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MBA's CREF/MULTIFAMILY HOUSING CONVENTION & EXPO
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CREF07

FEBRUARY 4-7 **2007**

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USS Credit Quality – Love Boat or Titanic?

Monday, February 5, 2007

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Corporate Asset Strategies

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USS CREDIT QUALITY – LOVE BOAT OR TITANIC?

Panel Outline

- A. Welcome and Introductions
- B. Panelist Insights
- C. Panel Discussion and Debate
- D. In Search of Higher Yields
- E. Is there an Iceberg Ahead?
- F. Questions, Answers and General Discussion
- G. Summary



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USS CREDIT QUALITY – LOVE BOAT OR TITANIC?

Welcome Aboard and Introductions

Michael Bellissimo

Chief Underwriter

ARBOR Commercial Mortgage, LLC

Susan G. Branscome

Principal

Q10 Triad Capital Advisors, Inc.

Michael M. Gerdes

Vice President, Senior Credit Officer

Moody's Investors Service

Michael L. Roch

Director, Real Estate Investments

Mortgage Portfolio Unit, MetLife

Catherine Quinn

President

Corporate Asset Strategies



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Panelist Insights

Susan Branscome –

Underwriting conduit loans has been progressively more aggressive during the last couple of years. These loans once originated have a ready securitization market and there has been limited resistance by buyers for less conservatively underwritten loans.

Life companies, wanting their share of the origination pie, have been more aggressive in underwriting vacancies, considering once taboo property types and accepting lower capitalization rates to arrive at value.

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Panelist Insights -

Continued

Michael Bellissimo –

The markets for MF financing are beyond competitive with all participants trying to find the term that will win the business. Borrowers are obtaining multiple bids and consolidating the best terms of each and re-issuing the deal for final bidders to hit the re-defined bogey. While this combination of most aggressive terms may create a loan that just won't work, they always seem to find a home!

The use of I/O is becoming more common, combining the concepts of max proceeds with max cash flow. The Hogs have definitely bellied up to the bar. Question is, who will get slaughtered?

We have seen Fannie Mae provide more delegated authority to DUS lenders recognizing our need to be more creative and responsive. With the top end of the risk share formula falling to the lender, we are “effectively” balance sheet lenders and the responsibility for discipline rests with us.

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Panelist Insights -

Continued

Michael Roch - To sum it up: 2006 was a repeat of 2005 and we see no change for 2007. Competition from Wall St. conduit lenders fighting for volume and competition from insurance companies fighting for slightly higher yields than fixed income products continue to push underwriting quality standards to the lowest levels since the late 1980's. As a result, borrowers continue to take advantage of this market and assert their leverage to push for proceeds and flexibility, chipping away at what was once untouchable traditional commercial mortgage standards such as reserves, strong insurance requirements and prepayment structures. Borrowers have a great deal of confidence that if they solicit enough lenders, they will get the structure they want and in most cases, they will succeed. Additionally lenders have started to underwrite to the upside of future cash flows instead of income in place which is reminiscent of the late 1980's "hockey stick" underwriting.

Given the current state and based upon history, one would project a pending "Titanic" scenario. However real estate fundamentals remain strong, rental growth rates are trending up, new construction remains controlled, interest rates remain relatively low and the capital markets still love real estate. So for the time being, (unless there is some major exogenous event) we anticipate good performance in the real estate markets with caution on the loans being underwritten over the last few years. "



Continued

Michael Gerdes – Moody's has borne witness to the impact on credit of the surge in liquidity flowing into the real estate sector. We believe that the new wave of liquidity is being allocated differently from the one in the 1980's, with the bulk of mortgage debt this time being channeled into driving up leverage on existing assets instead of constructing new ones. As a result, we have hope for a "soft landing" or in the parlance of this panel, continued smooth sailing.

However, we are concerned that going forward, appreciation will most likely need to be earned the old fashioned way, by boosting income, versus extending the free ride of cap rate compression we have just experienced. We also are concerned that the traditional boundaries between debt and equity underwriting have begun to blur somewhat. In the past, debt was underwritten on income in place, while equity value was derived by projecting into the future. Recently, securitized lenders have been lending on upside in future cash flows. Absent appropriate loan structuring, any economic downturn or stress on a property financed to a future stabilized value could cause the Love Boat to sink like the Titanic.

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Panel Discussion and Debate

How have underwriting standards changed in the last few years?

- Financial
- Structural

Does it differ by type of Lender - portfolio, FNMA, FHLMC, conduit, CDO?

What Unique/Interesting Structures are you seeing?

What concerns you the most?

Are Lenders improving their positions in any way?

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Panel Discussion and Debate - continued

How have condo conversions impacted multifamily underwriting?

What Multifamily, Office, Industrial, Retail, Other property type specific issues do you see?

Has the use of CDOs had any impact?

What happens when cap rates go up?

When Interest Rates increase?

When excess capital flows out of the real estate sector?

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In Search of Higher Yields

How often are you seeing Lenders broaden their lending programs to include asset types they have not traditionally underwritten such as Healthcare, Lodging, Parking Structures, Infrastructure - Other? Any concerns?

