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February 21, 2003

Summary Minutes: Capital Markets Committee
Sunday, February 2, 2003
2:00 PM- 3:00 PM
San Diego Convention Center
San Diego, California

Chair:

Brian F. Stoffers
Chief Operating Officer & Executive Managing Director
L.J. Melody & Company

Vice Chairs:

Joseph P. Forte, Esq.
Partner
Dechert

J. Christopher Hoeffel
Senior Managing Director
Bear Stearns & Co., Inc.

Kevin J. Riordan
Managing Director
Teachers Insurance & Annuity Association of America

John Scheurer
Managing Director
Allied Capital Corporation

Guest Participant

Justin Daly
Staff Counsel
U.S. House of Representatives, Financial Services Committee

MBA Staff Representative:

Leanne Tobias
Director, Commercial Real Estate Finance
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The Capital Markets Committee of the Mortgage Bankers Association (MBA) met at 2:00 PM on Sunday, February 2, 2003, at MBA's Commercial Real Estate Finance/Multifamily Housing Convention in San Diego. The meeting was led by Committee Chair Brian Stoffers, Chief Operating Officer and Executive Managing Director of L.J. Melody & Company, and by Vice Chairs Joseph P. Forte, J. Christopher Hoeffel, Kevin J. Riordan and John Scheurer.

Mr. Stoffers thanked the Vice Chairs and all Committee members for their contributions to the work of the Committee. Mr. Stoffers introduced each Vice Chair and initiated a panel discussion on recent and emerging market trends for commercial mortgage backed securities (CMBS). Mr. Stoffers noted that although January 2003 CMBS volume was down slightly from January 2002, the CMBS market had achieved record volumes. Mr. Stoffers predicted that 2003 CMBS issuances would remain strong, particularly in the first half of the year.

Mr. Hoeffel agreed that 2003 would be an extremely active year for CMBS issuances, and predicted that issuances for the months of February, March and April 2003 would total in the $25 billion range. Mr. Hoeffel anticipates that issuances will trend downward in the latter part of 2003 in keeping with mortgage origination forecasts. Mr. Hoeffel noted that issues being brought to market as of early

2003 are of higher quality than has been the case in prior years. Mr. Hoeffel also observed that this trend was reflected in the narrowing of spreads for securities rated AAA to A and that spreads for securities so rated were at the narrowest in four years. By contrast, Mr. Hoeffel has observed widening spreads for CMBS issues rated BBB to B, as market fundamentals weaken.

Mr. Riordan concurred that CMBS spreads are tightening and noted that this trend would diminish their attractiveness as investments for pension funds. By the same token, pension funds will issue debt securities during the coming months due to their attractiveness as a low-cost source of capital. Mr. Riordan also forecast a rising number of delinquencies in CMBS pools due to ongoing economic weakness. He also recommended that investors shift capital toward issues backed by regional malls and neighborhood strip centers, and away from issues backed by multi-family and office properties.

Mr. Scheurer commented that the CMBS sector had posted a strong year during 2002, especially in contrast to the corporate debt sector. To date, Mr. Scheurer and his colleagues have seen delinquencies remain within acceptable limits—about 2% of seasoned loans in CMBS pools.

Mr. Forte observed that the capital markets would benefit from the development of a standardized Participation Agreement, such as the draft Agreement being developed by MBA's Portfolio Investors Committee, and recommended that the Capital Markets Committee review the draft from a capital markets perspective. He also noted that CMBS issuances were being structured with numerous tranches in order to shield investors from risk, and that yields for B-piece buyers were increasing.

Mr. Forte briefed the group on recent federal legislative developments affecting the CMBS market. He noted the passage of the Terrorism Risk Insurance Act of 2002 (TRIA) and detailed the key terms of the Act. Mr. Forte observed that enactment of TRIA had been in part in response to the concerns of CMBS issuers, buyers and the rating agencies, that Moody's had reacted favorably to the statute, and that the program would likely enhance confidence in the CMBS markets going forward.

