
Atlanta Actuarial Club

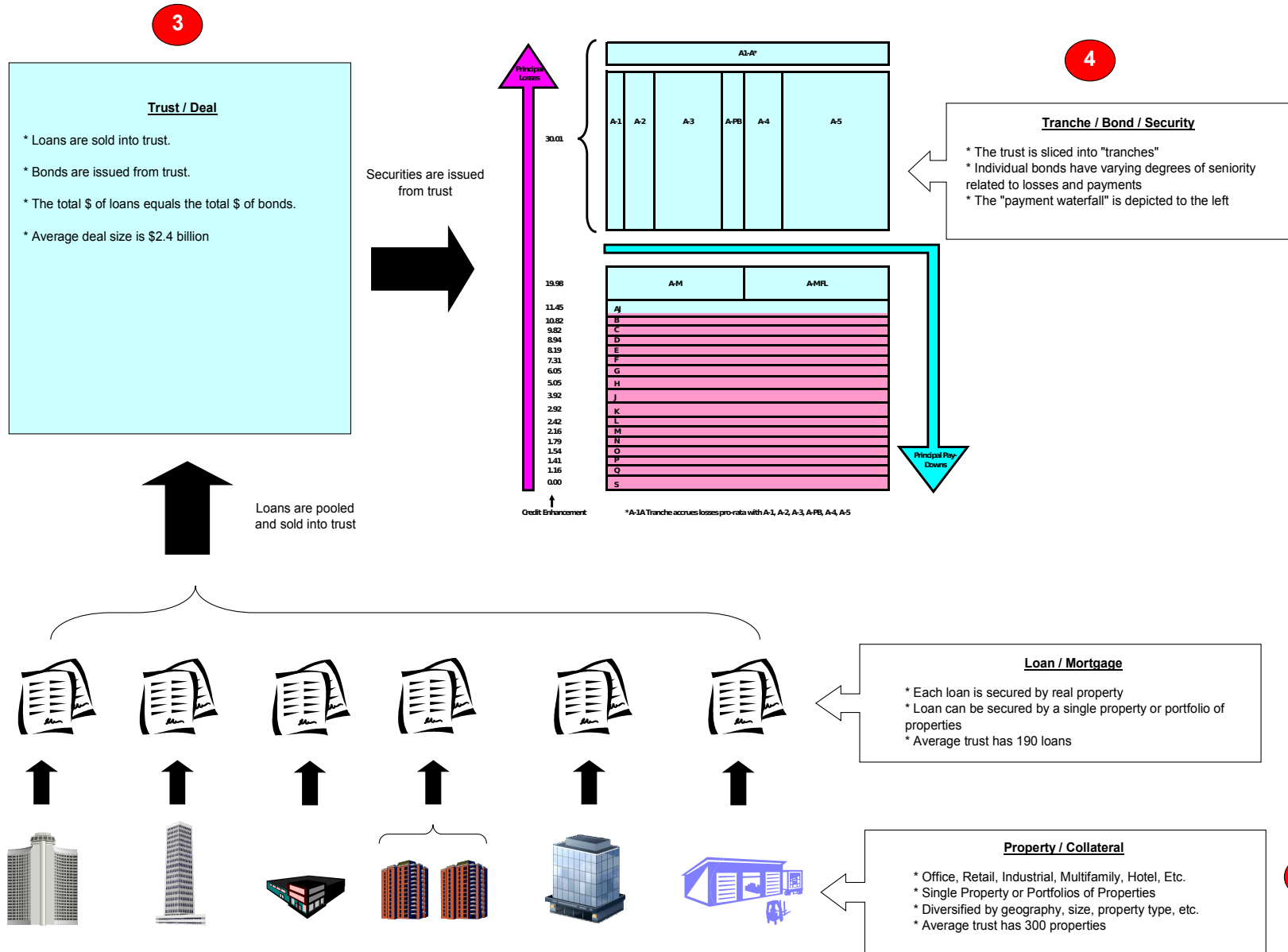
November 12, 2010

Commercial Mortgage Backed Securities: Where Do We Go From Here?

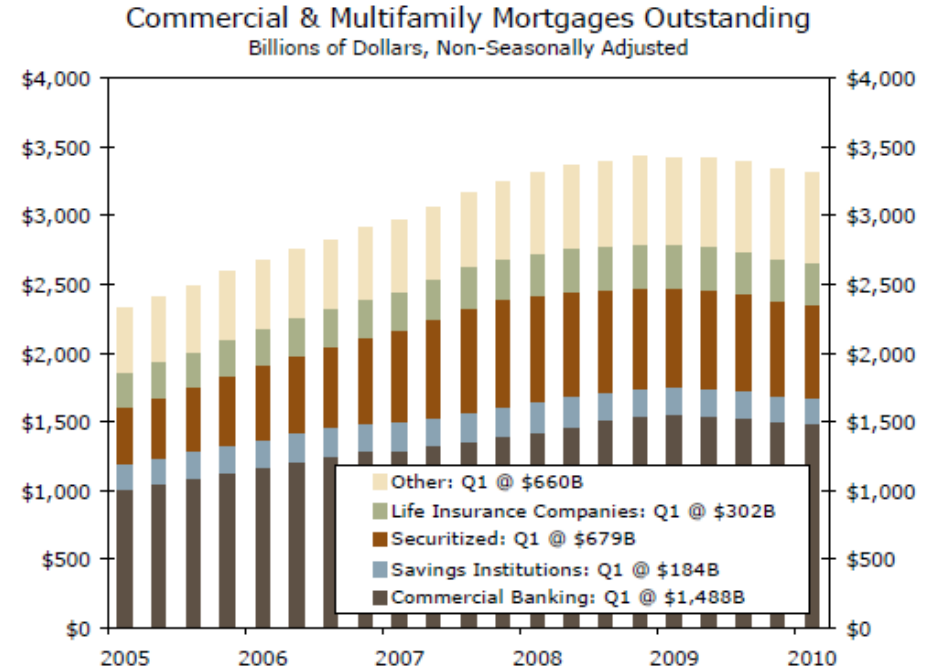
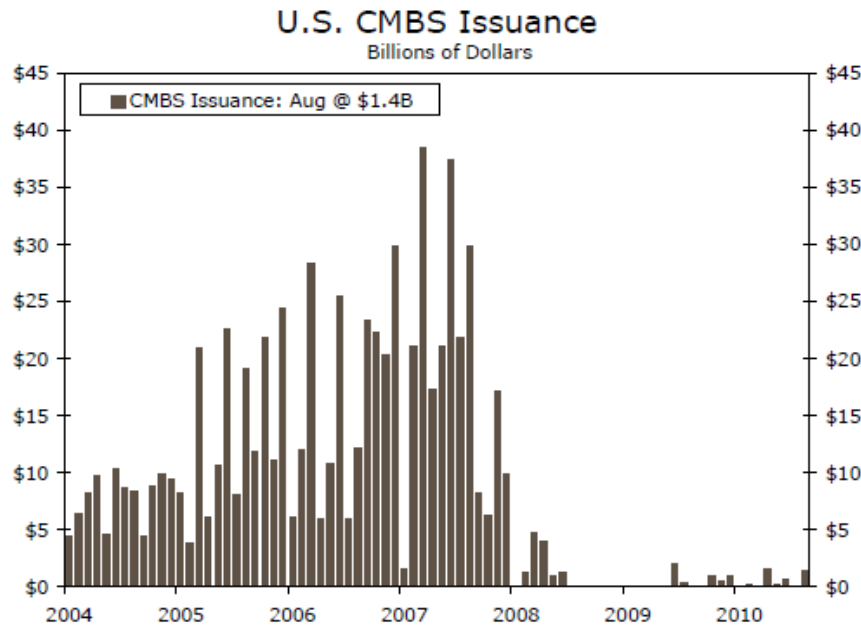
Dave Goodson
Stephen Buschbom

CMBS Context: Security Description and Who's Involved

What are Commercial Mortgage Backed Securities?



