MORTGAGE BANKERS ASSOCIATION
Investing in communities

PRINT | EMAIL

December 20 , 2004

Summary Minutes: MBA Capital Markets Committee
Tuesday, November 16, 2004
2:00 PM ET
Conducted via Conference Call

Chair:	**John Scheurer** **Managing Director** **Allied Capital**	
Vice Chairs:	**Bret Ersoff** **Managing Director** **Lehman Brothers**	**Guy K. Johnson** **President** **Johnson Capital**
	Joseph P. Forte, Esq. **Partner** **Dechert**	**Gale Scott** **Managing Director** **Standard & Poor's**
	Peter Horos **Senior Portfolio Manager** **Allstate Investments**	
MBA Staff Representative:	**Leanne Tobias** **Director, Commercial Real Estate Finance** **Tel: (202) 557-2840** **Email: ltobias@mortgagebankers.org**	

The Capital Markets Committee of the Mortgage Bankers Association (MBA) convened by conference call at 2:00 pm ET on Tuesday, November 16, 2004. The meeting was led by Committee Chair John Scheurer of Allied Capital, and by Vice Chairs Bret Ersoff, Lehman Brothers; Joseph Forte, Dechert; Peter Horos, Allstate Investments; and Guy Johnson, Johnson Capital. Ken Cohen, Managing Director, Lehman Brothers, and Kim Diamond, Managing Director, Standard and Poor's, also presented material on behalf of the Committee.

CMBS Borrower Guide. John Scheurer briefed the Committee and the membership on MBA's new Borrower Guide to CMBS. The guide, developed by MBA in partnership with the Commercial Mortgage Securities Association (CMSA), was created to educate CMBS industry participants and improve the transparency of the CMBS market by providing a brief summary of the parties and issues that may arise when obtaining a loan that is subsequently securitized. The guide may be viewed at: CMBS Borrowers Brochure. Multiple copies of the guide may be obtained at cost through the MBA website at http://shop.mbaa.org.

Capital Markets Advocacy Update. John Scheurer, Joe Forte and Leanne Tobias briefed members on advocacy issues of interest to the Committee:

- MBA, its REMIC Task Force, and members of the Capital Markets Committee have helped to lead an industry coalition advocating federal legislation to modernize the real estate mortgage investment conduit (REMIC) vehicle used to issue commercial mortgage-backed securities (CMBS). Federal legislation has been introduced in both the U.S. Senate and the U.S. House of Representatives to permit the certain REMIC collateral modifications and substitutions, when approved by the lender. While the legislation did not become law in 2004, it has won broad bipartisan support and been described as sound public policy by House Ways and Means Committee Chairman Bill Thomas. Chairman Thomas has pledged to work with MBA and its partners to find a suitable legislative vehicle after Congress convenes in 2005.
- The legislation would make the REMIC vehicle more useful for commercial and multifamily borrowers. Changes in the REMIC collateral rules sought under the proposed legislation include additions of loan collateral, including land, letters of credit and reserves. The proposal would allow property owners, with lender consent, to demolish existing improvements if such demolitions are required in connection with the construction of new improvements for new or existing tenants. The legislation would make possible, with lender consent, collateral substitutions of properties with equal or greater value, and the release of collateral, including outparcels or pad parcels, that would improve the property's cash position and the security of the REMIC loan. Loan prepayments and defeasance provisions (the substitution of Treasury securities that replicate the payments due under the

loan, in exchange for a release of the real property from the REMIC collateral) would also be permitted if approved by the lender.

- MBA and its Capital Markets Committee helped to spearhead the successful 2004 extension of the 'make available' provisions of the Terrorism Risk Insurance Act (TRIA) through December 31, 2005. The extension requires insurance carriers to offer terrorism insurance coverage to commercial and multifamily properties on the same terms as made available for other perils. The extension was particularly important to CMBS lenders because CMBS pools almost uniformly require terrorism coverage for properties collateralizing CMBS bonds.
- During the coming year, MBA and its members will support efforts to extend TRIA beyond 2005, in order to permit Congress and the insurance industry sufficient time to develop appropriate long-range policies to assure the availability of affordable terrorism insurance. The Capital Markets Committee and its members will be active in this effort.

