

Summary Minutes: PORTFOLIO INVESTORS COMMITTEE
November 18, 2004
4:00 PM – 5:00 PM, Eastern Time
Conducted via Conference Call

Chair:

Thomas C. Jensen, Senior Portfolio Manager
Allstate Investments, LLC

Vice Chairs:

E.J. Burke, Executive Vice President
Key Bank

Donald A. Dibble, Assistant Vice President
Jefferson Pilot Financial

Robert O'Rourke, Managing Director
Guardian Life Insurance Company

MBA Staff Representative:

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The Portfolio Investors Committee of the Mortgage Bankers Association (MBA) convened via conference call at 4:00 PM, Eastern Time on Thursday, November 18, 2004. The meeting was led by Committee Chair Thomas Jensen, Senior Portfolio Manager of Allstate Investments and Vice Chairs E.J. Burke, Executive Vice President of Key Bank; Donald Dibble, Assistant Vice President of Jefferson Pilot Financial; and Robert O'Rourke, Managing Director of Guardian Life Insurance Company.

Mr. Jensen opened the meeting and thanked the Vice Chairs, all Committee members and all other attendees for their interest in the work of the Committee, and reviewed the Committee's mission statement.

Regional Roundtables. Tom Jensen briefed the membership on 2004 roundtables sponsored by the Committee. Three roundtables were held for senior executives of commercial real estate portfolio lenders in 2004:

- April 2004 roundtable in New York City, sponsored by New York Life Investment Management and facilitated by Michael Kelly, Director of New York Life. Speakers included Peter Muoio of Maximus Advisors on the commercial real estate outlook, and Michael Mannix of Life Comps and Joan Freedman of Sagamore Advisors on Life Comps' portfolio benchmarking efforts.

- June 2004 roundtable in Northbrook, Illinois, sponsored by Allstate Investments, and facilitated by Thomas Jensen. Speakers included Ken Riggs of Real Estate Research Corporation on commercial real estate financing and sales trends, and Karen Johnson of Debt Exchange and Mike Mannix of Life Comps on loan sales and portfolio benchmarking.
- October 2004 roundtable in Seattle, Washington, sponsored by Genworth Financial and facilitated by Deborah Towner, Senior Vice President of Genworth. Speakers included Scott Biethan and Ken Barnes of Cushman and Wakefield on commercial real estate trends, and Erick Gustafson of MBA on the 2004 election outlook.

Senior executives from 15 portfolio lenders from the life insurance, commercial banking and pension lending sectors participated in MBA regional roundtables during 2004.

2005 Roundtables. Five roundtables are planned for 2005 by the Portfolio Investors Committee:

- **Lender Roundtables:** Three roundtables for senior commercial real estate executives of portfolio lenders will be held during 2005: Robert O'Rourke and Guardian Life will sponsor an April 2005 roundtable in New York City; E.J. Burke and Key Bank will sponsor a June 2005 roundtable in Dallas, Texas; and a West Coast roundtable will be held in fall 2005 (sponsor to be announced). Members of the Portfolio Investors Committee are invited to contact Leanne Tobias of MBA (ltobias@mortgagebankers.org) with suggestions for speakers and discussion topics for the 2005 lenders forums.
- **New Roundtable Initiative for Portfolio Servicers:** MBA, in conjunction with its Portfolio Investors Committee and Asset Administration Committee, is initiating a new roundtable series for servicers of portfolio lenders. The next such roundtable will be held at MBA's May 2005 Commercial Asset Administration and Technology Conference in Chicago, Illinois. Contact Katie Schwarting of MBA (kschwarting@mortgagebankers.org) for further information or with suggestions for discussion topics.
- The **Basel II Roundtable Series** with the Federal Reserve Board is discussed under **Advocacy Initiatives**, below.

Advocacy Efforts. E.J. Burke of Key Bank, Robert O'Rourke of Guardian Life and Leanne Tobias of MBA briefed the Committee on recent and emerging advocacy initiatives of concern to the Portfolio Investors Committee. The following items were discussed:

- **TRIA 'Make Available' Extension.** The successful extension of the "make available" language of the Terrorism Risk Insurance Act of 2002 (TRIA) through December 31, 2005. During 2004, MBA and the Portfolio Investors Committee helped to spearhead the successful 12 month extension of TRIA's 'make available' provisions. The extension of the "make available" language was necessary to ensure that insurance carriers continue to offer terrorism coverage on a par with other perils during 2005. The provision is important to life insurance companies, commercial banks, pension funds and other portfolio lenders that require terrorism coverage for properties on which they place debt.
- **TRIA Reauthorization.** During 2005, MBA and its members will support efforts to reauthorize TRIA beyond its December 31, 2005 sunset date, in order to provide Congress and the insurance industry with sufficient time to develop appropriate long-range measures to assure the continuing availability of affordable terrorism insurance. The Portfolio Investors Committee and its members will be active in this effort.
- **Basel II.** Final international guidelines for the New Basel Capital Accord (Basel II) were issued in June 2004 by the Bank for International Settlements. The final Basel II guidelines included changes recommended by MBA in the treatment of mortgage-backed securities and in the treatment of acquisition, construction and development (ADC) lending. Basel II implementation efforts now shift to the national level, as regulators begin to develop standards for U.S. adoption of Basel II. In preparation for U.S. implementation, MBA has joined an effort to help the Federal Reserve Board and other U.S. banking regulators define

