

CMBS 001



CMBS 001 An Introduction for Borrowers

Prepared by

The Education/Research Committee of
the Commercial Mortgage Securities
Association

CMBS 001

An Introduction for Borrowers

What is CMSA?

The **Commercial Mortgage Securities Association (CMSA)** is an international trade organization for the commercial real estate capital markets with 4,000 individuals representing over 300 member firms. The mission of the CMSA is to improve the liquidity of commercial real estate debt through access to the capital markets.

The **Commercial Mortgage-Backed Securities (CMBS)** industry itself has grown from less than \$10 billion in CMBS outstanding in the early 1990's to almost \$600 billion today.

CMSA sponsors various educational programs to increase the understanding of CMBS by all constituencies – borrowers, as well as investors. CMSA works to improve the market through such efforts as standardized investor reporting; issuance of CMBS Loan Documents Best Practices and the “Borrower’s Guide to CMBS” co-authored with the Mortgage Bankers Association. Find out more information about CMSA on its website cmbs.org.



CMBS 001:

CMBS 001: An Introduction for Borrowers has been prepared by the Education/Research Committee of the Commercial Mortgage Securities Association. The sixty-minute presentation is intended to provide borrowers and their representatives an overview on using Commercial Mortgage-Backed Securities (CMBS) as a competitive source of capital for real estate financing. For more information on hosting a CMBS 001 Seminar, call Shane Beeson of CMSA at (212) 509-1844 or visit the CMSA website at www.cmbs.org.



CMSA also sponsors CMBS 101:

CMBS 101: An Introduction to Commercial Mortgage-Backed Securities, developed by Sally Gordon of Moody's Investors Service, is presented by the Education/Research Committee of the CMSA. The four-hour presentation is intended to provide CMBS industry participants an understanding of the mechanics, macro-economics and investment characteristics of CMBS. For more information, call Shane Beeson of CMSA at (212) 509-1844 or visit the CMSA website at www.cmbs.org.

Upcoming presentations of CMBS 001 and 101 include:

January 30th, 2006 – during ASF Conference, *Las Vegas*

February 7th, 2006 – during MBA CREF Conference, *Orlando*

March 29th, 2006– with IRP Tutorial, *Chicago*



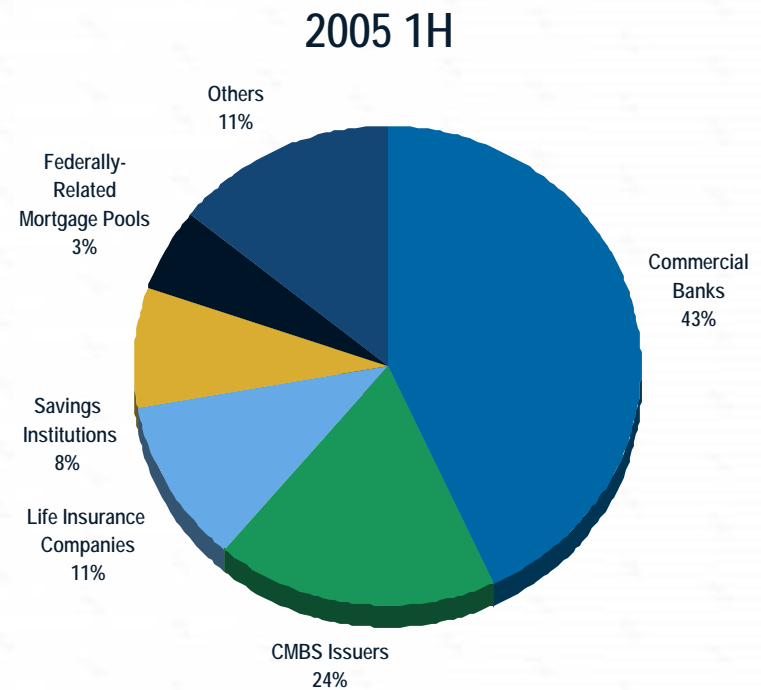
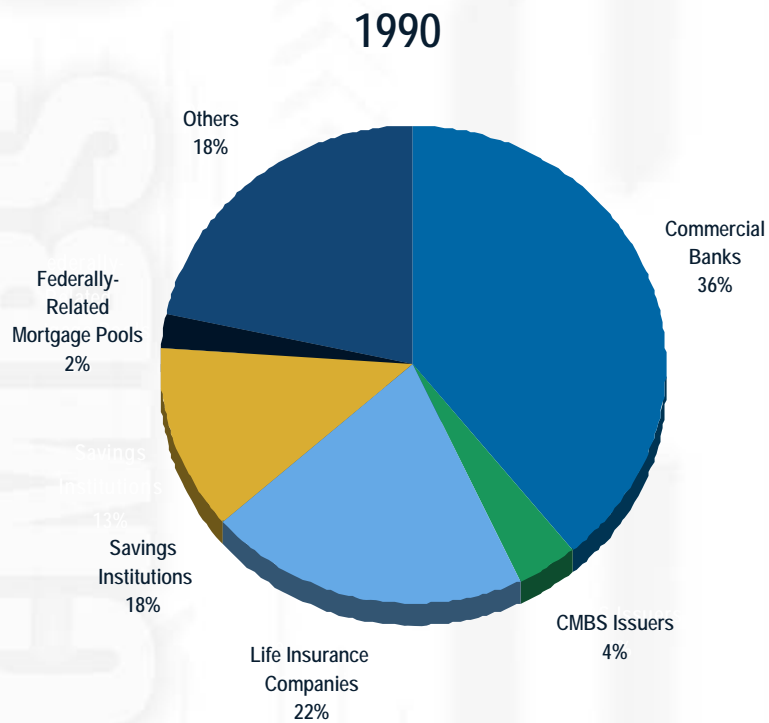
CMBS — The Big Picture

