CMBS 2.0

Monday, August 15th

CRE Finance Council

WHERE CAPITAL AND IDEAS MEET™

CRE Finance Council® Overview

CRE Finance Council (formerly CMSA) includes all segments of commercial real estate finance

- IG Bondholders
- Issuers
- Multifamily Lenders
- Portfolio Lenders
- Securities and Loan Investors
- Servicers

The CRE Finance Council is the "voice" of commercial real estate finance:

- Increase CRE liquidity responsibly
- Create standards, increase transparency and information flow
- Platform for all voices in the CRE finance industry
- Advocate with one voice on behalf of the industry

CMBS 2.0 Overview

- Overall State of the CMBS Marketplace
- CMBS 2.0 vs. CMBS 1.0
- CMBS 2.0 – Under Construction
- Appraisal Considerations

State of the CRE Market

State of the CRE Market:

- <u>Liquidity Returning</u>: CMBS issuance trending up
- <u>Significant Loan Maturities</u>: $1 trillion in loans mature in next several years
- <u>Severe U.S. Recession</u>: Unemployment, business performance, falling property values
- <u>“Equity Gap”</u>: CRE assets have a combined gap of roughly $600 billion

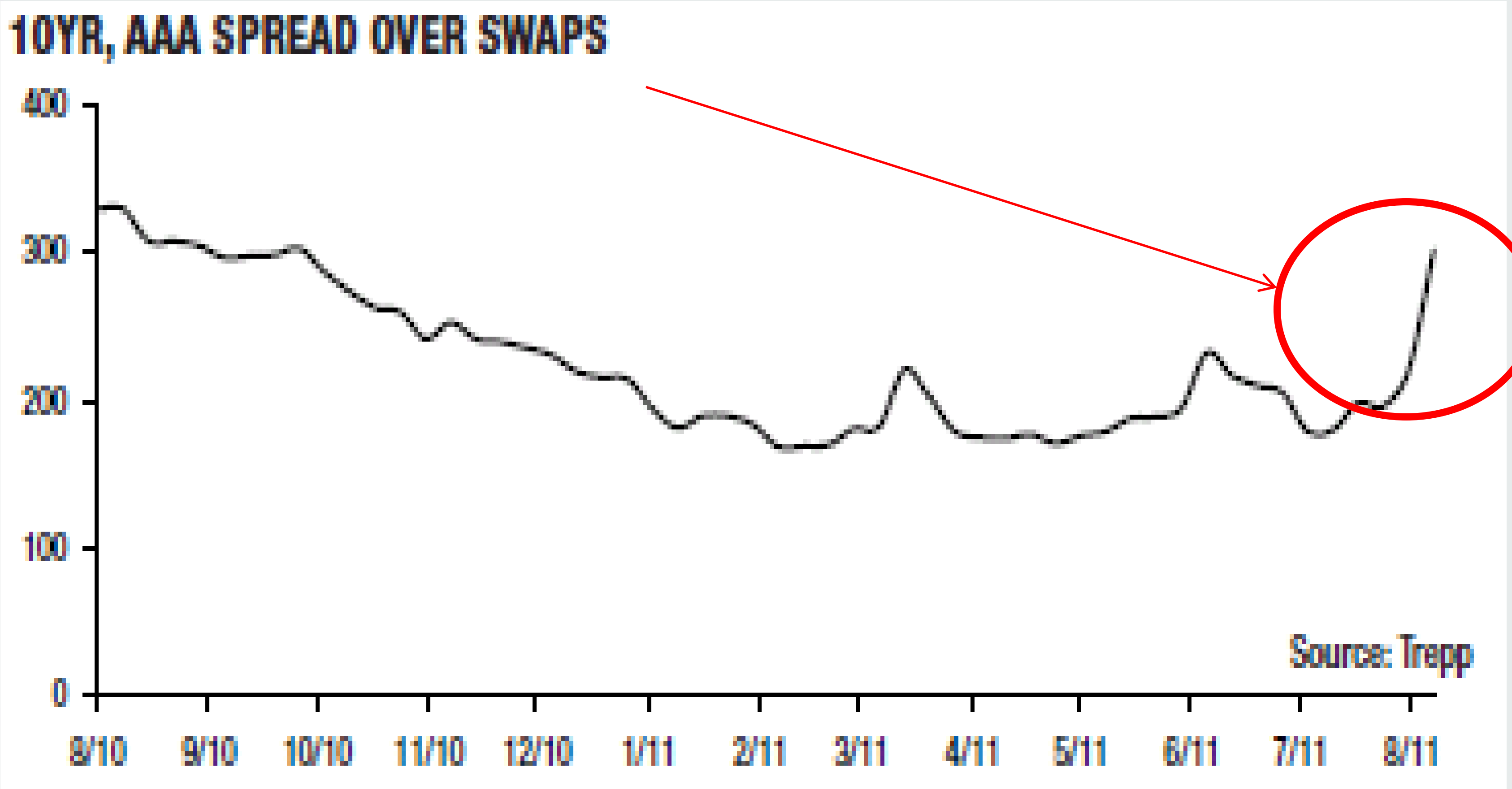
CMBS Restarting – U.S. Total Issuance

- 2007: $230 billion
- 2008: $12.1 billion
- 2009: $2.9 billion
- 2010: $12.3 billion
- 2011: $22.5 billion to date w/ projections of $30-35 billion total

