</sup>, \$2.2 billion of bridge equity and \$250 million of permanent equity
- ◆ The Firm has reduced its exposure to \$5.8 billion<sup>1</sup> through the following:
  - Fannie Mae purchased \$7.1 billion of the total debt
  - Freddie Mac committed to purchase an additional \$1.8 billion of debt
  - A 90% interest in 16 select Orange County / San Diego properties has been sold, generating net proceeds of \$1.4 billion
  - \$1.4 billion of existing debt and \$370 million of preferred equity was assumed

## Lehman Brothers' Share of Archstone-Smith Distribution



1. Includes share of \$750 million revolver commitment.

# S&P Commentary – Archstone-Smith Trust

Risks and Risk Mitigation in PTG

## ◆ World-Class Multifamily Portfolio

- “With over 95% of the trust’s investments concentrated in Washington, DC, Southern California, the San Francisco Bay Area, Chicago, New York, Boston, southeast Florida, and Seattle, we believe ASN has completed a transformation from a southeastern regional REIT to a nationwide REIT concentrated in protected, supply-constrained markets.”<sup>(1)</sup>
  - “We like this strategy, and we believe it could help ASN operationally outperform peers.”<sup>(1)</sup>
- “We think ASN’s markets in New York City and the West Coast--together close to 57% of property-level income--are driving solid 2007 results.”<sup>(2)</sup>

## ◆ High-Growth Coastal Markets with Substantial Barriers-to-Entry

- “ASN focuses its investment activities on markets characterized by high barriers to entry against new supply; expensive single family home prices; and strong economic fundamentals.”<sup>(1)</sup>
- “Barriers to entry exist in protected markets in which there is a very limited amount of land zoned for apartment development, and where local municipalities are reluctant to zone additional land for apartment communities.”<sup>(1)</sup>

## ◆ Significant Value Creation through Development Platform

- “ASN places considerable emphasis on value created through the development of new apartment communities.”<sup>(1)</sup>
- “...ASN’s large development pipeline, totaling about 6,700 units, should begin to contribute meaningfully in late 2007 and 2008.”<sup>(2)</sup>
- “In addition, ASN has a significant pipeline of future development projects and is a building a platform for investment in Europe.”<sup>(2)</sup>

1. Source: Standard & Poor’s Stock Report dated May 12, 2007.

2. Source: Standard & Poor’s Stock Report dated October 6, 2007.

# S&P Commentary – Buying vs. Renting

## Recent turmoil in the for-sale housing market and strong renting fundamentals will benefit the multifamily sector

- ◆ Housing market volatility combined with the dislocation in the mortgage market will push many to rent
  - “Typically, as new households form, they tend to have a general bias toward homeownership instead of renting. However, the current housing market volatility combined with the dislocation in the mortgage market are pushing this bias toward renting and will very likely continue to weigh on for-sale housing through 2008 and likely into 2009.”<sup>(1)</sup>
  - “...Many former renters in these communities were enticed to buy a home sooner than they normally would have, thanks to the breadth of mortgage products that considerably lowered the hurdle for homeownership. Now some of these homebuyers are having a hard time making their payments as their mortgage terms change and/or they are unable to refinance due to declining home values and tighter underwriting. Eventually, these homebuyers are very likely to return to the rental pool, thus creating more demand for multifamily rentals, while their homes add to a growing inventory of foreclosed properties.”<sup>(1)</sup>
- ◆ Fundamentals for multifamily remain strong while single-family housing will continue to suffer
  - “Over the next 12 months, we don't see any catalysts that would put pressure on demand for conventional rental units, except in select markets that are suffering from excess condo and single-family supply. Job growth remains positive, multifamily supply is under control, and the for-sale housing market remains volatile, which is keeping potential buyers on the sidelines.”<sup>(1)</sup>
  - “Long-term demographics should continue to support both the for-sale and rental markets. Specifically, the projected growth of the 20- to 44-year-old cohort should buoy rental demand. Rental fundamentals should also remain favorable, and rent growth should stay positive. For at least the next year or two, the for-sale market will likely be wheezing while rentals keep jogging along--even if they're not exactly sprinting.”<sup>(1)</sup>

1. Source: Standard & Poor's RatingsDirect article from September 20, 2007 titled “Buying Versus Renting: These Days, Single Family Pain Is Multifamily Gain.”

