The Importance of the Doctrine of Equitable Subrogation to the Nevada Economy

Report to

Nevada Land Title Association

Prepared by

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January 24, 2011

EXECUTIVE SUMMARY

This study examines the impact that vitiation of the doctrine of equitable subrogation would have on the Nevada economy. Weakening this doctrine would produce a cascade of negative economic effects.

First, title insurance for replacement commercial loans would become more burdensome to obtain and more expensive. Equitable subrogation is a significant element in the defense of many title insurance claims, particularly mechanics' lien claims. Without equitable subrogation available as a defense, title insurers would place stricter underwriting requirements on borrowers in order to be willing to insure the absolute priority of many commercial construction replacement loans. Not all borrowers currently able to qualify their loans for title insurance would be able to meet these stricter requirements. Further, a substantial increase in expected losses would force a substantial increase in the price of lien priority coverage for such loans. Title insurance is crucial for commercial construction lenders, so these price increases would drive up construction costs, particularly for the troubled projects most in need of refinancing.

Second, borrowers who could no longer meet the stricter underwriting requirements or afford the higher prices necessary for their lenders to obtain title insurance for senior replacement loans would no longer be able to obtain senior debt. These borrowers would need to resort to some kind of junior financing for which their lenders could obtain title insurance. Junior debt bears much higher interest rates than senior debt. These higher interest rates would increase the projected cost of construction to a point at which many Nevada construction projects would no longer be undertaken or completed. The decline in construction activity would decrease Nevada construction industry employment and exacerbate the already extremely high Nevada unemployment rate.

Third, a decline in Nevada construction activity and employment would spread throughout the Nevada economy, as purchases of goods and services by construction companies and their employees decreased, leading to slowdowns in business activity in other industries, and further increases in unemployment.

Fourth, the decline in Nevada economic activity would cause a material decrease in Nevada tax revenues. This decline would exacerbate the multi-billion dollar budget shortfall currently faced by Nevada. It would also decrease contributions to the insurance programs provided by the state to its employees, placing further strain on already fragile institutions.

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SECTION 1 – INTRODUCTION

1.01 Qualifications of Dr. Nelson R. Lipshutz

This report has been prepared by Nelson R. Lipshutz. Dr. Lipshutz holds an A.B. degree from the University of Pennsylvania and S.M. and Ph.D. degrees from the University of Chicago in theoretical high energy nuclear physics, and an M.B.A. in finance from the Wharton School of the University of Pennsylvania.

Since 1972, he has carried out studies of the title insurance industry throughout the United States. He has designed statistical and financial reporting systems used as the basis for title insurance regulatory review in approximately 25 states, including Delaware, Pennsylvania, New York, and Texas. He has served as a consultant to title insurers in areas including rate analysis, loss reserving, title plant valuation, and mergers and acquisitions. He has taught economics at Northeastern University, and is the author of a textbook on the economics of the title insurance industry. He has presented expert testimony and reports on title insurance to the Insurance Departments of California, Colorado, Delaware, Florida, New Jersey, New Mexico, New York, Pennsylvania, Texas, and Wisconsin; the National Association of Insurance Commissioners; Administrative Law Judges; the Commerce Committee of the Florida Senate; the Insurance Committee of the Michigan House of Representatives; the U.S. Department of Housing and Urban Development; and Federal District Court in North Carolina.

Dr. Lipshutz has also carried out studies in other financial industries. He served as chief financial analyst on a study of the solvency prospects of the private mortgage insurance industry carried out on behalf of the Federal National Mortgage

Association, the Federal Home Loan Mortgage Corporation, and the U.S. Department of Housing and Urban Development.

Dr. Lipshutz has also carried out studies of the impact of regulations on non-financial industries. He carried out several studies on behalf of the U.S. Consumer Product Safety Commission on the economic impacts on consumers and manufacturers of proposed bans on the sale of various asbestos-containing consumer products. He served as chief economist on a study on behalf of the U.S. Environmental Protection Agency of the impact of water and air pollution regulations on prices, output, and capital financing requirements in the U.S. pulp and paper industry, and presented invited testimony on the results of this research to the President's Council on Wage and Price Stability.

Dr. Lipshutz's professional history is set forth in more detail in the Appendix and on the Regulatory Research Corporation website at www.regulatoryresearch.com

1.02 Purpose of Report

This report analyzes the economic consequences on commercial mortgage lending in Nevada of any decision by the Nevada Supreme Court that a subsequent mortgagee cannot gain the priority of a predecessor mortgagee and therefore become senior to intervening mechanics' liens by operation of the doctrine of equitable subrogation. This report is an economic report only. It does not purport to render any legal opinion.

1.03 Sources Relied Upon

In carrying out this analysis, we relied upon data collected from lender websites; on U.S. government data; on telephone interviews and e-mail correspondence with commercial lenders; on telephone interviews and e-mail correspondence with title insurance underwriting management personnel; on data compiled by the Research and

Analysis Bureau of the Nevada Department of Employment, Training and Rehabilitation; on the IMPLAN input-output model for Nevada;[1] and on other public sources. Sources are noted in the footnotes and on the tables.