Remaining CMBS Market

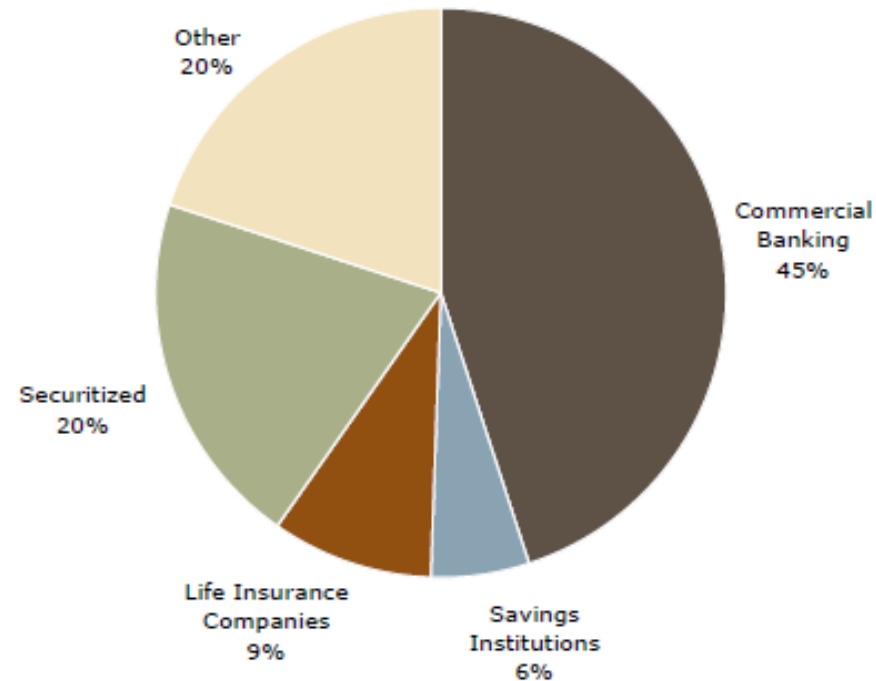


Source: Federal Reserve Board, Property & Portfolio Research, Real Capital Analytics, Reis, Inc. and Wells Fargo Securities, LLC

- Roughly \$700 billion remains outstanding in the CMBS market, ~3 years from the peak of issuance
- Q4 issuance of \$6.5B is a 3 year high, but represents a fraction of average quarterly volumes from 2006 or 2007
- Commercial banking volumes are lower, reflecting the overall trend of tight lending conditions at banks
- Life insurers have returned to the commercial real estate lending market, along with the ramping of “opportunity” / “distressed” funds seeking higher yields (represented as ‘Other’ above)

Remaining CMBS Market

Commercial & Multifamily Mortgages Outstanding
Q1 2010

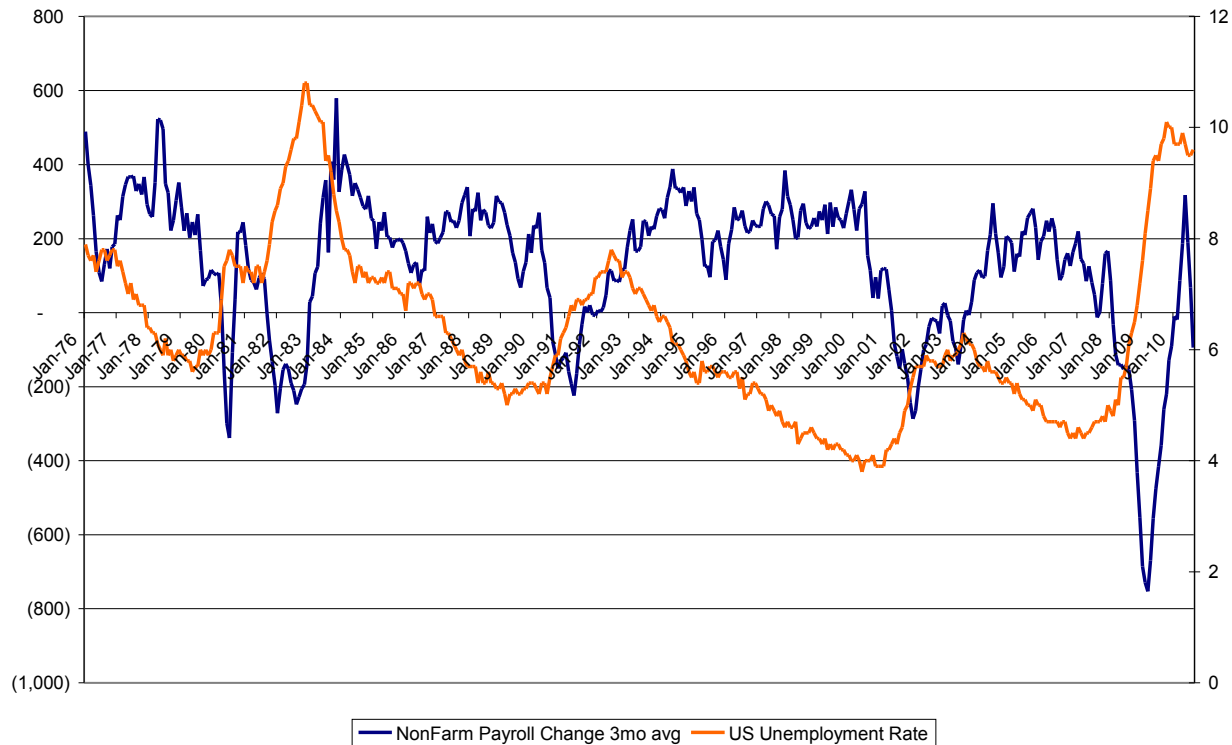


- Within Commercial Real Estate, despite the recent decline in lending, banks remain the primary credit provider
- Life insurers also remain a key constituent, as appetite for exposure will be a driver of CMBS returning, as well as through direct lending efforts