Mr. Forte also discussed passage of the Sarbanes-Oxley Act, which requires CEOs to personally certify to the accuracy of their financial statements. Mr. Forte observed that the Committee and MBA favored actions to enhance corporate accountability and market transparency, but noted that the regulations for the statute—which require that the certification be completed by only one entity—was not especially well-suited to the structure of CMBS transactions. Mr. Forte stated that MBA and its members were developing a response to the regulations and would work to develop a certificate that accurately reflects the structure of the CMBS industry.

Mr. Stoffers then introduced Justin Daly, Special Counsel to the Committee on Financial Services of the U.S. House of Representatives. Mr. Daly briefed the group on the circumstances surrounding the passage of the Sarbanes-Oxley Act, and noted that Congress would be reluctant to address any technical corrections through a legislative amendment. Mr. Daly recommended that MBA and its members adopt a common position on Sarbanes-Oxley and then work with the CMBS industry to offer a unified position to the SEC on appropriate regulatory changes. Several Committee members noted that appropriate changes for the CMBS sector might include a split certification process, wherein each party to the transaction would submit a certification in its field of expertise; or a sub-certification program, wherein a single party to a transaction might certify a transaction in reasonable reliance on several sub-certifications by other responsible parties.

Mr. Stoffers noted that Russell Richardson of Prudential Asset Management has played a key role in responding to the Sarbanes-Oxley Act on behalf of MBA. Mr. Richardson has prepared a draft modification to an earlier Sarbanes-Oxley certificate proposed by the Bond Market Association, in order to better reflect the needs of MBA's members. Mr. Richardson's draft will be circulated for comment to MBA and its members. Following MBA's review and approval, the modified certificate will be presented to members of the Capital Consortium: the Bond Market Association, the National Association of Realtors, the Real Estate Roundtable and the Commercial Mortgage Securities Association.

Mr. Stoffers then led the Committee Vice Chairs in a panel review of economic and real estate market fundamentals and their effect on the CMBS industry. He observed that although the 2003 economic outlook was flat and real estate fundamentals were weakening, that real estate performance still outstripped that of the equity and corporate debt markets.

Mr. Riordan noted that yields were very tight, and that the key market challenge going forward would be to maximize performance vis a vis both yield and credit risk.

Mr. Scheurer observed that while CMBS underwriting would have to be done with greater care in light of weak economic fundamentals, sound loans were still being produced. Mr. Hoeffel concurred that tougher underwriting standards would become the norm.

Mr. Hoeffel and Mr. Stoffers observed that concern about war and terrorism risk would undercut the travel, entertainment and hotel sectors in the short run. There was general agreement among the panelists that hotel underwriting standards had been tightened by the rating agencies since 1999, and would continue to be tightened.

Mr. Forte observed that CMBS would continue to be structured in numerous tranches and employ more complex structures in order to reduce investment risk.

Mr. Hoeffel predicted that floating rate issues would continue to be favored in the CMBS sector relative to fixed rate transactions because of the substantial spreads between U.S.Treasuries and LIBOR. Mr. Riordan observed that weakening real estate fundamentals would continue to enhance yields for B piece buyers.

Mr. Stoffers then introduced new MBA staff members working with the Committee. Leanne Tobias is MBA's new staff representative to the Capital Markets Committee. Ms. Tobias can be reached at 202/557-2840 or at leanne_tobias@mbaa.org. Joanna Serra has joined MBA's Legislative Affairs group and will assist Alicemary Leach in updating the Committee on federal legislative developments. Ms. Leach can be reached at 202/557-2736 or at alicemary_leach@mbaa.org. Ms. Serra can be reached at 202/557-2816 or at joanna_serra@mbaa.org.

Mr. Stoffers thanked the Vice Chairs, Mr. Daly and all participants in the meeting for their insights and for their participation in the meeting. The meeting was adjourned at 3:00 PM.

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