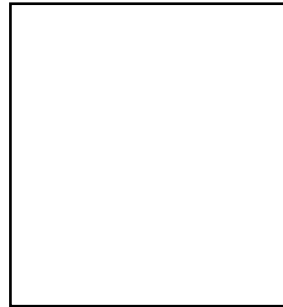


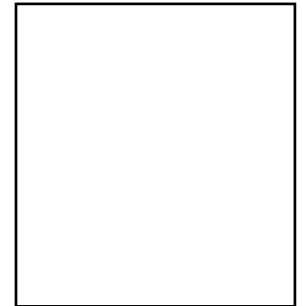
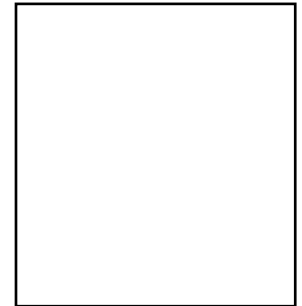
Fitch Ratings

everything you need **more than you expect**



Recent Trends in CMBS

Susan Merrick, Managing Director



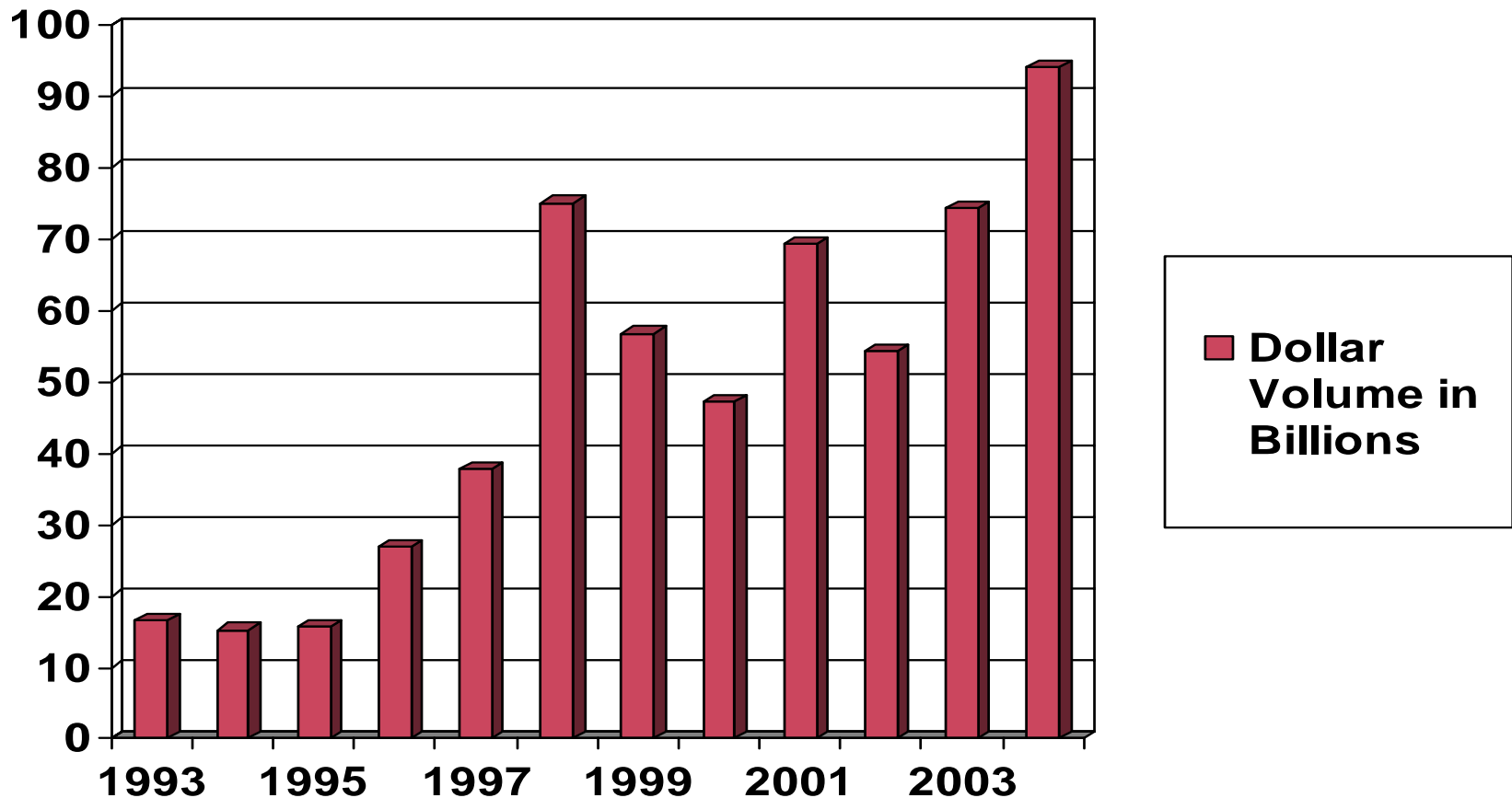
Securitization of Commercial Real Estate Loans