How about different loan types such as Construction, Transitional/Reposition? Any concerns?

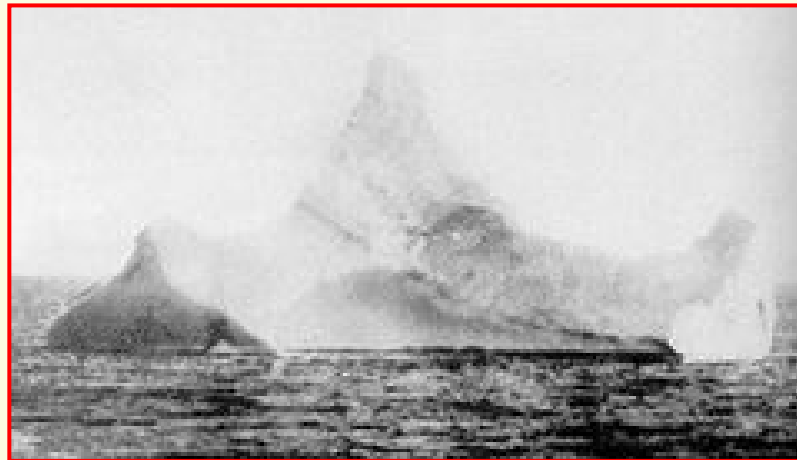
Are you seeing more debt tranching (A, B, C's) where the Lead Lender brings other Lenders into the deal and different "classes" with different rights exist?

What happens when there is a problem? Do you foresee any issues for Lender, Borrower or Mortgage Banker?

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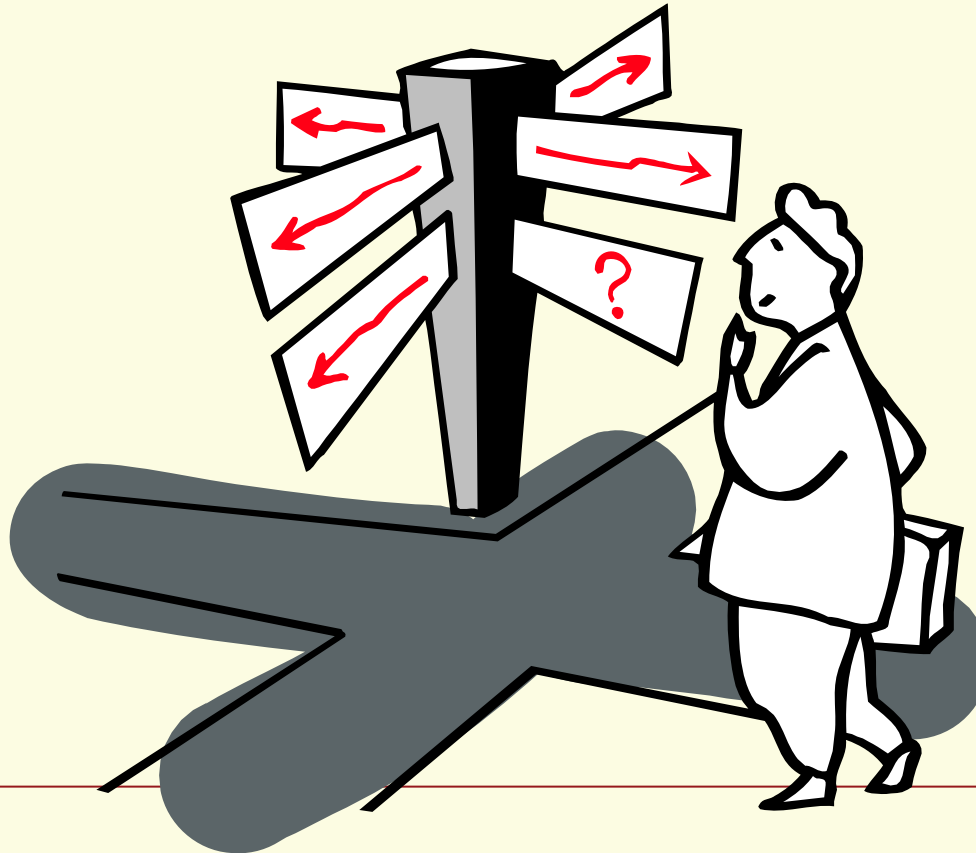
Is there an iceberg ahead?

What are your predictions for the next: year, 5 years, 10 years?



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Questions, Answers and General Discussion



Summary

Huge inflows of capital have lead to unprecedented changes in underwriting basics:

- Interest Only - No amortization
- Lowered debt service coverage ratios
- Increased loan to value ratios with values based on lower cap rates than ever and NOI underwritten very aggressively – often above income in place
- Fewer structural features
- Lenders entering new lending areas sometimes without the requisite expertise

Nonetheless, strong fundamentals and improvements in real estate property markets and a continuing low interest rate environment will likely save us from any major catastrophes in the near term.

Love Boat or Titanic? Some would say we've gone where no one has gone before...

Thank you!