[1] Minnesota IMPLAN Group, Inc., IMPLAN System (data and software), 502 2nd Street, Suite 301, Hudson, WI 54016 www.implan.com

SECTION 2 -LIEN PRIORITY AND COMMERCIAL REAL ESTATE REFINANCING

Replacement lenders now play an enormously large role in Nevada. Table 1 shows that, as a consequence of the real estate collapse, nine Nevada banks with combined assets of $8.5 billion have failed since 2008, reducing the sources of local financing. [This figure excludes Washington Mutual, which was domiciled in Henderson and had assets of $307 billion, but was really a Washington state bank.]

Further, a huge number of commercial properties are in foreclosure. As of October 2010, there were 804 foreclosed commercial properties in Las Vegas alone.[2] Rehabilitating these commercial properties will take refinancing.

Major projects in particular can be faced simultaneously with mechanics' lien claims and refinancing needs. For example, the City Center project, financed in large measure by bank lines of credit, now simultaneously faces some $400 million in mechanics' lien claims and the need to refinance its bank lines with long-term debt.[3]

Lenders will not extend credit to already troubled projects unless they have adequate security. That security is guaranteed in large measure by title insurance.

[2] Cushman and Wakefield at http://blog.comre.com/buzz/nv-commercial-foreclosure-maps/
[3] "MGM, Dubai World Refinancing $1.8 Billion CityCenter Bank Loan," Bloomberg News, October 28, 2010 at http://www.bloomberg.com/news/2010-10-28/mgm-dubai-world-refinancing-1-8-billion-citycenter-bank-loan.html

SECTION 3 - LIEN PRIORITY AND TITLE INSURANCE

3.01 Title Insurance is Critical to Commercial Real Estate Lending

Title insurers do not only insure ownership interests in real property. An equally important function is to insure the priority of mortgage liens. About half of title insurance premiums are generated by the insurance of mortgage liens. Typical data are set forth in Table 2. (Specific data on Nevada are not available.)

Lenders do not purchase title insurance casually. They ***must*** have title insurance. Secondary mortgage markets require title insurance, both for general purchases and for loans that will be securitized. Lenders also demand title insurance for loans that will be held in their own portfolios. The Chief Credit Officer of a major Las Vegas bank puts it this way:

> "Title insurance is critical to the lending decision for most real estate secured transactions because the primary source of repayment is the sale or lease of the collateral. The lender's position must be absolute. Without this assurance very few banks would be able to finance this type of transaction. Financing for new and existing projects would not be feasible without a comparable risk management tool."

The need for lien priority title insurance is even more pressing for lenders providing funds outside their local area. Real estate is inherently local. Variations in real property laws and conveyancing practices from state to state, and even from county to county, are too great to be completely mastered by any one institution. A commercial lending officer at a very large national lender boiled this down to a simple equation: ***no title insurance, no priority; no priority, no loan.***[4]

[4] This analysis is based on discussions with lending personnel at the Bank of Nevada and Sovereign Bank.

3.02 Title Insurance Has Traditionally Been Priced On the Assumption that the Mechanisms of Claim Defense Include Equitable Subrogation.

Insurance, including title insurance, is priced based in substantial degree on the losses expected. It is often stated that title insurers have low losses. That is, of course, the intent, since title insurance is a loss prevention line, not a loss reimbursement line. (A similar statement can be made about boiler and machinery insurance.) However, losses have much more impact on title insurers than would appear from the raw financial statements.

A large fraction of title insurance is distributed through an agency system in which the agent performs almost all the search, examination, and underwriting work, and hence is paid a commission which is usually in the range of 85% of the premium dollar in order for the agent to recover its costs and make an adequate profit. This means that losses that constitute a small percentage of the total premium dollar constitute a very large percentage of the premiums that the insurer receives net of commissions. For example, a 10% ratio of losses to total premiums written by agents corresponds to a 66.7% ratio of losses to the portion of the agent-written premiums which are actually received by the title insurer. While some policies are directly issued by the insurer and so are not subject to commission, the overall effect is still very large. This fact is illustrated in Table 3.

Title insurance policies specify that the title insurer may either defend its insured against a claim or pay the claim amount up to the amount of the policy liability. A substantial proportion of total title insurance claims expense is the cost of claims defense. Title insurers make the choice to defend rather than pay because it is generally more economical. Absent the equitable subrogation defense, many more claims would need to

be paid in full rather than defended, which would substantially increase total loss costs. This increased risk of loss is especially important for mechanics' lien claims which are often associated with a project that needs refinancing because it has encountered financial difficulties.

The increased risk of greater losses due to vitiation of the doctrine of equitable subrogation is particularly important in Nevada.

