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Mr. Gerald Hines is founder and Chairman of HINES, a global leader in property development. The following is a speech Mr. Hines delivered at Property Forum, The Centre for Jewish Life, on 3 Dec 2008

It's interesting to see a large number of our brother, real-estate competitors here today. Lately, it's been an interesting time in the real estate business, since Lehman Brothers went broke. I think Lehman's bankruptcy was a major mistake on our regulators part.

We operate in many parts of the world. We have a 15% partnership in a project in Shanghai. Our Singaporean partner, who's in for 85% of the project, informed us two weeks ago that he was unable to fund the next draw, as he had another project in Thailand in which Lehman Brothers was *his* partner. Our project was 40 storeys, the glass curtain wall was three quarters completed and he had $100 million in there.

So we've all learned something. I guess we're going to have to introduce some new clauses so that our partnerships are not fixed at pro rata dilution. It's going to be subject to some very significant reduction in their percentage ownerships. When you have a partner, and you're providing the sponsorship, and your reputation is on the line, you need to take some major steps to be sure that your partner funds.

How did this credit crisis come about?

Well, it's a number of things. The increase in money supply has been huge and we've had a lot of political agendas. Let's take for example the credit crisis in sub-prime mortgages. Our political leaders who are presently in power were very concerned about enlarging home ownership beyond good valuations and market discipline and therefore encouraged sub-prime. But without good underwriting it inevitably fell apart.

Added to that, we had securitisations of sub-prime mortgages and these instruments created very toxic waste in all of our banks, because how can you foreclose on a securitised piece of mortgage? More, these instruments were rated AAA but they certainly weren't AAA. Now we have all that lying in our banks and the banks are afraid to lend and so we have a huge liquidity crisis.

I was in one in 1980 when I was Chairman of the Dallas Federal Reserve, under Paul Volker, who I'm very glad is coming into this new administration. He's heavy set and six foot, four inches tall, that's two metres, with a brain that's equal to that height. We had 15% yield on treasuries, 20 - 25% bank interest rates. The real estate community got completely wiped out, unless you were in the height of your equity. I had learned my lesson about five years before, and I'd gone to get equity, and those were what most of our projects were constructed on.

The investment banks got over leveraged and they all now have to go from 30:1, that's one part equity to 30 parts debt, to 10:1, or one part equity to 10 parts debt. That's a huge de-leveraging. In the US, UK, Spain and Russia I find the greatest problems. I see France, Italy and Poland to be in better shape, especially Poland. But in these other countries, it's going to be tough.

The effect of real estate on the general economy

Most of us have a great portion of our wealth in our real estate, in our homes, and when your homes are affected, and you see your values going down 20 - 30%, it gives a huge amount of insecurity and reduces spending, and we need spending to prop up our economies. We're going to have a retraction of the entire populace, because their wealth isn't as great.

Projections on the real estate market

I'm not that smart, no one's that smart. I think that what we see right now is we're in a panic. This is what I call the panic phase, and this panic phase, I think, will last until the latter part of January. Then, it will go into a recession, and I can't determine the slope of that curve, but I think it's going to be the shape of a U, not a V. It depends on what our monetary authorities do, and how broadly it's going to be based. One thing I can assure you is that prices will drop, but then you're going to see inflation. You can't have economies as large as the US and the UK, print money at the rate that they're going to be printing it, and not have inflation. So how are you going to protect yourselves against inflation? because it's going to come like a thunder down the road. I think that's a major factor to consider in your strategies, how you're going to protect yourself against inflation. Now real estate has normally been a damned good investment in inflationary economies, but I think we'll just have to see, and every person is going to have to make that decision on their own, but we think the real estate world will be better.

There'll be great opportunities, I would say, in the latter half of 2009. You will have to have equity and hopefully the banks will be reconstituted to be able to lend. That's something we have to see.

I think that we can't disregard our disciplines that we have because of political and social objectives. If we don't keep our discipline, we're going to repeat this again in five or ten years time. You know I think we've had a recession, a real estate problem, every ten years, but in five years we will forget it. So, I hope we don't forget this time, but I bet you, it will be forgotten.

Lessons to be learned.

In global dynamics, I think that we're going to have a lot of countries, especially the Eastern parts of Europe that are going to go through some very difficult times, because they don't have mature banking systems, like Russia. The others have developed them fairly well.

One of the other things they asked me to chat about was how some of these people start businesses. I was with a couple of young men the other night at Mendy's house discussing this, I'm thinking about how we did it, and we wanted to differentiate our product. Our product was real estate, but we didn't want to be me-too, and one of the things that I enjoy, I enjoy good architecture and working with really outstanding architects, but I happen to be an engineer, so I can work out how they wanted to get to a particular type of design, and do it at a reasonable cost, and that became our trademark, that we could produce an outstanding building, of outstanding architecture, and at only about 1-2% more than our competitors. Then we started back in 1965 producing low energy types of buildings, what you now call the Green Movement, we were able to reduce our service costs substantially, 25-40% lower than our competitors, and that gave us a big advantage, because we had total rents less, and then we found out that our financiers would give us normally a slightly better rate and sometimes more money, because we were the last to lose tenants, and the first to get them, on the cycle up. Then we tried to get the very top people as we expanded our organisation from the top business schools with what we thought were good, ethical principles, and that's the way. We don't have a book on how to operate in our business. We treat people like we say we're going to, and we do it, and that's produced a very good culture. We have a management business in the United States that takes us through these very tough times and they're tough right now. I'm happy to answer some questions, if you have them, and I told you I wouldn't keep you here long.

Q&A

> Q. You say that you believe that there'll be some interesting opportunities in the latter half of 2009. But development is something which isn't discussed anywhere at the moment, because of the lack of funding and you can possibly buy properties cheaper than they cost to construct, if you include the price of land. I'd just like to understand where you see the opportunities possibly emanating from?