CMBS: Appreciating the Fundamentals

Market Update: Macro Factors

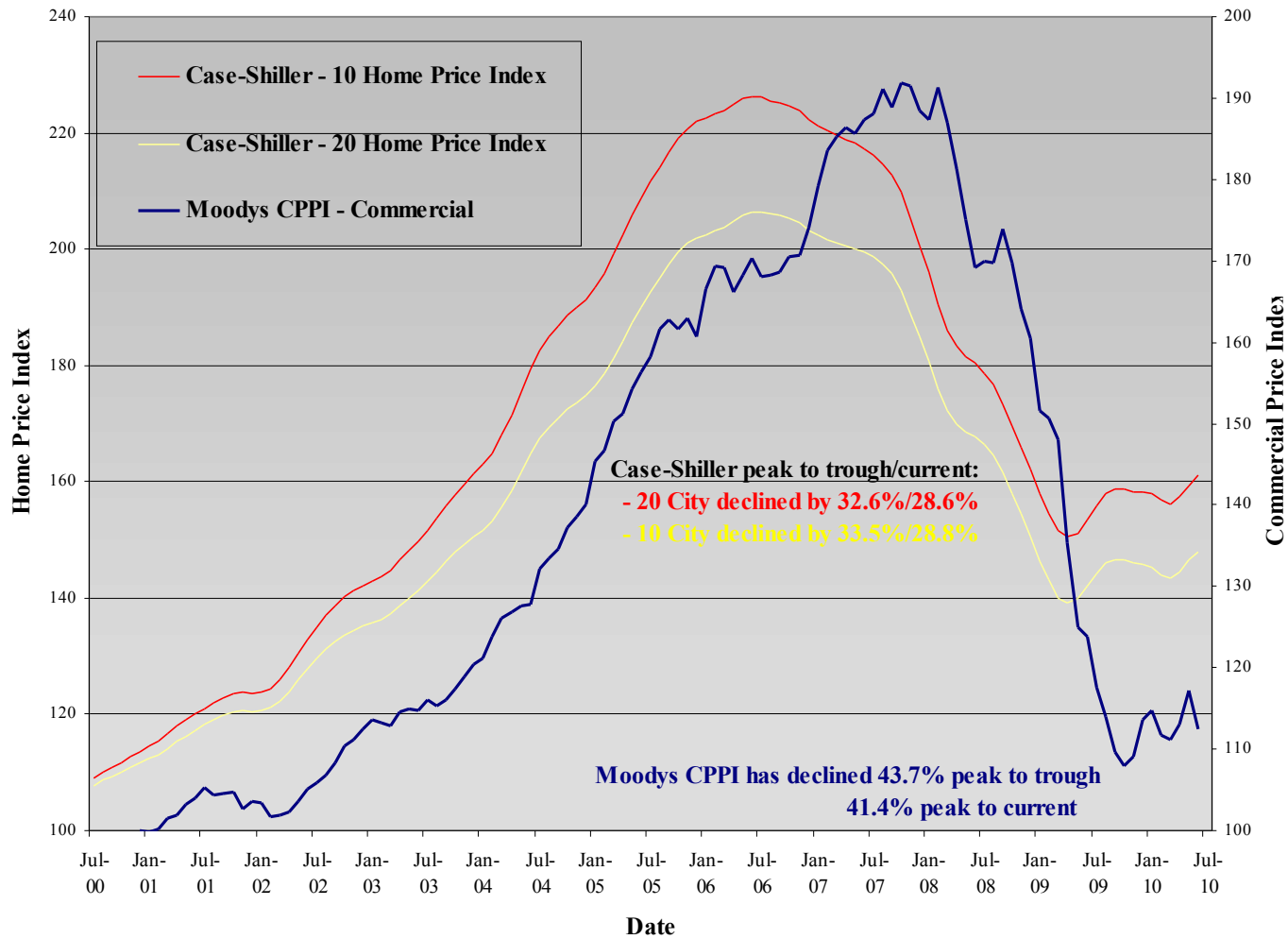
Employment



- While still elevated, the unemployment rate has declined 0.5% since year end (-0.3% in Q1, -0.1% in Q2)
- Nonfarm private payrolls have stabilized, but the pace of growth has been low and catalysts for larger improvements are not evident
 - Last month's non-farm payroll number had a more positive tone, with private payrolls up 159K
- Employment (or lack thereof) will drive

Market Update: Macro Factors

Commercial vs. Residential Home Home Price Indices



Source: S&P/Case-Shiller, Moody's, Bloomberg

CMBS: How Have the Markets Reacted?