CMBS market over the past 15 years:

- > Initial use of securitization
- > Loans originated for securitization
- > Acceptance as an asset class in fixed income market
- > Increasing % of loans originated are securitized

CMBS Market Growth

- > Approximately \$572B of CMBS has been issued
- > Fitch has rated approximately 700 deals totaling approximately \$375B



Fitch's Role in CMBS Market

- > Creates bonds with ratings which behave similarly to other bonds with equivalent ratings
- > Provides bond ratings on new transactions
- > Consults on new deal structures
- > Provides ongoing performance surveillance
- > Rates Master, Primary, and Special Servicers
- > Fitch was first in:
 - Reviewing lenders' loan origination practices
 - Providing comprehensive presale reports
 - Publishing loan and bond default and loss studies

Recent Trends: Positive, Negative, & Evolving

Trends & Issues:

- > Loan Level
- > Property Level
- > Pool Level

Loan Level Trends – Loan Structure

- > Interest-only periods
- > Escrows
- > Lock box and cash management agreements
- > Additional debt – total leverage
 - A/B Notes
 - Pari passu notes
 - Partnership debt

Loan Level Trends – Loan Structure

Fitch-Rated Deals

	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>
Interest Only Loans	2.9%	3.0%	8.7%	14.3%
Escrows				
Tax	88.2%	84.2%	76.3%	71.9%
Insurance	71.4%	70.8%	62.4%	61.2%
Cap Ex	78.9%	75.6%	67.3%	64.3%
Leasing Cost Reserves				
Upfront	35.0%	32.1%	25.9%	31.3%
Ongoing	50.0%	54.1%	42.7%	40.7%

Loan Level Trends – Cash Flow Underwriting

Trends & Issues:

- > Stabilized income vs. in-place income
- > Mark to market of rents
- > Quasi-investment grade tenants
- > Frequency and size of hold backs
- > Future rent steps

Loan Level Trends – Borrowers

Trends & Issues:

- > Institutional quality sponsors vs. new names
- > Higher leverage
- > Non-recourse carve-outs and caps on liability
- > Frequency of Tenants In Common (TIC's) ownership

Pool Level Trends

- > Larger deals
 - More liquidity
 - Better diversity
 - Improved technology and information
- > Increasing loan and pool leverage characteristics and sponsor concentrations
- > Diminished sponsor equity
- > Increased number of large loans in conduit deals:
 - Less homogenous transactions

Pool Level Trends

- > Subordination levels: downward trend reflects
 - lower than expected loan defaults and losses
 - Fitch's belief that bonds with similar ratings should have similar performance characteristics.
- > In 1992, Fitch estimated cumulative loan defaults would reach 30% and losses would average 40% = 12% expected loss
- > Fitch's experience at year end 2004 is an expected loss of 2%

CMBS vs. Corporates Bond Defaults

Corporate vs. CMBS Bond Defaults: 1990-2003
(%)

	Cumulative Defaults		Average Annual Defaults	
	Corporate	CMBS	Corporate	CMBS
Investment Grade	2.10	0.10	0.15	0.01
Below Investment Grade	55.00	1.61	3.94	0.12
All Bonds	11.00	0.19	0.78	0.01

Property Trends

- > Office - Modest increases in employment, not losing ground
 - Growth in CBD and suburban submarkets
 - Although rents have declined, amount of sublet space is decreasing, occupancy improving slightly
 - Positive signs of direct rent growth
- > Hotel - Seven quarters of steady growth
 - Delinquencies declining
 - Seeing more in recent deals – 10% vs. 5%

Property Trends

- > Multifamily – “darling of investors”, competition from Fannie Mae, Freddie Mac
 - Spike in vacancies resulting from low interest rates
 - Some markets still suffer as a result of overbuilding
- > Industrial - minimal delinquencies
 - New construction slowed quickly in response to overbuilding
 - Recent increase in capital spending will begin to have a positive impact by year end

Property Trends

Retail:

- > Performance has been consumer driven
- > Beneficiary of home mortgage refinancing
- > Wal-Mart factor – impact on grocery-anchored centers
- > Mergers in many retail sectors:
 - department stores
 - grocery chains

CMBS Outlook

- > CMBS will continue to outperform corporates, other structured products
- > Capital will continue flowing into commercial real estate – debt and equity – keeping cap rates low and values up, even if interest rates rise
- > Discipline and disclosure forced by the public markets will temper the highs and lows of cyclical swings, relative to what we saw in late 80s
- > Efficiency of pricing and risk allocation created by CMBS market will allow industry to continue to evolve
- > Recent origination trends – declining structural features, more aggressive underwriting and increased leverage – will put upward pressure on subordination levels in 2005

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