3.03 Absent The Principle Of Equitable Subrogation, Title Insurance Losses Would Increase So Much That Title Insurance For Liens Which Replace Prior Senior Liens Would Become More Expensive and Less Available In Nevada

The magnitude of potential Nevada title insurance losses on liens replacing prior senior liens is enormous. For example, at the present time, the City Center project is faced with serious refinancing issues while at the same time facing aggregate mechanics' lien claims of almost half a billion dollars.[5]

Problems of this magnitude are not unique in the annals of major construction projects, and can be anticipated to recur in the future. Lenders facing similar economic circumstances in the future can only consider replacing the current financing if their senior lien position is protected.

If a senior lien holder were to lose an amount of principal equal to the amount of mechanics' liens, the title insurer would be required to make up the bulk of the amount lost. Absent the equitable subrogation defense, title insurers would not be able to insure the senior priority of replacement loans at typical title insurance prices. Title insurers recognize this problem.

[5] The City Center project has mechanics' liens which aggregate $424 million. See Las Vegas Review Journal, October 4, 2010 at http://www.lvrj.com/business/mgm-resorts-reduces-citycenter-liens-104302219.html

The availability of equitable subrogation as a defense against mechanics' lien claims has an impact on the terms of coverage that a title insurer can offer. Providing coverage of the full amount of a replacement construction loan at the loan's inception had been the practice in Nevada until recently. Now it is common to simply cap the insurers' liability at an amount well below the loan amount, which is not acceptable to all lenders. It has also become much more common to provide coverage piecemeal covering each disbursement to the borrower, and to require the borrower to provide lien waivers from all contractors and to provide an indemnification from the borrower, secured by a cash deposit or a letter of credit, against mechanics' liens claims. If equitable subrogation is no longer available as a claims defense, prudent title insurers will make their underwriting requirements even more stringent.[6] Fewer and fewer borrowers will be able to meet these tighter conditions, particularly borrowers trying to refinance a construction project that has gotten into financial difficulties.

The issue also impacts the price structure of title insurance. Title insurance is currently priced on the assumption that title insurers can identify and eliminate most or all significant title risks based on the public record. Because mechanics' liens in Nevada are valid even before they are recorded, title insurers cannot be guaranteed that they have identified all potential title problems. Without equitable subrogation, insuring priority in an environment in which extremely large mechanics' liens have become common is much more like casualty insurance or performance bonding than traditional title insurance.[7] Traditional title insurance rates have amounted to a few tenths of one percent of the insured liability. Typical performance bond rates amount to one to five percent of

[6] This analysis draws on our discussions with underwriting personnel at Chicago Title Insurance Company, First American Title Insurance Company, and Fidelity National Title Insurance Company.
[7] Discussion with underwriting personnel at Chicago Title Insurance Company

the insured liability.[8] In the absence of the equitable subrogation defense, rising losses will drive the price of title insurance for replacement commercial loan senior lien priority inexorably upward.[9] It would take a price increase of several factors of ten to raise title insurance rates to the casualty insurance level which would be needed for provision of the coverage to remain economically feasible for the insurer.[10] Such an increase would raise the cost of construction by several percent.

[8] Viking Bond Service website
http://www.performancesuretybonds.com/typical_performance_bond_cost.htm
[9] Discussion with underwriting personnel at Fidelity National Title Insurance Company
[10] Discussion with underwriting personnel at First American Title Insurance Company

SECTION 4 - LIEN PRIORITY AND INTEREST RATES

4.01 Rates of Interest on Subordinated Commercial Loans are Much Higher than Rates on Senior Commercial Loans

Lenders who cannot obtain insurance of a senior lien position will not provide financing at first mortgage interest rates. Lenders making junior loans, even if their junior position is above that of some claimants and can be insured at that level, will charge a much higher interest rate in order to be compensated for the extra risk they are assuming that, if the borrower defaults, there will not be enough money available to pay off the loan principal after the claimants whose position is senior to theirs are paid.

The most frequently used type of junior lien financing generally available now for commercial real estate development is mezzanine financing. Mezzanine financing is a type of debt in which a company issues debt that is secured by a lien against the ownership interest in the project, not against the property itself. In the event of default, the lender takes over the developer, not just the property.[11] Mezzanine loans have the lowest priority of any debt, coming just before equity but behind all other loans. In the absence of equitable subrogation and a guarantee of priority, replacement lenders would be providing loans with a priority lower than that of mechanics' liens and other claims dating from a time after the original loan was made. Such loans would bear an interest rate comparable to the rate on mezzanine debt.

The differential between the interest rates for senior and junior commercial real estate loans is very large. Table 4 shows that the additional interest rate for mezzanine loans ranges from 1.65% to 15%, with a median of 5.9%.

[11] There are many different structures for mezzanine loans, but they are all based on this general idea.

4.02 The Increase in Interest Rates Produced by Commercial Loan Subordination Would Materially Increase Commercial Construction Costs in Nevada

A significant component of the cost of a commercial construction project is interest payments on the construction debt during the construction period. Table 5 indicates the magnitude of this effect for project with $1 billion in debt financing with a construction time of five years, which is typical for high rise developments in Las Vegas.