- ▶ 2005 volume of CMBS totaled over \$238 billion worldwide, including over \$169 billion of U.S. new CMBS issued in 2005
- ▶ Securitization of consumer receivables began in the 1980's, residential mortgages in 1970's, and commercial/multifamily mortgages in the mid-1990's

CMBS is an important source of capital for borrowers and commercial real estate professionals to understand and use

CMBS — The Big Picture

- ▶ At mid-year 2005, \$593 billion of the \$2.4 trillion U.S. commercial and multifamily mortgage loans outstanding are held as securities, a significant increase over the past fifteen years (Source: Federal Reserve, Flow of Funds)



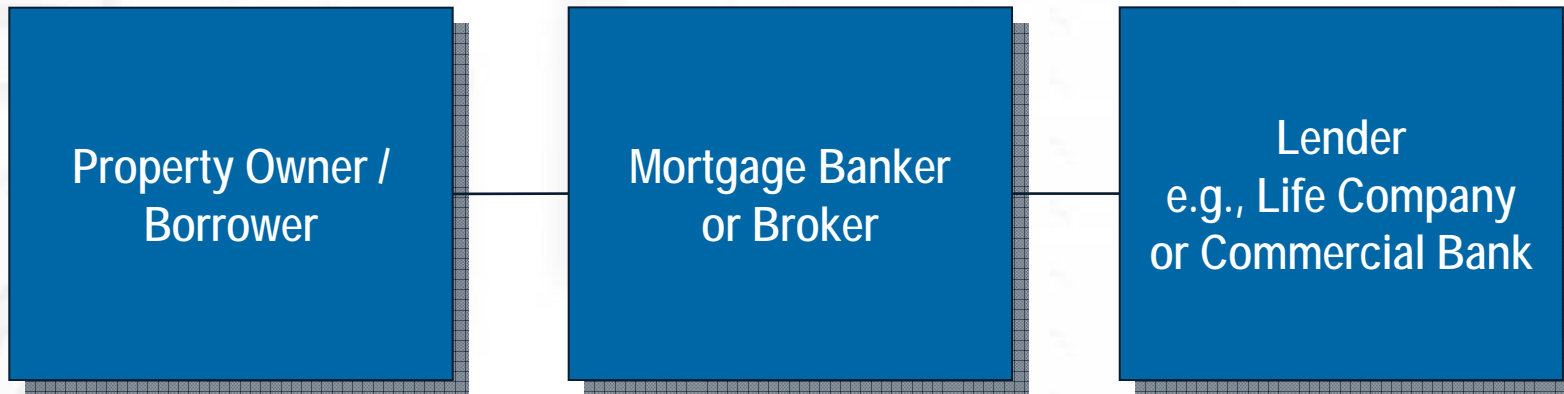
CMBS 001

- ▶ **Part 1: Untangling the Players** A description of the participants and their roles in delivering CMBS funds to borrowers
- ▶ **Part 2: The Real “Lender”** A description of CMBS investors
- ▶ **Part 3: CMBS is Not for Every Loan** A disclosure on the suitability of CMBS for various types of real estate loans
- ▶ **Appendix: More Information** An appendix with further information about CMBS

