CMBS 2.0
Monday, August 15th
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:

- **Liquidity Returning**: CMBS issuance trending up
- **Significant Loan Maturities**: $1 trillion in loans mature in next several years
- **Severe U.S. Recession**: Unemployment, business performance, falling property values
- **“Equity Gap”**: 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

<table>
<thead>
<tr>
<th>Property Type</th>
<th>1Q 2004</th>
<th>1Q 2007</th>
<th>1Q 2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>Retail</td>
<td>39%</td>
<td>24%</td>
<td>46%</td>
</tr>
<tr>
<td>Office</td>
<td>22%</td>
<td>35%</td>
<td>30%</td>
</tr>
<tr>
<td>Multifamily</td>
<td>22%</td>
<td>15%</td>
<td>4%</td>
</tr>
<tr>
<td>Hotel</td>
<td>2%</td>
<td>11%</td>
<td>6%</td>
</tr>
<tr>
<td>Industrial</td>
<td>5%</td>
<td>8%</td>
<td>3%</td>
</tr>
<tr>
<td>Other (2)</td>
<td>10%</td>
<td>8%</td>
<td>11%</td>
</tr>
</tbody>
</table>

(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
CMBS 1.0 vs. CMBS 2.0 Underwriting

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

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?
Contact Information

Mike Flood, Vice-President, Legislative & Regulatory Policy
Phone: 202-375-8917
E-mail: mflood@crefc.org

CRE Finance Council Government Relations Website:
https://www.crefc.org/advocacy