The entire amount of a construction loan is not disbursed at the beginning of a project; instead, the funds are released when they are needed as construction proceeds. Table 5 assumes that funds are released uniformly over the construction period. We have carried out the analysis assuming subordination interest rate premiums of 5.94% (the median value), 1.65% (the lowest reported value), and 15% (the highest reported value). This range of interest rate premiums indicates that the percentage increase in project cost caused by these interest rate premiums would range between 4% and 37.5%, with a median of 15%.

In Nevada, most large scale construction projects are hotel-casinos. Hospitality industry projects are perceived by lenders as being high risk,[12] and so the increase in construction cost in Nevada would be in the upper end of this range.

4.03 In The Depressed Nevada Real Estate Market, Commercial Construction Cost Increases Cannot Be Passed On to Purchasers, So That Commercial Construction Activity Would Be Materially Depressed

Construction loans need to be paid off, either through the proceeds of a property sale or their replacement with permanent take-out financing. In either case, the more money that is needed, the harder it is to get. Projects are undertaken only if the developer

[12] Discussion with commercial lending officers at Sovereign Bank

believes that the debt can be paid off and a profit can be made. The amount that can be borrowed and the purchase price that can subsequently be paid both depend on the ***value*** of the property, ***not*** on its construction ***cost.***

For lenders, one of the key criteria in making the decision of whether or not to make a loan is the loan to value ratio. For purchasers, the ratio of value to purchase price is the key determinant. And for commercial transactions, value is determined by projected net cash flow. In Nevada, commercial project net cash flow prospects are dismal.

As an example of the situation, consider office buildings in Las Vegas. A major office space broker reports that Las Vegas vacancy rates are up 33% since 2008, rising from 18% to 24%. Over the same period, rental rates for Class A office space have dropped 11%, from $35/square foot/year to $31/square foot/year.[13] The combination of these two effects is a drop in gross revenue of 18% without a corresponding drop in operating costs. In the face of diminished prospects for future profits, increased development costs will make many potential development projects more expensive to build than they will ultimately be worth. Such projects will simply not be undertaken.

Commercial construction projects are rarely funded entirely by debt. Virtually all lenders require that borrowers put up significant equity capital so that the borrower also has some "skin in the game." The most prominent investment opportunities in Nevada are in the gaming industry. Equity investors interested in the gaming industry can choose from many investment opportunities, and more and more of them are outside Nevada.

[13] "Office Trends Report - 3rd Quarter 2010 - Las Vegas," Grubb and Ellis

Nevada is experiencing substantial competition for the gaming-related business that is the backbone of the Nevada economy. A major trade journal reports[14] that new states are joining the current players (Nevada, Connecticut, Iowa, Missouri, Illinois, Mississippi, Louisiana, etc.). Ohio has broken ground on the first of four casinos, and Maine is opening another casino. New countries including Japan, Thailand, Taiwan, Jamaica, Fiji, Samoa, Saipan and Bermuda are joining the current major foreign players like Macau.

If financing conditions worsen in Nevada, many equity investors will pursue gaming opportunities elsewhere where the debt portion of the total capital package is easier to obtain. That means fewer future jobs for Nevada casino employees, and fewer jobs in all the Nevada businesses that provide goods and services to them.

[14] "Test of Time," Global Gaming Business, Vol. 9, No. 12, December 2010

SECTION 5 - LIEN PRIORITY AND THE OVERALL NEVADA ECONOMY

5.01 Construction Activity is Critical to the Nevada Economy

In the strong economy of the mid-2000's, construction jobs constituted 11% of total Nevada employment, as shown in Table 6. Since that time, construction jobs have decreased by 59%. This drop has been a major contributor to Nevada's worst-in-the-nation unemployment rate of over 14%. Table 7 shows that construction job losses constitute 27% of all Nevada job losses since the economic peak.

The decrease in the number of jobs, great as it has been, understates the economic impact on worker incomes. Construction jobs pay very well. Workers in the construction trades in Nevada in 2010 earned 26% more than the average for all Nevada occupations (annual wage of $51,046 vs. the average of $40,395).[15]

Further losses of construction jobs would have a serious impact on the state, in both the private and the public sectors.

5.02 A Material Decline in Commercial Construction Activity Would Lead To Substantial Job Losses in All Sectors of the Nevada Economy

The impact of construction job losses ripples through the entire Nevada economy. Construction workers buy groceries, visit doctors, purchase television sets, etc. Slowdowns in the construction industry depress economic activity in other industries as well.

In order to calculate the total impact of a slowdown in the commercial construction industry, we have used the IMPLAN input-output model for the state of

[15]Nevada Occupational Employment Statistics reported in Nevada Workforce Informer, Nevada Department of Employment, Training and Rehabilitation at http://www.nevadaworkforce.com/cgi/dataanalysis/oeswageselection1.asp?menuchoice=oeswageed

Nevada. IMPLAN models are used by many state and local governments to estimate the economic impacts of public policy decisions.[16]

An input-output model works in three stages:

1) First, it calculates the effects of a change in one industry on the industry itself. These are called direct effects.