CMBS 001 — Part 1

Untangling the Players in CMBS: A Description of the Participants and their Roles in Delivering CMBS Funds to a Borrower

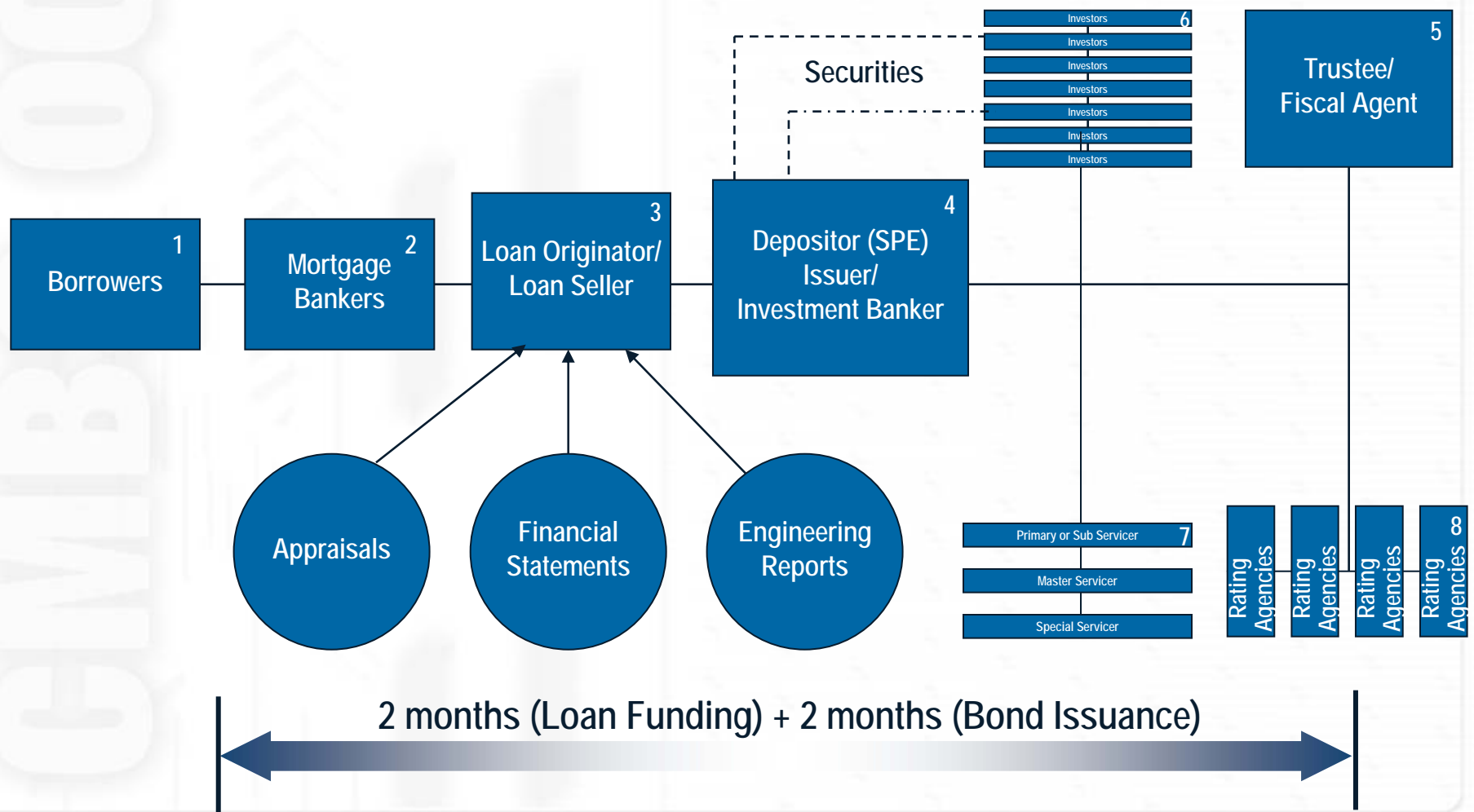
The Participants in a Conventional Mortgage Financing



START TO FINISH takes about 2 months

A horizontal double-headed arrow spans the width of the diagram, with vertical lines at each end. The text "START TO FINISH takes about 2 months" is centered above the arrow.