GH Well, what you've already seen is the price of land plummeting. I mean, not 10%, but 60, 70, 80%, so there's going to be opportunities where you find a market that you can go into, but of course it's going to take time, how we come out, and you're always two to three years behind that curve that you start to build. So I think the majority of the opportunities will be in existing property, and development properties will take a long time for investors, because the investors will be jumping in to buy existing properties.

We have about eight funds that total about $14 billion that we run and develop, but we're not going to be developing as there are not many opportunities where you're going to see the market for occupancy rates rise to where you have sufficient margins to build against. So the first opportunities will be in the existing properties, and maybe joint venturing with a landowner, where your dollars go in as a preference position, and the residual becomes what the land value is, at some point, and someone may gamble on that, because they'll say, well, we'll hold it for five or ten years anyway, but you're going to have to have good safety margins to play that game, which means the land has a variable life.

> Q. You mentioned that both the US and the UK are going to be particularly badly hit. But does not the sophistication of those markets and their experiences over the past 30 years of boom and bust mean that they're more likely to come back sooner than other less developed countries?

GH I know they're more dynamic, but the financial sector is not going to come back as quickly, because you have a difference in the profitability. Securitisation was 30 - 35% of all the investment banks' profitability. That's gone. You have a deleveraged business plan today, 1:10. It isn't 1:30 anymore, so it's different. The availability of debt and the profitability is going to be much less. So it may drive down land prices to where investors will receive a comparable return to what they expect in other industries.

> Q. It's been clear that a significant part of the problem is government removing legislation in order to allow markets to correct themselves, which obviously was a mistake. Markets can't correct themselves. It would be interesting to hear your opinion about what the government is doing at the moment, also the UK government?

GH Well, you obviously have seen the record of our good Treasury Secretary Hank Paulson with two or three initiatives that were incorrect, and I'm not sure we've got the formula yet, by just putting capital into the banks.

Some way they're going to have to correct all that toxic waste that's there. Whether it be okay, we're going to value that at 60 cents to the dollar, and we'll let you borrow against that, so there's some liquidity in the bank, but they've got to do something about that toxic waste, and they haven't done that yet. I think just putting capital in the banks is not going to clear it up. There are going to be other initiatives that they're going to have to try, because all the banks did was put it in their vault, and then close their doors to loans. That won't work.

I mean, they've swum to stay alive, and there's a few developers out there that said, what? And so they really don't know yet, I think. I think they've got two or three other initiatives they're going to have to try to get this thing moving. To get to where people will start to lend. I mean, when you have situations that you've got great projects, and the maximum that you can borrow on these huge projects, billion dollar projects, are $50 million per bank. I mean, major banks. That won't get the job done.

Q. Hines is unique as it is a global player relative to normally local players. Taking a long-term view, are you now going to concentrate your efforts and focus in certain regions?

GH As you know, the real estate business is a local business, and each of our offices and groups, they vary from ten people but they're normally about 35 or 40 up to a couple of hundred, so each of them look at that particular market, and at what are the dynamics of that market, and then we have funds that overlay each of the groups.

They can apply for equity funds on a value added type position, or a development position, and then we have a ton of managers who look and say, how are we going to do this? Does it make sense? I'm responsible to the fund and I don't care what your relationship with Hines is, does this make sense?

So each of them has a different dynamic, and it can only be expressed that way. We have teams that will go in and help them and if they need to build a 50 storey building and they've never done it then we'll have a team that goes in and has great experience and we don't make all the same mistakes again, and we'll get that building built.

But it's the local evaluation of what the opportunities are, and what the risk is. We also have a unique compensation plan, because as leaders in our business, we give 50% of the equity interest to our leaders. Now, it's carry-forward and carry-back, so if they make a profit, and then they lose, it's not like the investment banks. They get hit both ways, so they have a very direct interest in the profits of that particular area. It works.

Q. But you also take a perspective. Will there be specific markets where you will focus you're trading?

GH The good markets, like France and Italy. You've seen land prices fall 65%, 70% in France, and that's one of the best markets. They still had two million square metres of absorption last year. But in a market that we see falling, obviously we have to tighten up our underwriting for that particular area, but it's difficult, but we seem to get it done.

Q. In the US, do you think that institutional investors will continue committing capital to real estate as strongly as before, over the next five to ten years? Or, do you think they will feel threatened?

GH No, I don't think you're going to see the same with real estate, because you're not going to have the leverage. If you think, 30:1 is coming down to 10:1, you've got to deleverage your balance sheets, and there won't be as much real estate done, because the debt won't be available.

Q. The big financial companies, institutional investors, who normally fund real estate, do you think their migration to the asset class, will compress as well?

GH Most of the major pension funds have been, and I'd say that in Europe too, 10 to 12% in real estate, and all the major pension funds have taken major bids. I know one pension fund that focuses just on residential land, they've taken over $5 billion of write-downs. I mean, there's going to be some lessons learned, and so it's going to be a lot tougher. I can't tell you whether the allocation is going to be 8% but I think it will stay around 10%, but it's going to be watched very closely, and when you consider the number of real estate depressions we've had, there's been a lot, and as I say, about every ten years, and then we forget in five, so maybe we won't forget this time. This is a pretty tough one, guys and ladies.

Q. Over your established career, what the one deal that makes you smile?

GH Oh, my first big fifty-storey deal. That was back in about '64, '65, and the market rose and I was short of funds, and I was able to refinance, and we still continue to own that building, through one of our funds. That one made me smile, and I remember shortly thereafter I didn't want to put up all the equity myself, after you've been through a purchase, you want to be a joint venture, and not own 100%.

Thank you very much.