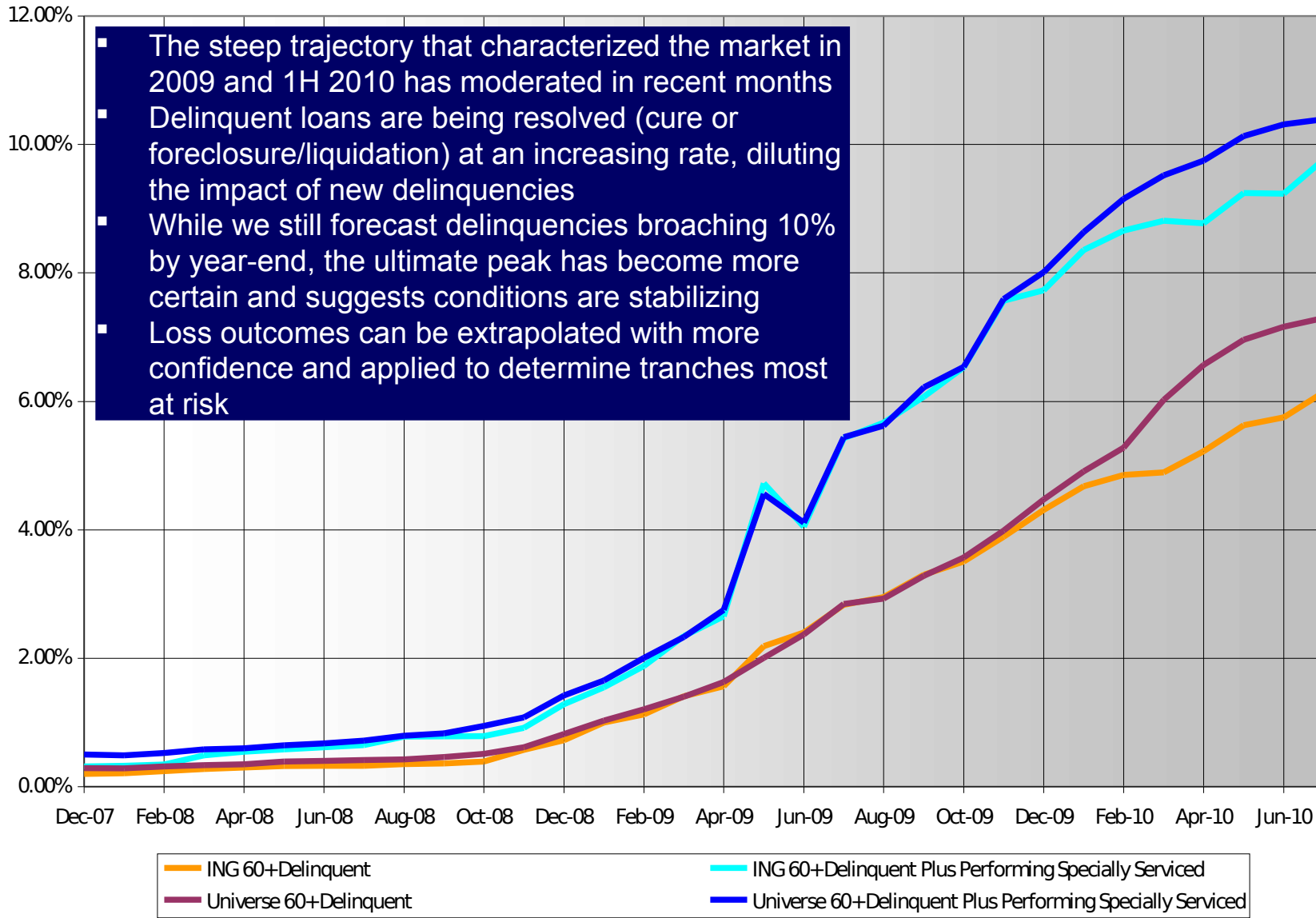
Borrowers

Loan Servicers

Issuers

Investors

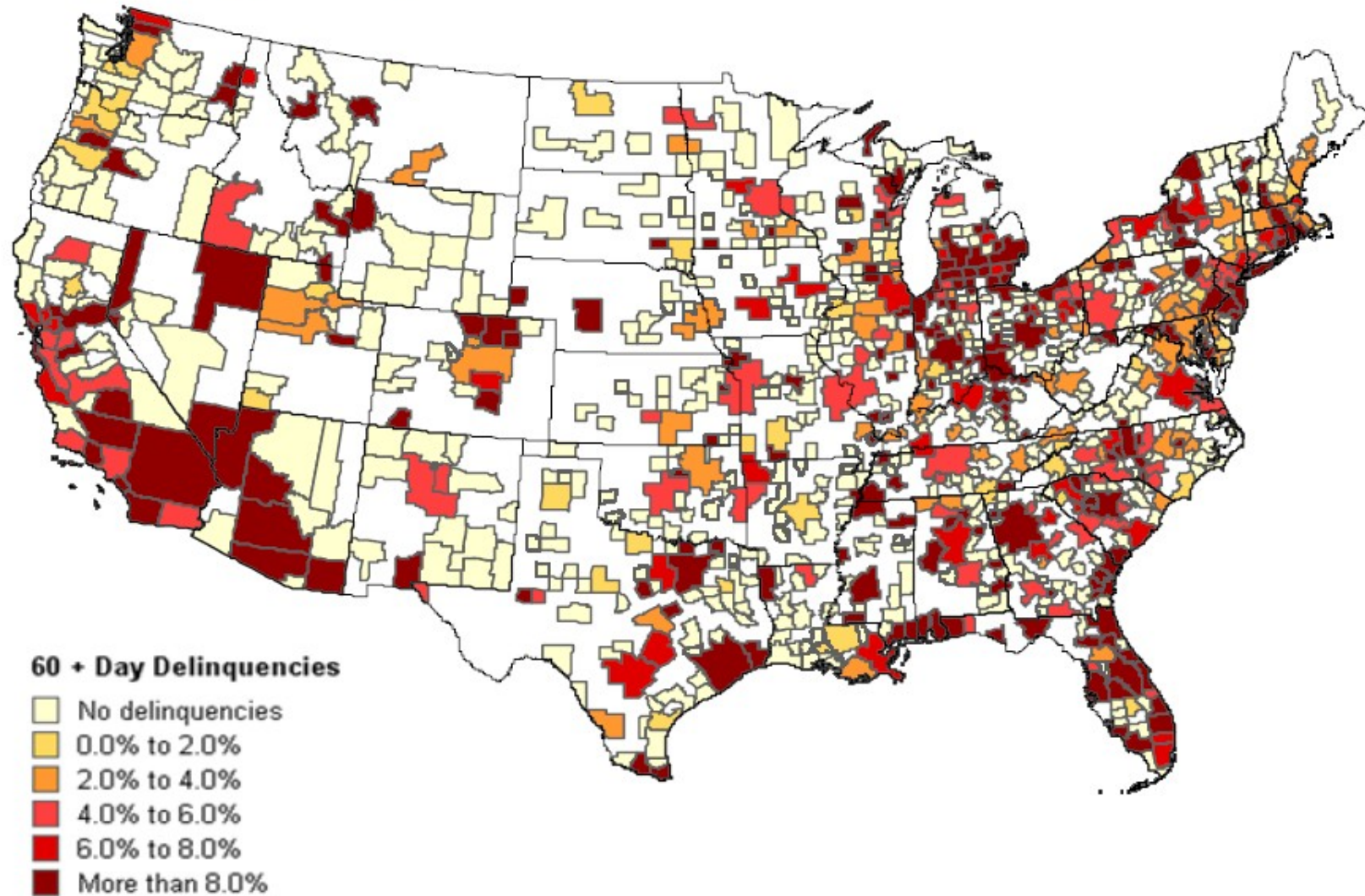
Market Reaction – Borrowers



Market Reaction – Borrowers

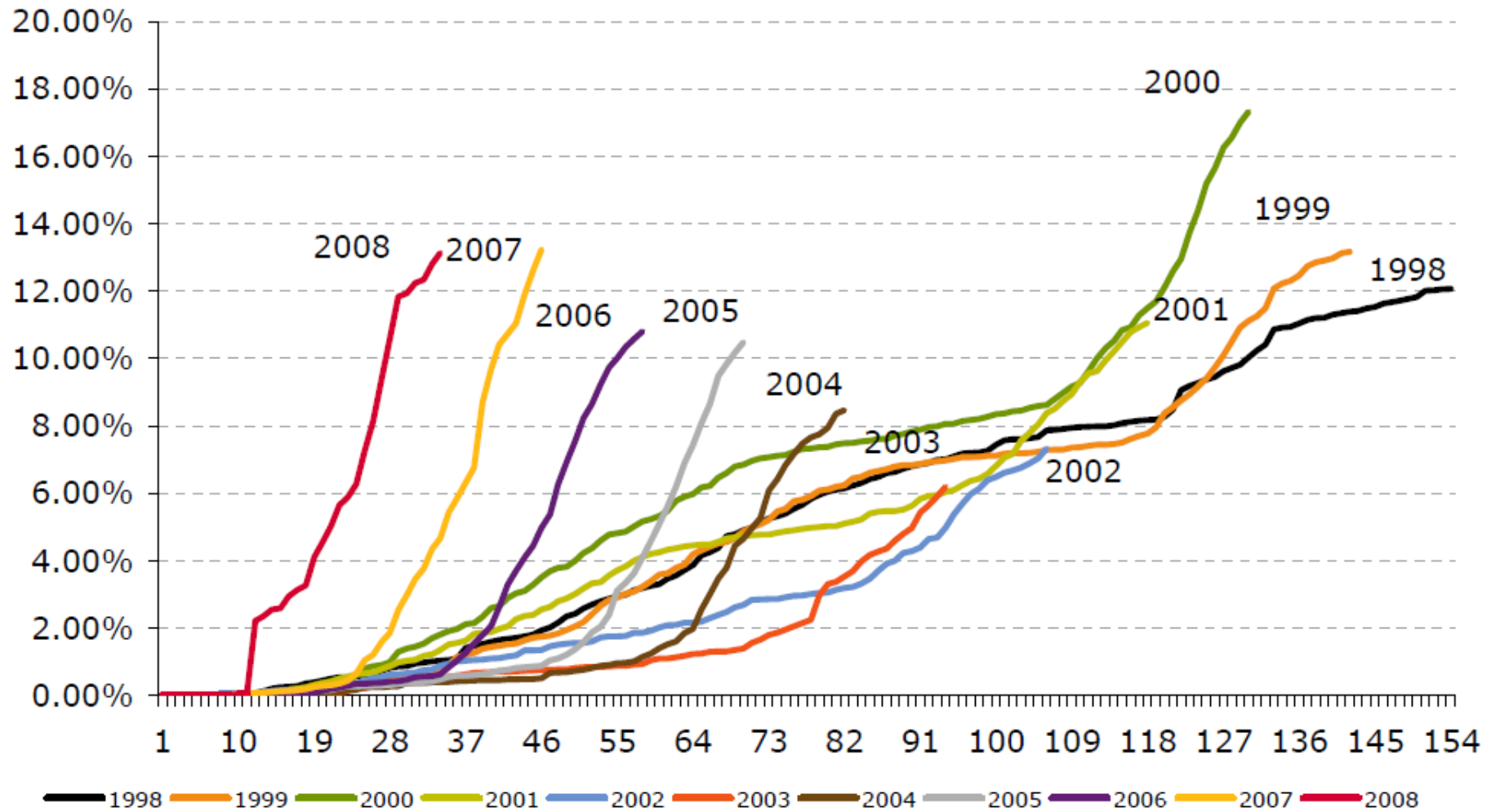
Delinquencies - CMBS Fixed-Rate Deals

60+ Day Delinquencies by CBSA