The Participants in a Securitization



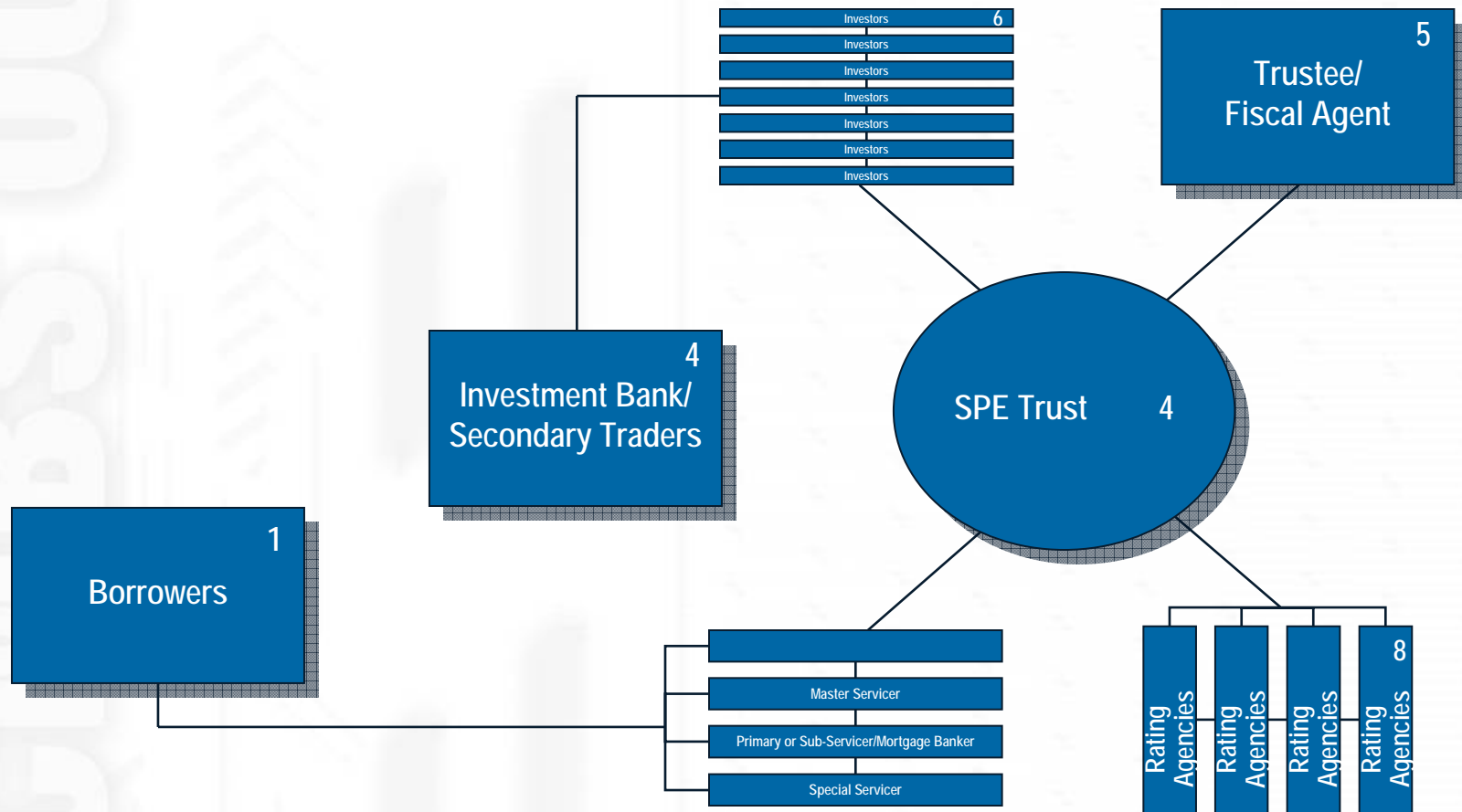
The Participants in a Securitization

1	Borrower:	Owns real property, improvements, interests in leases and related property; all of which will be pledged to the lender to secure the borrower's loan repayment and performance obligations.
2	Mortgage Banker:	An intermediary between the borrower and the loan originator, may act as advisor to borrower or as a specialist for a specific capital source, may assist in selecting best execution for the borrower
3	Loan Originators/ Loan Sellers:	Lends money to the borrower, secured by a first priority lien on borrower's real property and related collateral. As the "owner" of the mortgage loan, enters into a mortgage loan purchase agreement ("MLPA") to sell the loan to the securitization depositor.
4	Depositor:	An entity set up by the investment bank sponsoring the securitization. It purchases commercial mortgage loans and immediately sells loans to a trust in exchange for certificates issued by the trust. When the certificates are sold to investors, the cash proceeds are used to pay the mortgage loan sellers amounts due under each MLPA.
4	Investment Banker:	Has overall responsibility for structuring the securitization, bringing all the parties to the transaction, and selling the bonds/certificates (on behalf of the depositor) to investors. After the securitization closes, helps maintain a liquid secondary market for trading the bonds/certificates.
4	Issuer:	The trust is the record owner of the commercial mortgage loans, holds the loans on behalf of the investors, and issues the bonds/certificates. It is formed by the depositor pursuant to a pooling and servicing agreement ("PSA").
5	Trustee:	Pursuant to the PSA, is responsible for administering the trust on behalf of and making payments to the investors.
6	Investors:	Different investors with varying risk appetites purchase various certificates rated from AAA/Aaa (highest rated credit quality, lowest expected bond yield) to B/B (lowest rated credit quality, highest expected bond yield) and unrated certificates.