2) It then calculates the impacts that the direct effects produce in the industries that are customers of and suppliers to the directly affected industry. These are called indirect effects.

3) Finally, it calculates the effects that the indirect effects produce in the customers of and suppliers to the indirectly affected industries. These are called induced effects.

Table 8 summarizes the effects of declines in Nevada commercial construction on the overall Nevada economy. Because it is not possible to predict precisely how large this depression would be, it is prudent to consider the impact of several potential scenarios.

Even a tiny decline would produce a large effect. ***A 1% decline in Nevada commercial construction would produce a loss of 1,106 jobs (620 in construction, 486 in other industries and businesses) and a loss of $65 million in annual payroll.***

But a tiny decline is not what would be produced by vitiation of the doctrine of equitable subrogation. The prior sections of this report have demonstrated the significant depression in commercial construction that this vitiation would produce.

A 10% decline in commercial construction is the lowest likely limit of decline. ***A 10% decline in Nevada commercial construction would produce a loss of 11,075 jobs***

[16] For example, the IMPLAN model has been used by the Nevada Division of Water Resources, see http://implan.com/V4/index.php?option=com_content&view=article&id=64&Itemid=25http://implan.com/V4/index.php?option=com_content&view=article&id=64&Itemid=25

(6,237 in construction, 4,838 in other industries and businesses) and a loss of $650 million in annual payroll.

A 40% decline in commercial construction is more likely, given the large fraction of total Nevada commercial construction activity that is the completion or renovation of projects that need replacement financing. ***A 40% decline in Nevada commercial construction would produce a loss of 30,940 jobs (17,642 in construction, 13,298 in other industries and businesses) and a loss of $1.8 billion in annual payroll.***

Job losses of this magnitude are not negligible. The current Nevada unemployment rate is 14.3%. Table 9 presents the Nevada unemployment rates that would be produced if commercial construction declines because of the vitiation of the doctrine of equitable subrogation:

14.4% if there is a 1% decline in Nevada commercial construction

15.3% if there is a 10% decline in Nevada commercial construction

17.0% if there is a 40% decline in Nevada commercial construction

5.03 A Material Decline in Commercial Construction Activity Would Lead To Substantial Losses of Nevada State and Local Tax Revenues

Tax revenues are generated through economic activity. In a state like Nevada with no personal or corporate income tax, other taxes such as sales taxes, gasoline taxes, the modified business tax and similar levies generate the revenues that support public services, and these taxes are dependent on people purchasing taxable items and on businesses generating revenue. Even gaming taxes depend on people having sufficient income to play. When payrolls decline, business revenues and taxable purchases decline.

We have used the IMPLAN model to project the loss in Nevada state and local tax revenues that a decline in commercial construction activity would produce. The impacts are set forth in Table 10. Nevada state and local tax revenues would drop by

0.1% if there is a 1% decline in Nevada commercial construction

1.1% if there is a 10% decline in Nevada commercial construction

3.0% if there is a 40% decline in Nevada commercial construction

Decreases in tax revenues are particularly troublesome now. The Economic Forum[17] projects state revenues of $5.7 billion for the 2010-2011 biennium.[18] The Nevada state budget director estimates that this level of revenue will lead to at least a $2.5 billion budget shortfall.[19]

It is important to note that the decline in construction activity would also impact employee and employer contributions to the Nevada Public Employees Retirement System (PERS) and the State Retirees' Health & Welfare Benefits Fund. We have used the IMPLAN model to project the loss in contributions to these and similar programs. The impacts are set forth in Table 11. Nevada contributions to these public programs would drop by:

0.02% if there is a 1% decline in Nevada commercial construction

0.2% if there is a 10% decline in Nevada commercial construction

0.5% if there is a 40% decline in Nevada commercial construction

While these percentages are relatively small, they are significant given that these retirement funds are already under severe financial pressures.[20]

[17] The Economic Forum was created by the Legislature during the 1993 legislative session (NRS 353.226-229). The Economic Forum is responsible for providing forecasts of the state's general fund revenues for each biennium budget period.
[18] "Forecast of Future State Revenues," State of Nevada Economic Forum, December 1, 2010
[19] "$2.5 billion state budget deficit: 'Best-case scenario'," Las Vegas Sun April 23, 2010 @ http://www.lasvegassun.com/news/2010/apr/23/25-billion-deficit-best-case-scenario/
[20] PERS liabilities are 27.5% unfunded, see 2009 Popular Annual Financial Report; the State Retirees' Health & Welfare Benefits Fund is over 98% unfunded, see Note 1 to 2010 Fund Financial Statements.

