



Loan Origination Committee
May 9, 2006
11:00 am- 12:00 pm
Committee Conference Call Summary

Conference Call Introduction

The purpose of the conference call was to discuss important Loan Origination Committee issues and provide in-depth background on market conditions impacting collateral quality. Tom Kosonen, Managing Director, Bear, Stearns Company, discussed the efforts of the MBA Seismic Working Group at the recent ASTM International meeting in Toronto, Canada. Eric Nordman, Director, of the National Association of Insurance Commissioners (NAIC) discussed insurance market conditions and catastrophic insurance. The meeting concluded with a discussion of emerging issues.

Summarized below are the discussion topics of the conference call:

Seismic Working Group Update – Tom Kosonen updated the Loan Origination Committee on the recent activities of the Seismic Working Group. He first provided some general background about the creation of the Seismic Working Group, which was spurred by the lack of a seismic standard that was widely utilized in the commercial real estate finance industry. He indicated that at the ASTM International meeting in Toronto, much progress was made in closing the gap on important issues between the MBA Seismic Working Group and the existing ASTM – E2026-99 standard. Based upon this progress, a timetable has been established for the first ballot for the adoption of the standard to be cast in early August. In addition, the Seismic Working Group is in the process of creating an accompanying Seismic Handbook.

Wind Damage Insurance Conditions – Eric Nordman began his presentation by discussing historic patterns regarding the availability of wind damage insurance. Over the years, Florida has experienced significant disruptions in the availability and pricing of insurance after major hurricanes. The unusually severe 2005 hurricane season has created a hard (expensive) insurance market conditions throughout the coastal areas, especially the Gulf States and Florida. One reason why insurance prices have increased significantly in coastal areas for 2006 has been that insurance companies are recalibrating their risk models to take into account the past 5 to 10 years of storm activity versus 25 to 40 years in the past modeling efforts. Consequently, insurance companies have adjusted their rates to reflect the high losses of the recent past. Insurance companies are playing close attention to their concentration risk along coastal areas to make sure that a single event will not cause excessive losses, which has caused some insurance companies to reduce their exposure in certain markets. In reaction to these market conditions insurance companies have applied the following pricing strategies:

- Raise premiums
- Increased deductibles
- Introduced co-pays after deductible level is reached
- Caps on payments

MBA members pointed out the severity of the situation in Florida. Increases of 300% to 500% for wind damage insurance coverage are the norm, when insurance is available. Wind damage insurance for stick-built construction in Florida coastal areas is nearly impossible to find, but there is availability of wind damage insurance for commercial buildings that have been built to withstand a Class 3 hurricane. These large increases will put stress on property owners that are operating their building on thin margins. An example was provided of a property that experienced an increase from \$60,000 to \$280,000 for insurance from 2005 to 2006. Driving the increases are re-insurers that have agreed to remain in the market but at

substantially increased rates. Additionally, in Florida, the legislature recently capped payments from the Florida insurance fund to \$1 million per residential structure.

Catastrophic Insurance – Eric Nordman discussed the NAIC catastrophic insurance proposal. Based upon industry reaction, the proposal has been modified from an all-peril plan to a cafeteria plan where each insurance purchaser would be presented a list of coverages that they would select for purchase. This would allow the consumer to know exactly what they are purchasing, which was a major issue in Katrina claims. The purpose of the checklist will be to end the confusion between wind driven water damage and flood damage. The current proposal is for residential structures, but it could be modified to address commercial buildings. The proposal is based upon the following principles:

- A national program should promote personal responsibility among policyholders;
- A national program should support reasonable building codes, development plans, and other mitigation tools;
- A national program should maximize the risk-bearing capacity of the private markets, and;
- A national plan should provide a quantifiable risk management to the federal government.

Emerging Issues

- Concerns were raised about lender concessions for loans that are being securitized. A spike in properties with debt service coverage ratios below 130% are being added to securitization pools. Concerns were raised that rising insurance, taxes, and maintenance cost could severely stress the loans with the low debt service coverage ratio.
- Up to 70% of conduit loans are being performed on an interest-only or reduced amortization basis. Insurance companies have been holding the line of many of these concessions.

Next Call:

- The next Loan Origination Conference Call is July 18, 2006, 11:00 am – 12:00 pm EST.