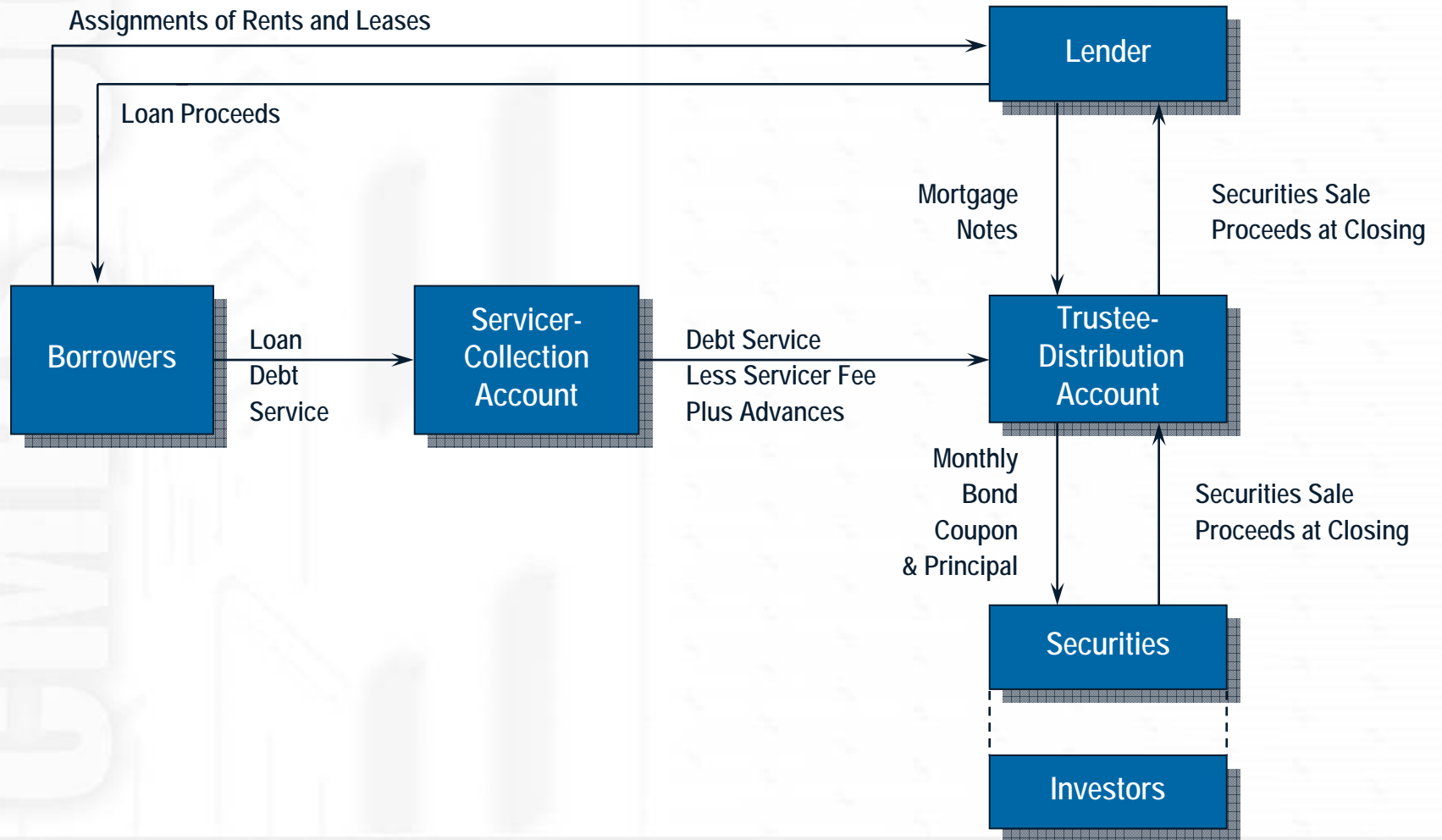
The Participants in a Securitization

7	Master Servicer:	Pursuant to the PSA, the master servicer is responsible for servicing all mortgage loans owned by the trust, which are not in default. These responsibilities include processing and (in most cases) approving borrower requests, collecting debt service and escrow/reserve payments due from the borrowers, and compiling property and borrower information.
7	Primary or Sub Servicer:	Will act on behalf of the master servicer as the main point of contact with the borrower and carry out related master servicer responsibilities. The primary or sub-servicer may be the originating mortgage bankers, typically hired by the Master Servicer. Typically, has no authority to make decisions regarding loan modifications. The Primary or Sub-Servicer is often the initial point of contact for the borrower for servicing questions and loan issues.
7	Special Servicer:	Pursuant to the PSA, the special servicer is named at the issuance of the CMBS to be responsible for servicing any mortgage loans that may default in the future. This role is many times performed by an affiliate of the B-Piece investor.
8	Rating Agencies:	Hired by the investment banker and issuer to assign risk of loss ratings on certain bonds/certificates issued for a securitization transaction. After the securitization funds, the rating agencies will continue to monitor performance of the trust's assets and certificates. There are 4 independent rating agencies: Moody's Investors Service, Standard and Poor's, Fitch, and Dominion Bond Ratings.

The Participants after the Securitization is Completed



Where the Money Goes



Where the Money Goes

▶ Borrower

- Assigns mortgages and leases in return for loan from loan originator (at loan closing)
- Remits monthly debt service to servicer collection account

▶ Loan Originator/Loan Seller

- Deposits mortgage collateral in trust in return for issuance proceeds from the securitization, a portion of which is given to borrower in return for lien

▶ Servicer

- Remits debt service (plus advances, less servicing fees) to trustee distribution account

▶ Trustee

- Distributes to investors certificate interest and principal, as specified in the trust agreements, from trustee distribution account