requirements that would allow certain acquisition, development and construction loans for commercial and multifamily real estate to be financed with lower capital set-asides. MBA participated in the first such meeting on this subject in September 2004. MBA efforts on this front will continue throughout the Basel II implementation process. Regulators estimate that Basel II will be adopted in the U.S. by early 2008.

- **Basel II Roundtable with Federal Reserve Board.** During the first quarter of 2004, E.J. Burke and Key Bank will sponsor an MBA Portfolio Investors Committee roundtable in Cleveland, Ohio for senior commercial real estate lenders to meet with Brad Case, the Federal Reserve Board official responsible for developing ADC lending requirements under Basel II. The session represents an excellent opportunity for senior banking executives to share their views on ADC lending with the key federal official responsible for banking regulation on this front. Contact Leanne Tobias of MBA (ltobias@mortgagebankers.org) for additional information.
- **OFAC (Office of Financial Assets Control) Guidelines.** OFAC is the Treasury Department unit responsible for enforcing sanctions against such countries as Cuba, Iran and the Sudan, as well as individuals and entities whose names are placed on the Specially Designated Nationals and Blocked Persons List (SDN list). The SDN list includes terrorists, terrorist organizations and narcotics traffickers. The OFAC regulations prohibit transactions with individuals and entities whose names appear on the SDN list. The regulations cover banks, insurance companies and other commercial real estate lenders who hold their debt on-balance sheet. Robert O'Rourke of Guardian Life, Vice Chair of the Portfolio Investors Committee, reports that many commercial real estate lenders find OFAC's requirements ambiguous, and that a variety of approaches have been developed to comply with the regulations. O'Rourke has begun to collect information on OFAC compliance, and will brief the Portfolio Investors Committee on the results of his review at the Committee's next meeting on February 6, 2005.

Portfolio Investors Committee members who wish to support the Committee's advocacy efforts are invited to contact Leanne Tobias (ltobias@mortgagebankers.org) at MBA.

Commercial and Multifamily Market Developments for Portfolio Lenders. The 2004 commercial real estate lending market has been characterized by the following developments:

- 2004 has been an exceptionally strong year for commercial and multifamily mortgage volumes, and portfolio lenders have absorbed an increasing share of new originations in the first nine months of 2004. Continuing lender and investor demand for commercial mortgages have put 2004 on track to exceed the record set in 2003. And while gradual interest rate increases are forecast, stabilizing property markets and low delinquency rates are expected to keep capital flowing to the real estate sector in 2005.
- Continuing a trend observed during 2003, 2004 commercial real estate spreads remain at record lows against Treasuries. Yields have been depressed by strong competition among lenders. At the same time, commercial and multifamily mortgage yields continue to be perceived as an attractive alternative to corporate debt, fueling investor demand for mortgage product.
- 2004 has been an excellent market for real estate borrowers, who have benefited from declining yields, strong investor appetite for mortgage debt and increased lender competition. Borrowers who own strongly-performing properties in the large loan segment have been particularly favored, although most well performing properties of any size have received excellent loan terms and execution from lenders in the current capital-rich environment.
- An emerging concern for portfolio 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. Some lenders restrict the number TIC members whom they will accept in a borrowing

syndicate. 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.

- Is the portfolio lending market becoming too overheated? Although some softening is being seen, for the most part underwriting standards are being adhered to, according to Tom Jensen, Don Dibble and other industry experts participating in the call. At the same time, lenders have begun to make concessions to win strong borrowers, including decreased reserve requirements, more interest only structures, and the relaxation of lockbox requirements. Other portfolio lenders are allowing current borrowers to refinance their loans before maturity, so that customers can lock in favorable rates. It was agreed that lender concessions and underwriting fundamentals bear watching during 2005.
- On the positive side of the ledger, real estate fundamentals remain steady or improving, and 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 luxury 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.

Next meeting: The next meeting of the Committee will take place on Sunday, February 6, 2005 at 10:00 am at the Mortgage Bankers Association's Commercial Real Estate Finance (CREF) Convention in San Diego, California. MBA members with suggestions for discussion topics may contact Leanne Tobias at ltobias@mortgagebankers.org.