TABLES

TABLE 1

NEVADA BANK FAILURES 2008-2010

Bank	Location	Date Closed	Assets	Deposits
Carson River Community Bank	Carson City	26-Feb-10	$51.1 million	$50.0 million
Community Bank of Nevada	Las Vegas	14-Aug-09	$1.52 billion	$1.38 billion
First National Bank of Nevada	Reno	25-Jul-08	$3.4 billion	$3.0 billion
Great Basin Bank of Nevada	Elko	17-Apr-09	$238 million	$220 million
Nevada Security Bank	Reno	18-Jun-10	$480.3 million	$479.8 million
Security Savings Bank	Henderson	27-Feb-09	$238.3 million	$175.2 million
Silver State Bank	Henderson	5-Sep-08	$2 billion	$1.7 billion
SouthwestUSA Bank	Las Vegas	23-Jul-10	$214.0 million	$186.7 million
Sun West Bank	Las Vegas	28-May-10	$360.7 million	$353.9 million
Washington Mutual, Inc	Henderson	25-Sep-08	$307 billion	$188 billion
TOTAL (excluding Washington Mutual)			$8,502,400,000	$7,545,600,000

SOURCES: Assets and deposits from Portal Seven at http://portalseven.com/banks/Failed_Banks_State_Wise.jsp?state=NV
Lising confirmed by FDIC failed bank listing at http://www.fdic.gov/bank/individual/failed/banklist.html

TABLE 2

RELATIVE IMPORTANCE OF LIEN PRIORITY INSURANCE

	State	Total Title Insurance Premiums	Mortgage Lien Priority Insurance Premiums	Mortgage Lien Priority Insurance Premiums as % of Total
[1]	New York 2009	576,217,556	284,491,005	49%
[2]	Pennsylvania 2009	400,898,912	235,388,898	59%

SOURCES:

[1] Results of 2009 New York Statistical Report filed with New York State Department of Insurance
[2] Results of 2009 Pennsylvania Statistical Call filed with Pensylvania Insurance Department

TABLE 3

IMPORTANCE OF TITLE INSURANCE LOSSES

	2009 Nevada Premium Written By			
	Insurer Operations	Affiliated Agents	Independent Agents	Total Premium Written
Gross Premium	28,473,692	62,379,057	76,443,461	167,296,210
Amount Received by Insurer*	28,473,692	9,356,859	11,466,519	49,297,070
Losses Incurred (Payable by Underwriter)				25,068,600
Losses as % of Gross Premium				15%
Losses as % of Amount Received by Insurer				51%

* assumes agency commission rate of 85%

SOURCES: Premiums and Losses from 2009 Annual Statements (Form 9) Schedule T compiled by American Land Title Association

TABLE 4

INTEREST RATES FOR COMMERCIAL FIRST MORTGAGE AND MEZZANINE LOANS

		Commercial Loan First Mortgage		Commercial Loan Mezzanine		Mezzanine Interest Rate Premium	
		Low	High	Low	High	Low	High
[1]	Caffrey & Company	4.40%	6.50%				
[2]	Steelhead Capital	5.12%	7.35%	9%	11%	1.65%	5.88%
[3]	Deschutes Capital			5.25%	11.25%		
[4]	Sovereign Bank	3.79%	3.79%	9.79%	18.79%	6.00%	15.00%
[5]	Bank of Nevada			10.70%	11.70%		
	Average	4.44%	5.88%	8.69%	13.19%	2.81%	8.75%
	Median						5.94%

SOURCES:

[1] http://www.caffreyloans.com
Based on average for

Apartments	4.40%
Mobile Home Park	4.60%
Anchored Retail	5.50%
Non-Anchored Center	5.70%
Single Tenant Retail	5.65%
Office	5.70%
Industrial / Flex	5.77%
Self-Storage	6.00%
Medical Office	5.00%
Hotel	6.50%
Owner Occupied	4.50%
Land	8.50%
Other	6.25%
Average	5.70%

[2] http://www.steelheadcapital.com/
Based on average for
Multi-family commercial
Office, industrial, etc.

[3] http://www.deschutescapital.com/
Based on midpoint of range of prime + 2% to 8% with prime of 3.25% per Wall Street Journal.

Bottom of range	5.25%
Top of Range	11.25%
Median	8.25%

[4] Telephone discussion with commercial lending officer
Senior mortgage loans priced at LIBOR plus 300 basis points.
1-year LIBOR of 0.79% per http://www.moneycafe.com/library/libor.htm, Sources: Fannie Mae, British Bankers' Association
Mezzanine finance rate carries a premium of at least 600 basis point over senior loan.