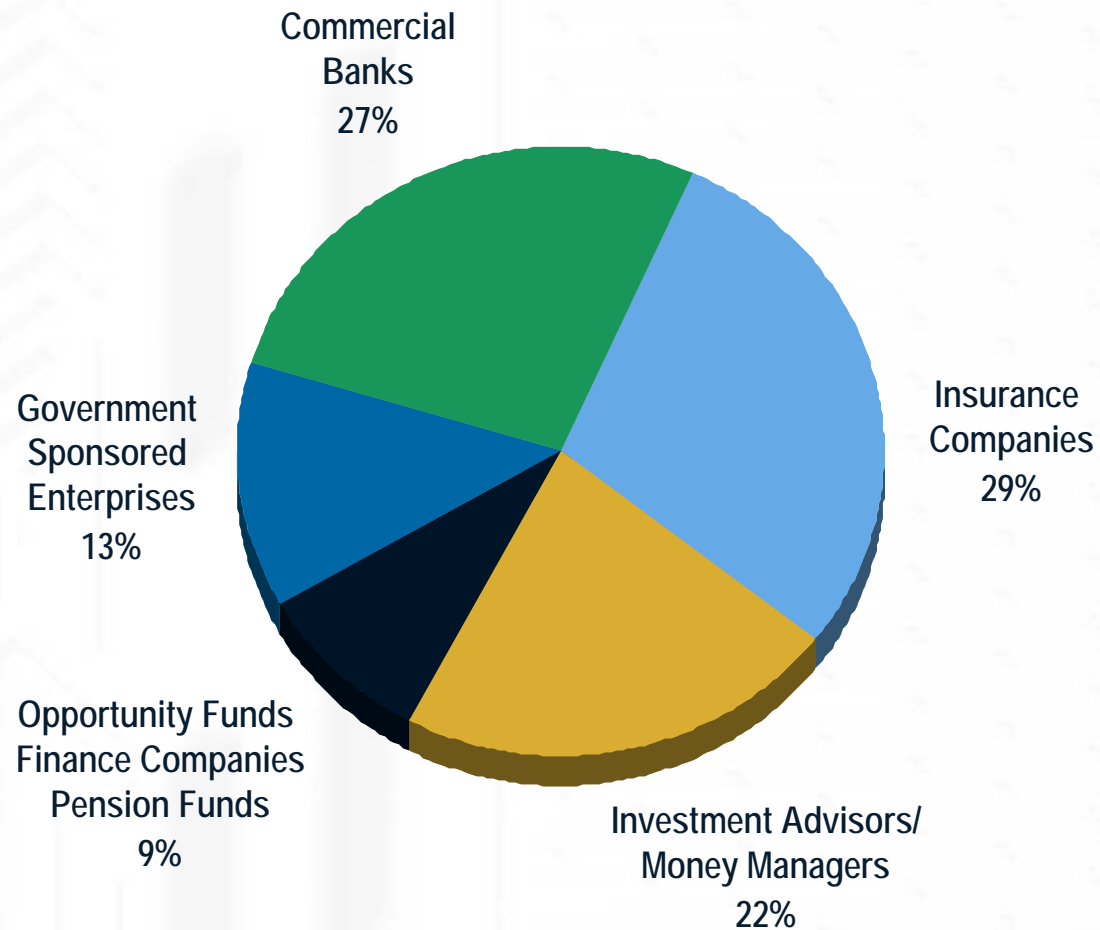
▶ Investors

- Purchase certificates and receive certificate interest and principal

CMBS 001 — Part 2

The CMBS “Lender”