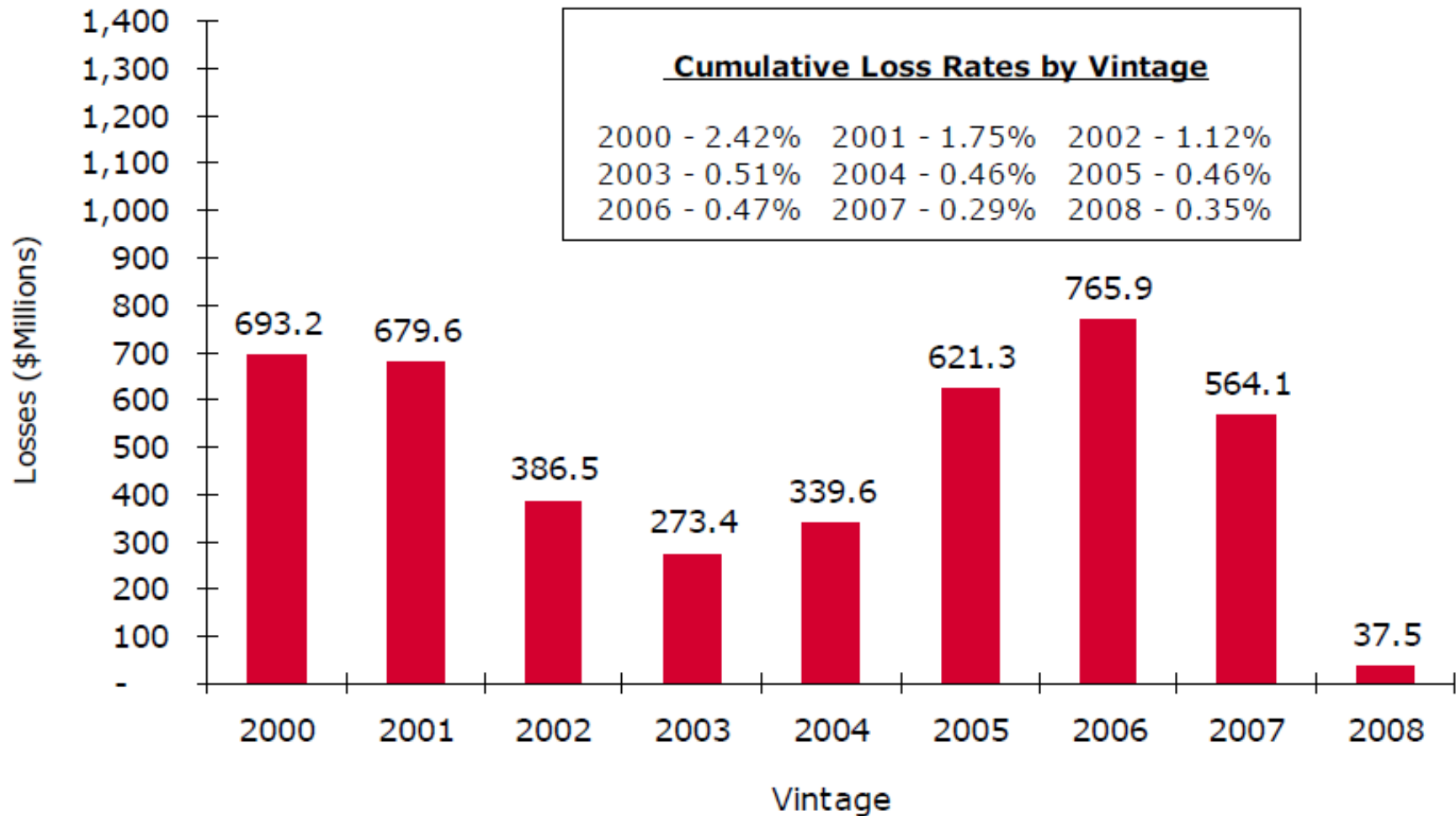
Market Reaction – Loan Servicers

Cumulative Defaults by Vintage - CMBS Fixed-Rate Conduit Deals



Market Reaction – Loan Servicers and Investors

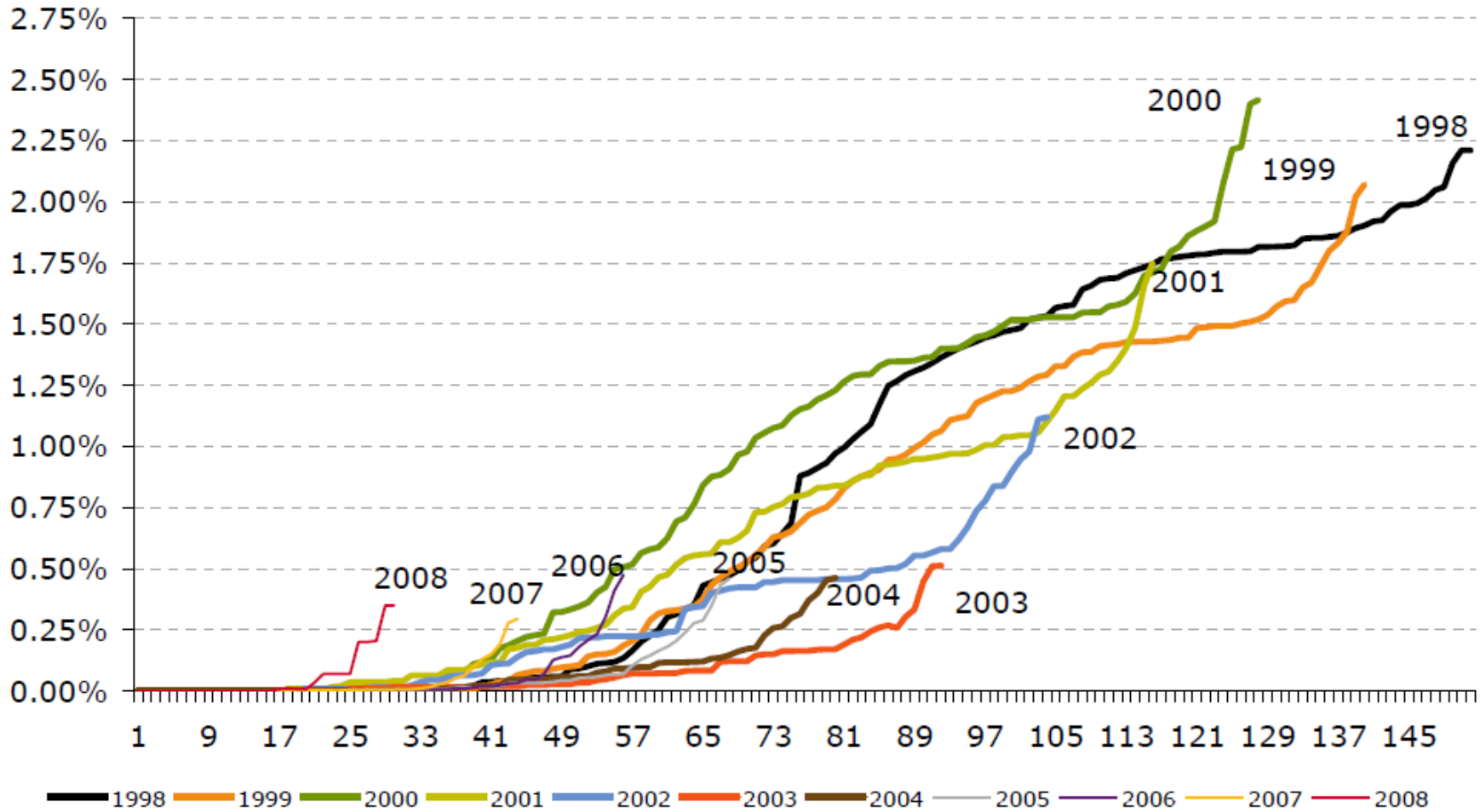
Exhibit 5: Cumulative Losses by Vintage for Fixed-Rate Conduit Transactions