[5] Telephone discussion with credit officer
Mezzanine finance rate carries a premium of 500 to 600 basis point over senior loan.
Senior loan rate estimated at 5.7%

TABLE 5

INCREASE IN COST OF A $1 BILLION CONSTRUCTION PROJECT IF SENIOR DEBT FINANCING WERE UNAVAILABLE

		Additional Interest Rate of			
		5.94%	1.65%	12%	15%
Project Cost (assuming availability of first mortgage financing)		$ 1,000,000,000	$ 1,000,000,000	$ 1,000,000,000	$ 1,000,000,000
Project Duration (years)		5	5	5	5
Outstanding Debt					
Start		0	0	0	0
End of year	1	200,000,000	200,000,000	200,000,000	200,000,000
End of year	2	400,000,000	400,000,000	400,000,000	400,000,000
End of year	3	600,000,000	600,000,000	600,000,000	600,000,000
End of year	4	800,000,000	800,000,000	800,000,000	800,000,000
End of year	5	1,000,000,000	1,000,000,000	1,000,000,000	1,000,000,000
Average Debt Outstanding					
Year	1	100,000,000	100,000,000	100,000,000	100,000,000
Year	2	300,000,000	300,000,000	300,000,000	300,000,000
Year	3	500,000,000	500,000,000	500,000,000	500,000,000
Year	4	700,000,000	700,000,000	700,000,000	700,000,000
Year	5	900,000,000	900,000,000	900,000,000	900,000,000
Additional interest during construction					
Year	1	5,940,000	1,650,000	12,000,000	15,000,000
Year	2	17,820,000	4,950,000	36,000,000	45,000,000
Year	3	29,700,000	8,250,000	60,000,000	75,000,000
Year	4	41,580,000	11,550,000	84,000,000	105,000,000
Year	5	53,460,000	14,850,000	108,000,000	135,000,000
TOTAL		148,500,000	41,250,000	300,000,000	375,000,000
Project Cost with Junior Loan Financing		$ 1,148,500,000	$ 1,041,250,000	$ 1,300,000,000	$ 1,375,000,000
Increase in project cost		14.9%	4.1%	30.0%	37.5%

TABLE 6

CONSTRUCTION AS FRACTION OF TOTAL NEVADA EMPLOYMENT

Year	Quarter	%
2004	1	9.7%
2004	2	10.1%
2004	3	10.4%
2004	4	10.8%
2005	1	10.8%
2005	2	10.9%
2005	3	11.1%
2005	4	11.3%
2006	1	11.4%
2006	2	11.4%
2006	3	11.1%
2006	4	10.8%
2007	1	10.6%
2007	2	10.5%
2007	3	10.3%
2007	4	10.0%
2008	1	9.6%
2008	2	9.4%
2008	3	9.2%
2008	4	8.7%
2009	1	8.0%
2009	2	7.2%
2009	3	6.7%
2009	4	6.5%
2010	1	6.0%
2010	2	5.6%
2010	3	5.4%

SOURCE: Nevada: Construction; All Employees; Thousands; SA Bureau of Labor Statistics, reported at http://www.economagic.com/

TABLE 7

NEVADA JOB LOSSES 2006 TO 2010

	Number of Nevada Employees			
	Peak Month	Peak Value	October 2010	Change
CONSTRUCTION	June 2006	146,200	60,000	-59%
LEISURE AND HOSPITALITY	December 2007	342,500	300,600	-12%
EVERYTHING ELSE	February 2007	1,056,100	864,400	-18%

	Number of jobs lost	As %
CONSTRUCTION	86,200	27%
LEISURE AND HOSPITALITY	41,900	13%
EVERYTHING ELSE	191,700	60%
TOTAL	319,800	100%
Total Number of Jobs at Peak	1,297,100	
Jobs lost as %	25%	

SOURCE:

Bureau of Labor Statistics, compiled by Economagic at http://www.economagic.com/

TABLE 8

IMPACT OF COMMERCIAL CONSTRUCTION DECLINE
ON NEVADA EMPLOYMENT AND PAYROLLS

	Commercial Construction Decline of		
	1%	10%	40%
Jobs Lost:			
Construction	620	6,237	17,642
Other	486	4,838	13,298
TOTAL	1,106	11,075	30,940
Payroll Lost:			
Construction	$ 42,533,569	$ 427,872,192	$ 1,211,097,034
Other	$ 22,329,509	$ 222,303,946	$ 609,997,156
TOTAL	$ 64,863,078	$ 650,176,138	$ 1,821,094,190

SOURCE: IMPLAN model. Breakdown of effects is as follows:

	Commercial Construction Decline of		
	1%	10%	40%
Jobs Lost:			
Direct Effects	620	6,237	17,642
Indirect Effects	181	1,786	4,750
Induced Effects	304	3,052	8,549
Payroll Lost:			
Direct Effects	42,533,569	427,872,192	1,211,097,034
Indirect Effects	9,656,585	95,273,247	254,205,603
Induced Effects	12,672,925	127,030,699	355,791,553

TABLE 9

IMPACT OF COMMERCIAL CONSTRUCTION DECLINE ON NEVADA UNEMPLOYMENT RATE

		With commercial construction decline of		
	November 2010 Baseline	1%	10%	40%
Job losses	NA	1,106	11,075	30,940
Total employment	1,333,700	1,332,594	1,322,625	1,302,760
Total unemployed	190,800	191,906	201,875	221,740
	14.3%	14.4%	15.3%	17.0%