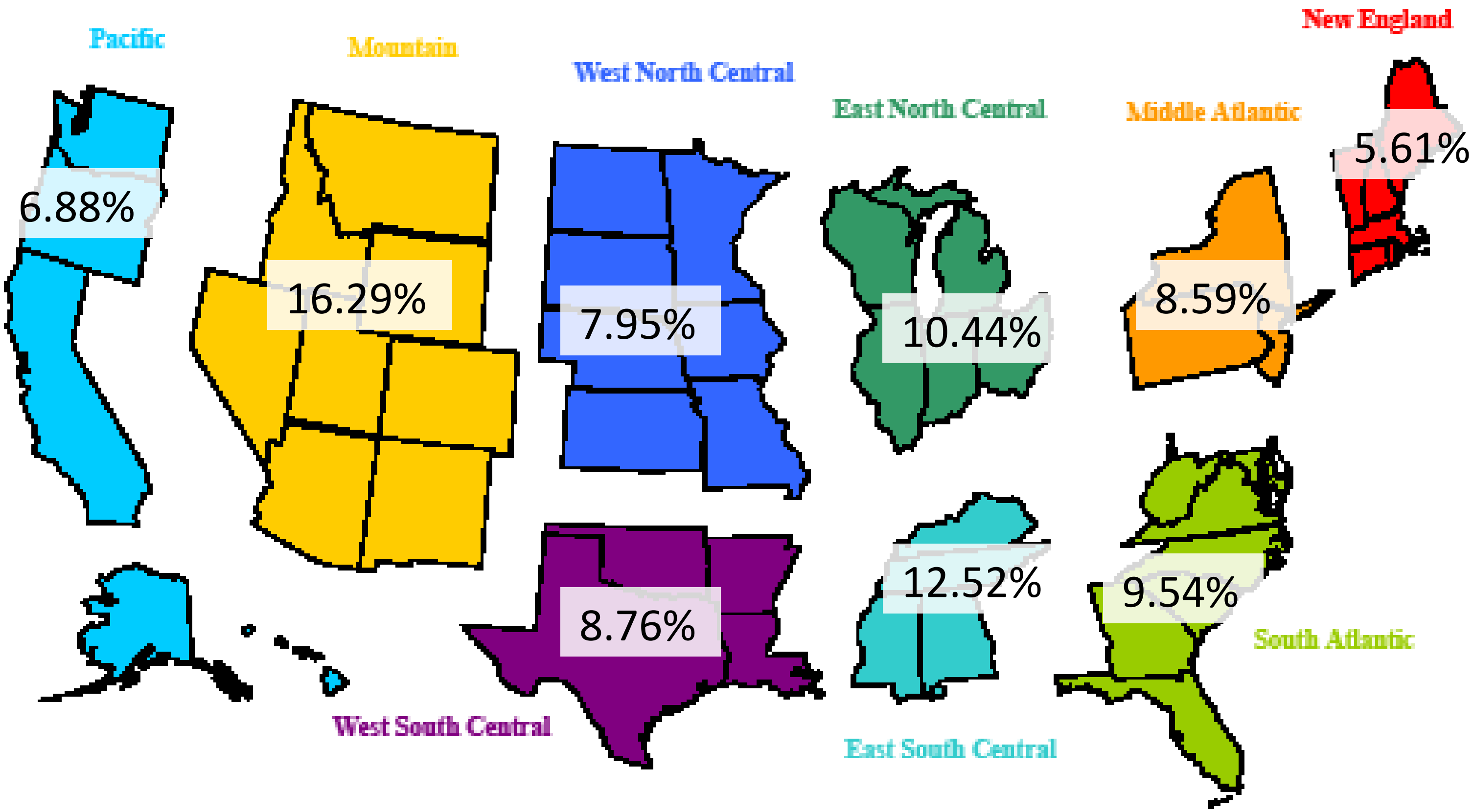
2011 CMBS Marketplace

- Forecast for 2011 projects up to $30 billion. Current calendar is moderate
- First “public” deal priced last Friday
- August market volatility has created a *slowdown* in CMBS recovery
- The backlog of matured loans continues to grow
- Regional differences in collateral performance remain significant

Volatility Has Caused a CMBS Recovery Slowdown



U.S. CMBS Delinquency Rates: Significance of Regional Variation



Source: Trepp, LLC

What is CMBS "2.0"? How is it different from 1.0?

Goals of CMBS 2.0

- Increased Transparency & Disclosure (IRP™, Annex A)
- Risk Alignment
- More conservative underwriting

Recent Deal Structures

- Increased disclosure (CREFC Standards, Regulation AB)
- Low leverage and more conservatively underwritten loans
- Enhanced "representations and warranties"
- Investor voice starting to be active and heard

Property Type Composition

CMBS 1.0 vs. CMBS 2.0

Property Type Composition (1)

Property Type	1Q 2004	1Q 2007	1Q 2011
Retail	39%	24%	46%
Office	22%	35%	30%
Multifamily	22%	15%	4%
Hotel	2%	11%	6%
Industrial	5%	8%	3%
Other (2)	10%	8%	11%

(1) Moody's Rated Transactions. Does Not Include Fusion Loans

(2) Including but not limited to Mixed Use, Manufactured Housing, Self Storage, Assisted Living, and Healthcare

Source: Moody's Investors Service

Source: Moody's Investor Services

CMBS 1.0 vs. CMBS 2.0 Underwriting

• Years	2003-04	2010-11	2007
• Pool balance	1,145	1,243	3,249
• Fitch DSCR	1.35x	1.30x	1.05x
• Fitch LTV	84.2%	86.5%	110.7%
• Fitch haircut	3.8%	6.3%	5.2%
• Pool with sub debt	24.8%	24.4%	37.5%
• Pool with IO loans	10.9%	3.6%	55.5%
• Credit enhancement			
AAAsf	15.0%	18.2%	11.8%
BBBsf	5.6%	7.2%	4.2%

Source: Fitch Ratings