# Pricing Verification

**On top of the daily P/L analysis done by the Product Controllers, the Firm also conducts a monthly price verification exercise that utilizes conservative principles**

- ◆ Preparation
  - Gather third party servicers' data
  - Reconcile and segment all positions
- ◆ Determine Collateral Value
  - Use 3<sup>rd</sup> Party sources
  - Apply 10% haircut for selling costs and liquidity
- ◆ Determine Discount Rate
  - Obtain spreads from published newsletters
  - Based on property type (and LTV for debt)
- ◆ Model the Investment
  - Use a waterfall liquidation structure based on the investment
  - For Debt, take the lesser of the capped face, available proceeds or PV as a “market” value and compare to basis
  - For Equity, compares proceeds to LB (“market value”) with the basis
  - Research is conducted for each position based on Asset Summary Reports & Deal updates on Servicers web-sites, and discussions with asset managers and the business
- ◆ Mark Adjustments
  - Discuss variances outside thresholds with the business for potential mark adjustments
    - Variance Limits: \$1 million overvaluation and \$3 million undervaluation
    - Real Estate classified as “available for sale” is carried at lower of cost or market

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## Scenario Modeling

# Stress Scenarios For Commercial Mortgage Business

Scenario Modeling

The Firm utilizes 13 stress scenarios to determine the worst-case losses. For the Commercial Mortgage Backed Securitization (CMBS) business, the three scenarios with the worst impact on CMBS spreads are detailed below.

It is worth noting that while our stress tests show the potential for losses in these hypothetical scenarios, in fact, our actual experience in the current challenging environment has been that the global CMBS business has generated positive revenues ranging from approximately \$47mm to \$89mm per month for the last three months, including September. This includes recording losses on positions offset by gains on securitizations

## Stress Scenarios and Impact on CMBS Business as of August 31, 2007

Spread Widening Assumptions	Scenarios		
	Credit Crunch	Rating / Default & HF Risk	HY / LBO / Default Risk
AAA	36bps	12bps	8bps
BBB	255bps	80bps	65bps
Below Investment Grade	300bps	130bps	117bps
<b>Expected Impact to the Firm (in \$ MMs)</b>	<b>(269)</b>	<b>(93)</b>	<b>(73)</b>

- ◆ Credit – Crunch -widening of credit spreads similar to but is not limited to what was seen during July and August 2007. Mortgages decline significantly. Most other markets experience a flight to quality move, EMG credit spreads gap, and fx carry trades unwind
- ◆ Rating/Default and Hedge Fund Risk - Significant rating risk (e.g. GM), one name default in CDX or HVOL coupled with hedge fund blow-out on structured credit products causing panic selling, significant market widening with CDS basis gapping out (modeled after the period Jul 18, 2002 - Aug 2, 2002)
- ◆ HY / LBO / Default Risk - Global default rate increase coupled with lower recovery. Investor demand dries up after "hot" market, leading to a longer syndication time line or no syndication in large LBO or M&A loan deals (modeled after the period Sep 16, 2002 - Oct 17, 2002)

# Residual Profit Analysis On Americas PTG Assets

Scenario Modeling

**Stressing our portfolio for a valuation movement similar to 1991/92 would result in a loss of \$940 million. The '91 to '92 downturn is comparable, although more severe than the risk assumed in our Risk Appetite model. The US Principal Transaction Group assets detailed below incorporates the majority of the equity and debt investment reported as less liquid assets**

## Portfolio Profit/(Loss) Statement as of July 31, 2007 given certain Scenarios<sup>1</sup>

US PTG in \$ millions	Profitability at Stabilized Value	Potential Profitability on Current Portfolio	Stress 3Q:'91 to 3Q: '92	
			Downturn - Current Value	10% Decline - Current Value
Liquidation Value	18,306	11,854	9,720	10,283
Firm Cost Basis	13,934	10,660	10,660	10,660
Gross Portfolio Profitability	4,372	1,194	(940)	(377)

- ◆ With a 10% decline in property values, including the embedded value that we already take into account, we foresee a loss in an orderly liquidation of \$377 million
- ◆ With an orderly disposition, we expect to generate a profit of \$1,194 million
- ◆ The cost basis of the PTG portfolio is currently \$10.7 billion. The expectation is that investments will be made in the underlying assets to increase their values. We expect that these investments will increase the cost basis to \$13.9 billion and allow the Firm to harvest \$4.4 billion in profits

<sup>1</sup> Stabilized Values reflect returns and costs associated with fully developing all projects and/or reaching projected levels of occupancy

# Conclusion

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- ◆ Combination of three businesses with substantially different risk factors
  - Flow-driven CMBS
  - Investment-driven PTG
  - Low risk Advisory
  
- ◆ Well-established securitization engine
  - Bulk of balance sheet exposure
  - Securitizations on average once a month or even more frequent, different geographies and properties, average whole loan holding period approximately four months
  - De-minimis non-investment grade retained interest securities
  
- ◆ Diversified principal business
  - Careful selection of investments
  - Risk-sharing with partners
  - Transitioning from “hold” to “flow” business by using Real Estate funds to migrate assets