Source: Wells Fargo Securities, LLC, and Intex Solutions, Inc.

Market Reaction – Loan Servicers and Investors

Cumulative Losses by Vintage - CMBS Fixed-Rate Conduit Deals



Market Reaction – Issuers and Investors

New Issue CMBS has been well received and on track to reach \$10B in issuance in 2010

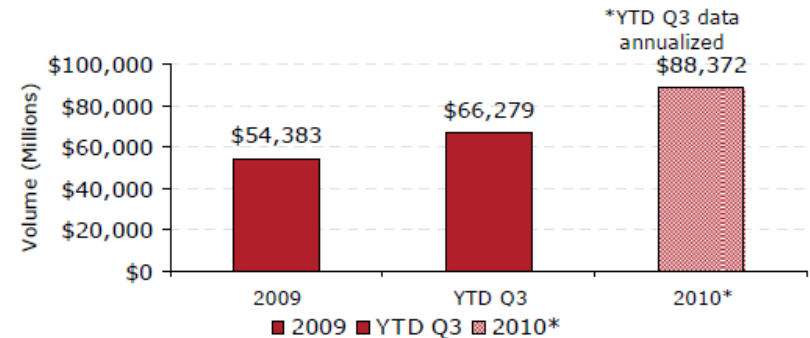
- Higher quality but less diversified collateral and simpler structures are key characteristics
- 6 new deals, >\$6B in the pipeline for issuance in Q4
- Demand from conduit lenders, leading to more favorable resolutions for properties in the broader CRE markets

Exhibit 3: New Issue Transactions Priced YTD 2010

Ticker	Original Balance (\$mm)	Closing Date	Sellers	Loan/Property Count	Offering Type
2010 Multi-Borrower Deals					
GSMS 2010-C1	788	8/17/10	Goldman Sachs; Citigroup; Starwood	23 / 48	144A
JPMCC 2010-C1	716	6/24/10	JPMorgan; Ladder Capital	36 / 96	144A
RBS 2010-MB1	310	4/22/10	RBS, Natixis	6 / 81	144A
Total	1,815				
2010 Single-Borrower Deals					
JPMCC 2010-CNTR	485	9/03/10	Centro Properties	1 / 72	144A
VNO 2010-VNO	660	8/18/10	Vornado Realty	1 / 40	144A
OBP 2010-OBP	650	7/08/10	Durst Organization, Bank of America	1 / 1	144A
Total	1,795				
Total 2010 Issuance YTD	3,609				
2009 Single Borrower Deals					
JPMCC 2009-IWST	500	12/23/09	Inland Western Retail Real Estate	1 / 55	144A
BALL 2009-FDG	460	12/15/09	Flagler Development	1 / 44	144A
DDR 2009-DDR1	400	11/25/09	Developers Diversified Realty	1 / 28	144A
Total	1,360				

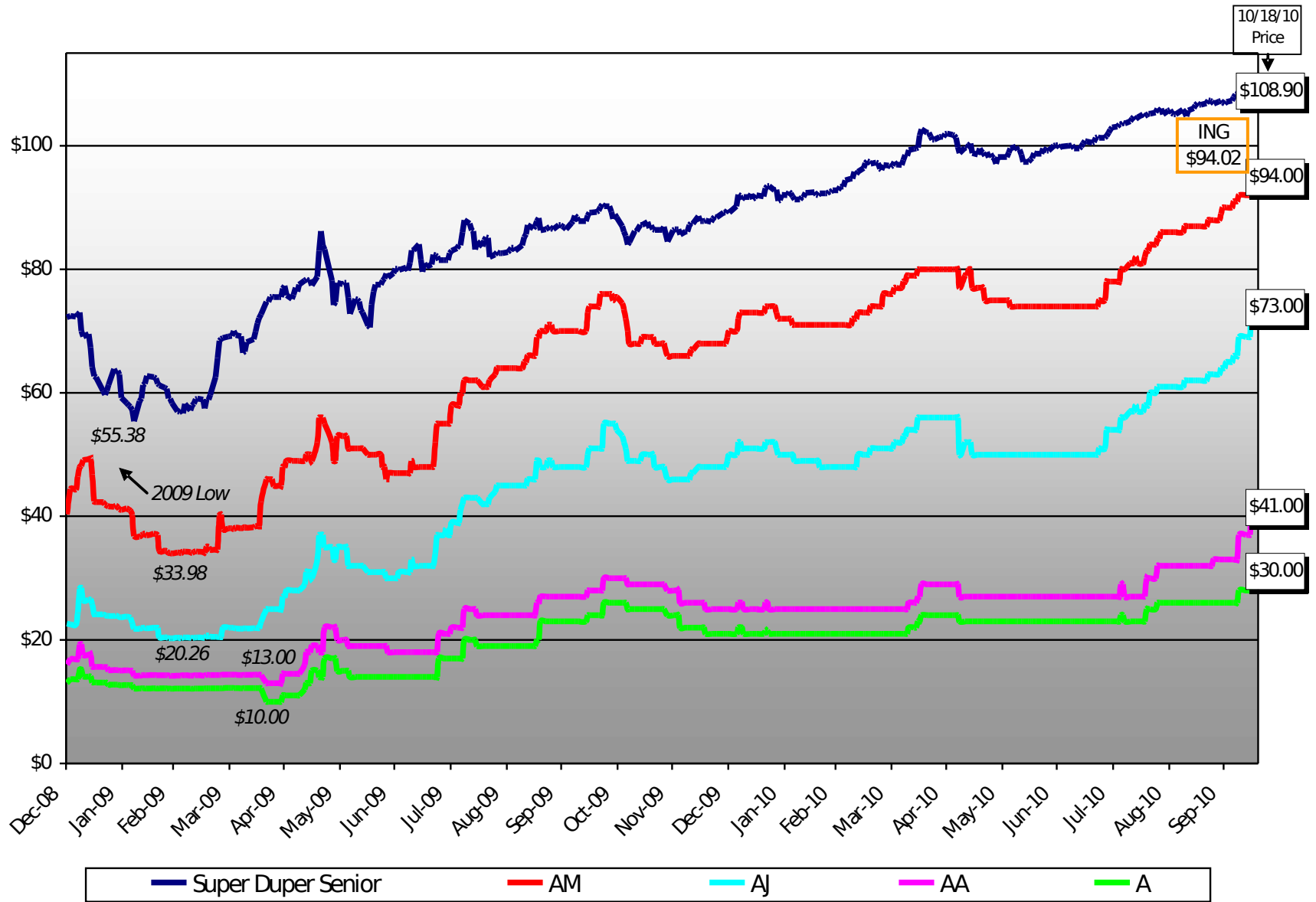
Source: Transaction documents, Trepp, LLC and Bloomberg LP.