What is CMBS “2.0” – Process Changes

Items of note from 2010 and 2011 deals:

- **Annex A Disclosure 2.0 –** initial disclosures
- **Investor Reporting Package™ 5.1 –** ongoing disclosures
- **Operating Advisor** – liaison between bondholders and servicers (Risk Retention)
- **Special Servicer Replacement** – New thresholds for bondholder votes (Risk Retention)

CMBS 1.0 vs. 2.0 – Summary

- Underwriting - CMBS 2.0 Loans are underwritten to 2004 standards.

- CMBS Loan Pools
  - CMBS 1.0: $2 to $3+ billion, 150+ loans, as many as 12 B-Piece buyers
  - CMBS 2.0: $1 to $2 billion, 50 loans, larger loan sizes, fewer tranches, ~4 active b-piece buyers today

- CMBS is historically a 75% LTV business, and it is expected that CMBS migrate there due to refinance needs.

- CMBS deals have uneven asset quality.

- Substantial refinance risk lies ahead for CMBS 1.0

- Increased subordination on CMBS may be required

CMBS "2.0" – Still Under "Renovation"

CMBS Faces a Litany of Reforms:

- SEC's Regulation AB
- Industry Standards and Adoption
  - PSA Standardization
  - IRP and Annex A Disclosures
  - Representations & Warranties
- Risk Retention
  - Operating Advisor, B-Piece Structure, Change of Control
- Rating Agency Reform
- GSE/Multifamily Finance Reform

CMBS "2.0" – Still Under "Renovation"

$64,000 Question: Will we go back to CMBS 1.0 and are we already headed there?

Appraisal Considerations

- How does one determine the appropriate capitalization rate in such a volatile marketplace? The appropriate value to assign to the property?

- Will CMBS 2.0 be successful, or will we slide back to CMBS 1.0? If so, how fast?

- How will new Dodd-Frank regulations change CMBS 2.0, including retention and disclosures?

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