Capital Markets Committee members who wish to support the Committee's advocacy efforts are invited to contact Josh Denney (jdenney@mortgagebankers.org) or Leanne Tobias (ltobias@mortgagebankers.org) at MBA.

CMBS Industry Trends and Performance. Committee leadership briefed members on key trends in the CMBS market. Click on the following links to access slides and other materials discussed during the presentation:

Attachment 1
Attachment 2

The 2004 CMBS market has been characterized by the following developments:

- Domestic CMBS volumes stand at record levels as of October 2004, and are expected to outstrip the 2003 record of $77.8 billion. As of October 2004, U.S. CMBS issuance stood at $75.1 billion. The 2004 U.S. total is expected to easily top $85 billion. International volume increased by $10 billion or 74% during the first 10 months of 2004, versus the same period in 2003. The U.S. market has been dominated by fusion deals, crafted to boost yield while maintaining sufficient pool diversification. Fusion transactions combine large CMBS loans and smaller conduit transactions in a single pool.
- Continuing a trend observed during 2003, 2004 CMBS spreads remain at record lows against swaps, and trading has been within a tight range. At the same time, CMBS offer investors better yields than do REIT stocks and other equity issues, as well as heightened liquidity. As a result, CMBS continue to be perceived as an attractive alternative to AAA to AA corporate debt, fueling investor demand for CMBS product.
- The B-piece and mezzanine markets grew more competitive during 2004. Substantial capital continued to be available for mezzanine product in 2004, with transactions focusing on the recapitalization of operating properties, rather than on new construction. The number of well-capitalized B-piece buyers has more than doubled since 2001, with roughly a dozen entrants competing in this market. Increased competition among B-piece buyers has strengthened prices and kept spreads low.
- All told, 2004 has been an excellent market for real estate borrowers, who have benefited from declining yields and strong investor appetite for CMBS securities, which have fueled competition among CMBS lenders. Borrowers who own strongly-performing properties in the large loan segment have been particularly favored.
- An emerging concern for CMBS lenders has been the increasing presence of borrower groups organized as tenants in common (TICs). TIC borrower syndicates are typically tax motivated, necessitating especially careful underwriting scrutiny of properties brought to the table. In working with TIC borrowers, it is also useful for lenders to ensure a single managing entity for the borrowing group and appropriate mechanisms to efficiently fund capital calls and reserve requirements. Capital Markets Committee Chairman John Scheurer discussed Allied Capital's guidelines as an example of the conditions that lenders are imposing on TIC borrowers. A summary of the guidelines, prepared by Allied Capital to assist MBA's Capital Markets Committee membership, is posted above.
- Is the CMBS market becoming too overheated? Not just yet, according to industry experts participating in the call. Investors and issuers are more strongly capitalized than they were in 1998, when high levels of leverage prompted substantial sell-offs in the wake of a market downturn. At the same time, a number of troubling trends have emerged that bear watching in 2005. Some originators have begun to lend against the speculative value of commercial properties, while others have raised their lending limits. More frequent lender concessions include decreased reserve requirements and eliminated hard lockbox requirements for borrowers. Increasing competition among B-piece buyers has reduced the ability of individual firms to enforce market discipline.
- At the same time, real estate fundamentals remain steady or improving, and CMBS default levels remain low. U.S. office markets are believed to have bottomed in 2004, although the pace of U.S. job creation continues to bear watching. Look for a gradual uptick in office sector performance during 2005. The lodging sector has begun to recover, while retail has remained steady, fueled by strong consumer sales. Industrial property performance has been steady, if unremarkable. 2005 industrial results will depend on the pace of economic recovery. Performance in the multifamily market is expected to improve in 2005 as gradual interest rate increases enhance the attractiveness of renting relative to owning. As was the case in 2003, health care properties have experienced higher degrees of loss severity than other product types.

Next Meeting: The Committee's next meeting will take place on February 6, 2005 at 1:00 om Pacific Time at MBA's Commercial Real Estate Finance (CREF) Convention in San Diego, California.

@ 2003 Mortgage Bankers Association
1919 Pennsylvania Ave. NW • Washington, DC 20006-3404 • (202) 557-2700