Exhibit 2: Total CRE Transaction Volume



Source: Real Capital Analytics, Inc., Wells Fargo Securities, LLC.

Market Reaction – Investors

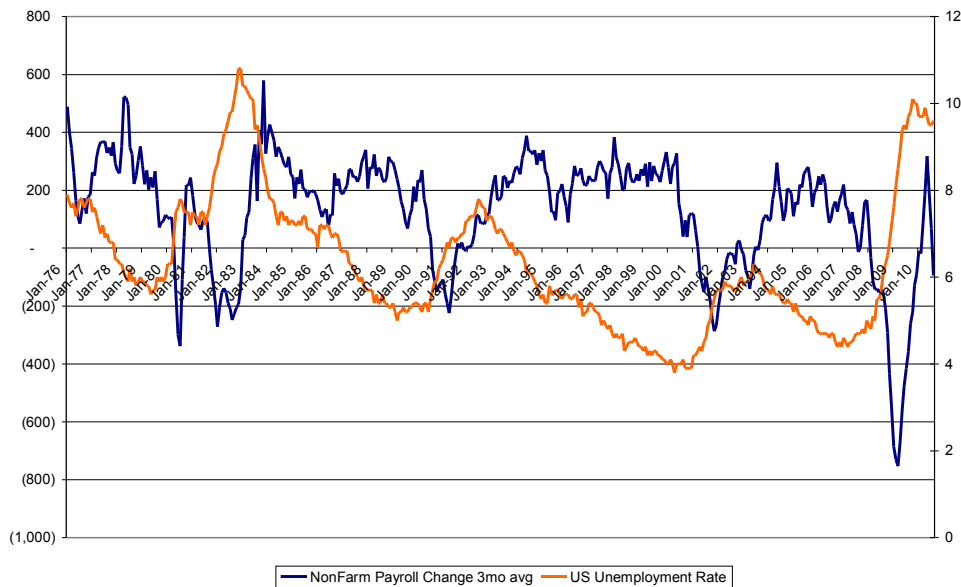


Source: JP Morgan

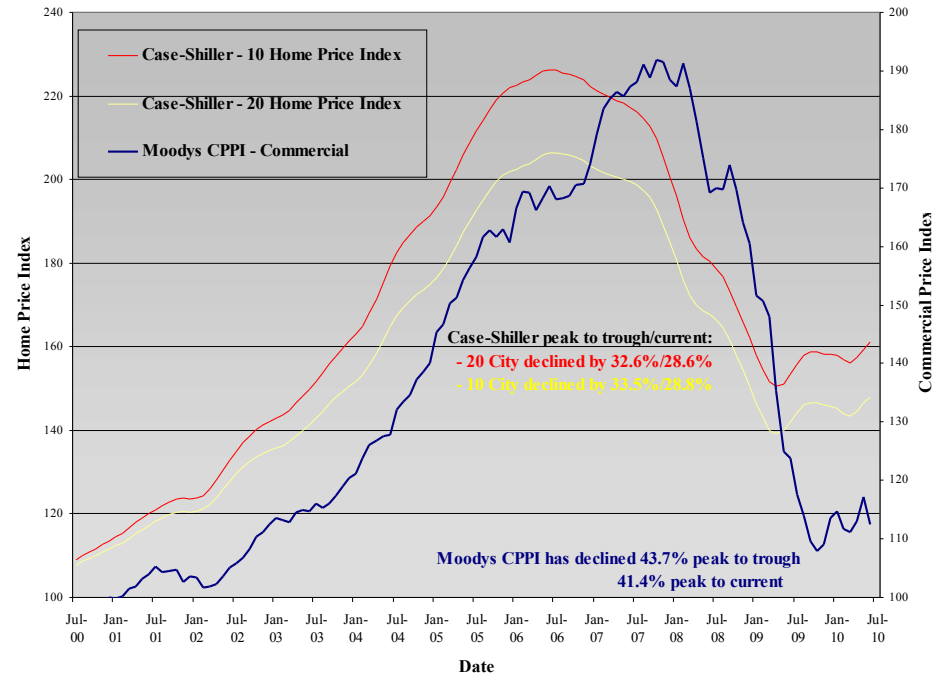
Putting It All Together;
Where Do We Go From Here?

Macro Factors are Flattening, Volatility has Followed

Employment



Commercial vs. Residential Home Price Indices



Source: S&P/Case-Shiller, Moody's, Bloomberg

- Key drivers of CMBS performance have recently exhibited signs of stability, following elevated periods of volatility
- Volatility (seen in VIX, MOVE index), by most measures, has declined measurably
- A de-leveraged buyer base should contribute to a lower volatility environment for CMBS, reflected in higher prices and greater risk appetite by issuers and investors

A Key Catalyst in the Recovery, Gov't Program Impacts are Diminishing

111TH CONGRESS
1ST SESSION **H. R. 1106**

To prevent mortgage foreclosures and enhance mortgage credit availability.

IN THE HOUSE OF REPRESENTATIVES

FEBRUARY 23, 2009

Mr. CONYERS (for himself, Mr. FRANK of Massachusetts, Mr. BERGAN, Mr. BLUMENAUER, Mr. COHEN, Mr. DELAHUNT, Ms. EDWARDS of Maryland, Mr. ELLISON, Mr. GONZALEZ, Mr. GUTIERREZ, Ms. JACKSON-LEE of Texas, Mr. JOHNSON of Georgia, Mr. LEWIS of Georgia, Ms. ZOE LUPREY of California, Mr. MILLER of North Carolina, Mr. NADLEY of New York, Ms. LINDA T. SANCHEZ of California, Ms. WASSERMAN SCHULTZ, Ms. WATERS, and Mr. MARSHALL) introduced the following bill, which was referred to the Committee on Financial Services, and in addition to the Committees on the Judiciary and Veterans' Affairs, for a period to be subsequently determined by the Speaker, in each case for consideration of such provisions as fall within the jurisdiction of the committee concerned

A BILL

To prevent mortgage foreclosures and enhance mortgage credit availability.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*
3 SECTION 1. SHORT TITLE; TABLE OF CONTENTS.

4 (a) SHORT TITLE.—This Act may be cited as “Help-
5 ing Families Save Their Homes Act of 2009”.