SOURCES: Baseline unemployment rate from Bureau of Labor Statistics
Press Release December 17, 2010 Table 5
Job losses from Table 8

TABLE 10

DECREASE IN NEVADA STATE AND LOCAL TAX RECEIPTS
IF COMMERCIAL CONSTRUCTION DECLINES

	Commercial Construction Decline		
Fiscal 2008-2009 Baseline Tax Receipts	1%	10%	40%
4,182,178,734	4,447,647	44,190,803	123,383,575
Percent decline	0.1%	1.1%	3.0%

SOURCES: Baseline tax data from Department of Taxation Annual Report Fiscal 2008-2009
Tax losses per IMPLAN model, made up as follows:

	Commercial Construction Decline		
	1%	10%	40%
Indirect Bus Tax: Sales Tax	2,018,909	20,035,166	55,915,735
Indirect Bus Tax: Property Tax	1,260,271	12,506,627	34,904,492
Indirect Bus Tax: Motor Vehicle Lic	25,045	248,544	693,655
Indirect Bus Tax: Severance Tax	15,677	155,571	434,181
Indirect Bus Tax: Other Taxes	475,402	4,717,777	13,166,749
Indirect Bus Tax: S/L NonTaxes	117,916	1,170,174	3,265,815
Corporate Profits Tax	0	0	0
Personal Tax: Income Tax	0	0	0
Personal Tax: NonTaxes (Fines- Fees)	421,914	4,229,144	11,844,372
Personal Tax: Motor Vehicle License	63,245	633,950	1,775,475
Personal Tax: Property Taxes	31,835	319,102	893,694
Personal Tax: Other Tax (Fish/Hunt)	17,433	174,748	489,407
Total State and Local Tax	4,447,647	44,190,803	123,383,575

TABLE 11

DECREASE IN CONTRIBUTIONS TO NEVADA STATE BENFIT PROGRAMS
IF COMMERCIAL CONSTRUCTION DECLINES

		Commercial Construction Decline		
Baseline Contributions		1%	10%	40%
	1,333,406,435	258,058	2,586,984	7,252,083
Percent decline		0.02%	0.2%	0.5%

SOURCES:

Baseline tax data from Department of Taxation Annual Report Fiscal 2008-2009

Public Employees Retirement System	1,300,000,000	Popular Annual Financial Report 2009
Retirees' Health & Welfare Benefits Fund	33,406,435	Financial Report 6/30/2010

Contribution losses per IMPLAN model, made up as follows:

	Commercial Construction Decline		
	1%	10%	40%
Employee contributions	74,072	742,560	2,081,616
Employer contributions	183,986	1,844,424	5,170,467
TOTAL	258,058	2,586,984	7,252,083

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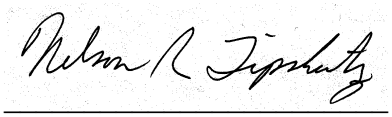

Nelson R. Lipshutz

APPENDIX

PROFESSIONAL BIOGRAPHY OF DR. NELSON R. LIPSHUTZ

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EDUCATION:

M.B.A. (1972), WHARTON SCHOOL, UNIVERSITY OF PENNSYLVANIA. Concentration in Business Finance. Graduated first in class. Elected to Beta Gamma Sigma (general academic honors).

Ph.D. (1967) and S.M. (1963), UNIVERSITY OF CHICAGO. Concentration in theoretical high energy nuclear physics. National Science Foundation Cooperative Graduate Fellow. Elected to Sigma Xi (scientific research).

A.B (1962), COLLEGE OF ARTS AND SCIENCES, UNIVERSITY OF PENNSYLVANIA. Major in Physics. General Honors Program. Mayor's Scholar. John L. Haney Scholar. Elected to Pi Mu Epsilon (mathematics) and Sigma Tau Sigma (tutoring).

EMPLOYMENT:

AUGUST 1977 TO PRESENT: President, Regulatory Research Corporation.

AUGUST 1972 TO AUGUST 1977: Senior Consultant in Regulation and Economics, Arthur D. Little, Inc.

AUGUST 1970 TO AUGUST 1972: Management Research Analyst and Member, Board of Directors, Management and Behavioral Science Center, Wharton School, University of Pennsylvania.

SEPTEMBER 1967 TO AUGUST 1970: Instructor/Research Associate (1967-69) and Assistant Professor (1969-70), Department of Physics, Duke University.

JANUARY 1967 TO SEPTEMBER 1967: Atomic Energy Commission Postdoctoral Research Associate, Enrico Fermi Institute for Nuclear Studies, University of Chicago.

PROFESSIONAL:

SPRING 1986: Instructor, College of Business Administration, Northeastern University.

1993: Coordinator, industry and consumer advisors to Title Insurance Working Group of the National Association of Insurance Commissioners.

CIVIC: President, Waban Improvement Society, 1992-93.

BOOK: *The Regulatory Economics of Title Insurance*, Praeger Publishers (1994)