Source: U.S. Government

10 TITLE II—FORECLOSURE MITI- 11 GATION AND CREDIT AVAIL- 12 ABILITY

13 SEC. 201. SERVICER SAFE HARBOR FOR MORTGAGE LOAN 14 MODIFICATIONS.

15 (a) SAFE HARBOR.—
16 (1) LOAN MODIFICATIONS AND WORKOUT
17 PLANS.—Notwithstanding any other provision of
18 law, and notwithstanding any investment contract
19 between a servicer and a securitization vehicle or in-
20 vestor, a servicer that acts consistent with the duty
21 set forth in section 129A(a) of Truth in Lending Act
22 (15 U.S.C. 1639a) shall not be liable for entering
23 into a loan modification, workout, or other loan modi-
24 fication plan, including, but not limited to, disposition

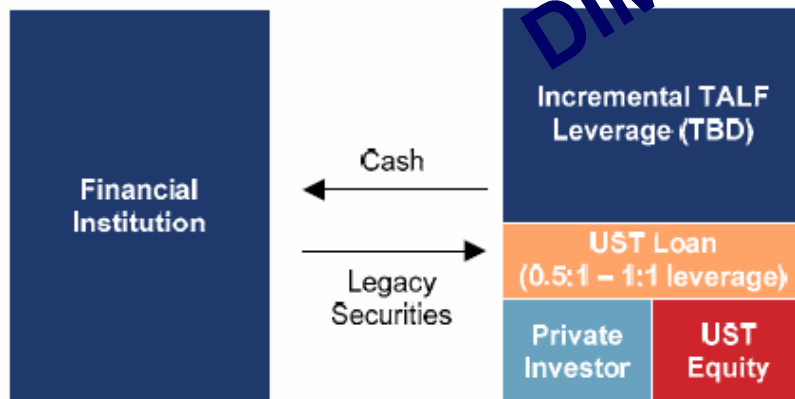
- Government interventions can dramatically impact performance fundamentals and market conditions for structured credit

- Liquidity impacted by commitment of government funding: Quantitative easing, TARP, TALF, PPIP
- Fundamentals affected by government legislation impacting bankruptcies, modifications, foreclosure, financing, mortgage rates

■ We monitor potential legislation and changes in regulatory/accounting guidelines in several ways:

- Monitoring political developments through relationships with lobbyists and industry groups, as well as direct lobbying efforts (i.e. ACLI)
- Prioritizing analysis of potential bills, press releases, and treasury initiatives to assess their impact on the market
- Deepening our understanding of TALF and PPIP impacts through direct investment proposals

Illustrative Structure



Source: internal generation

Capital Concerns Alleviated, Rating Agency Problems Addressed

➤ NAIC adopts ACLI proposal to ease capital treatment of downgraded CMBS

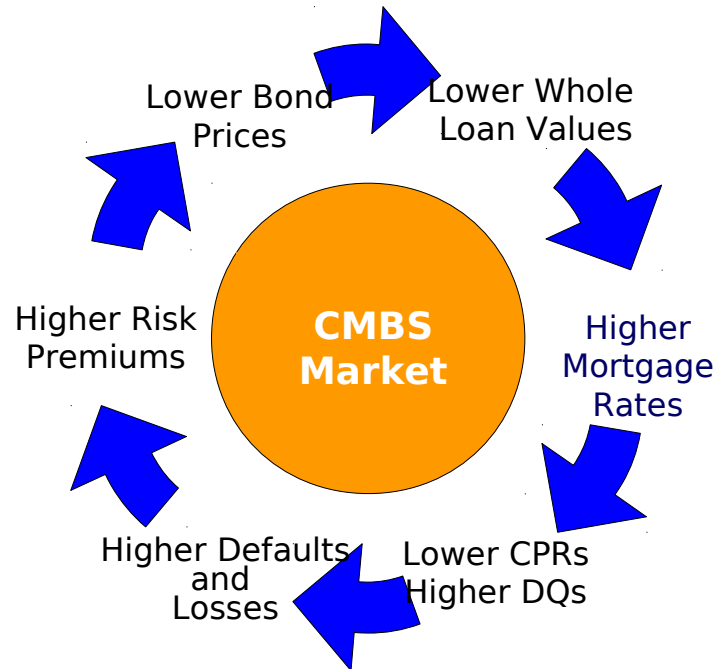
- Old system: ratings agency downgrades translated directly into punitive capital charges:

NAIC Rating	S&P Rating	Capital Charge
NAIC 1	AAA, AA, A	0.67%
NAIC 2	BBB	2.17%
NAIC 3	BB	7.67%
NAIC 4	B	16.68%
NAIC 5	CCC, CC, C	38.36%
NAIC 6	D	44.10%

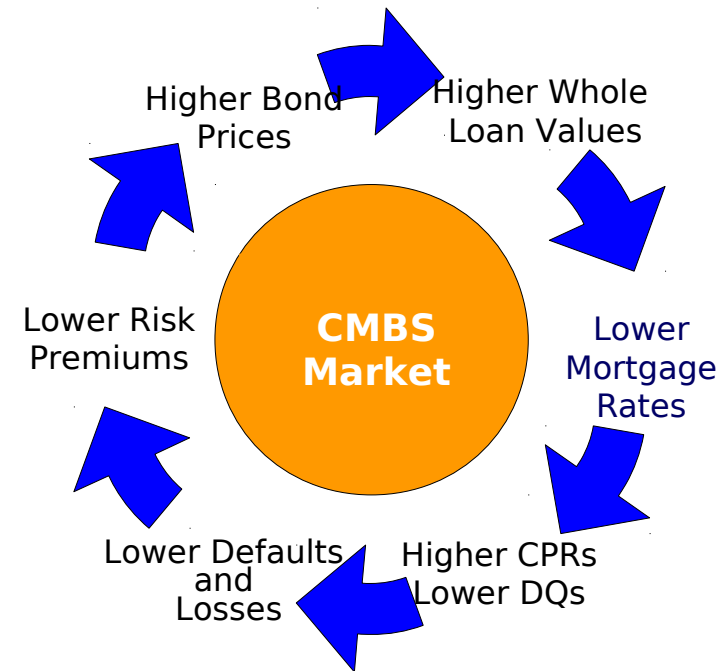
- Expected magnitude of loss not taken into account; only consideration was probability of loss.
- New system: a third party (Blackrock) projects bond outcomes under 5 scenarios; NAIC rating and capital requirement are based on expected loss.
 - Major improvement: emphasis on degree of loss, not just probability of first dollar loss
 - Results:
 - Final modeling results still TBD, so degree of capital savings still unclear.
 - Capital savings anticipated, particularly for junior and mezzanine tranches where small (or no) loss is forecast, but rating agency downgrades have been severe
 - Mitigates forced selling from insurers
 - Improves outlook for CMBS sectors with ratings uncertainty (Junior AAAs, Mezzanine AAAs)

The Cycle: Vicious to Virtuous

Q2 2007- Q1 2009



Q2 2009 - Current



- We look for the CMBS to continue its reversal from a vicious cycle to a virtuous cycle
- Against this backdrop, market values will increase and risk appetite will improve, particularly for well structured risks that address new problems from the credit crisis
- As the reversal completes, the market will rationalize inefficiencies and punish holders of poorly structured risks; the end of the road is coming for the can