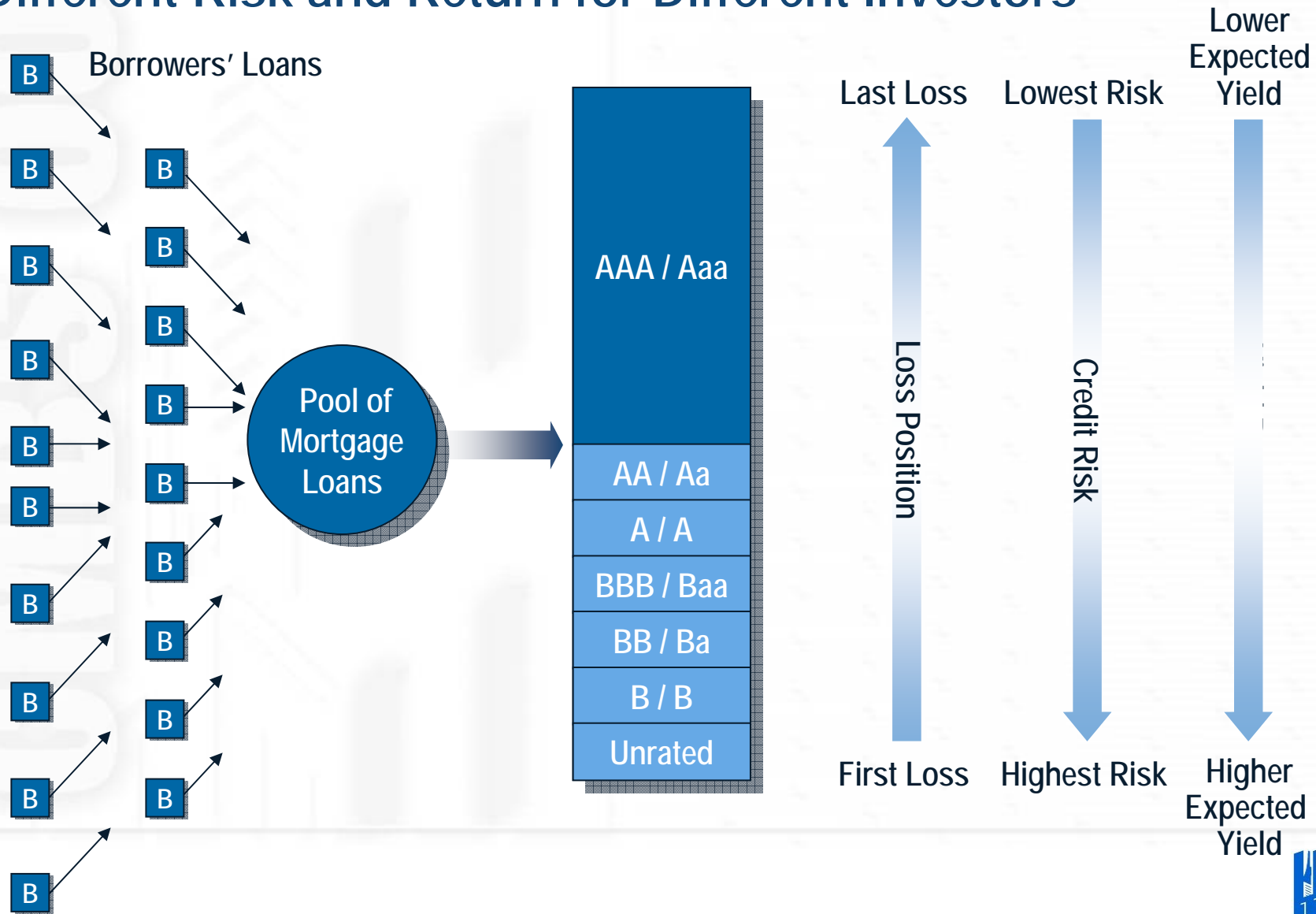
Purchasers of CMBS



Source: Morgan Stanley



Different Risk and Return for Different Investors



Who is the Lender? (Post-Closing of CMBS)

- ▶ In a **CONVENTIONAL LOAN** — The lender is **one entity** funding the loan, processing payments, processing any changes (such as assumptions, or releases), receiving all P&I payments and receiving early prepayments, working out a problem loan
- ▶ In a **CMBS LOAN** — All those functions associated with a traditional lender are handled separately by different parties — therefore, **the person to contact to inform or process any changes IS NOT NECESSARILY THE SAME ENTITY as the one which provided the funds for the loan**
- ▶ At the loan closing, a borrower will be informed as to the interim servicer for the loan. After depositing the loan into the REMIC Trust, a borrower will be informed as to the primary (or sub), master, and special servicers for their loan. The responsibilities of each servicing entity is governed by REMIC rules, the Pooling and Servicing Agreement (“PSA”), and the loan documents.

CMBS Is Just Another Source of Capital

- ▶ CMBS connects **sources of real estate capital to users of real estate capital** — creating a vehicle by which the investors involved in the fixed income capital markets can invest (or “lend”) their money with the real estate owners. A fixed income security is required — **CMBS is the vehicle to link these two markets.**
- ▶ Accredited investors in fixed income securities (“institutional investors”) can choose to invest their funds in CMBS, or in US Treasury Bonds, or in ABS or MBS or High Yield Corporate Bonds.....**why do investors choose CMBS?**
 - Value relative to other bonds
 - Performance track record
 - Call protection (lack of prepayability)
 - Secondary market liquidity

CMBS 001 — Part 3

CMBS — It's Not For Every Loan: Disclosure on Suitability of CMBS for Various Types of Real Estate Loans

The Definition of a REMIC

A Real Estate Mortgage Investment Conduit or “REMIC” (also referred to as “the Trust”) : An entity that owns a pool of mortgage loans and elects to be treated as a REMIC for tax purposes. The Trust issues multiple classes of investment interest (each with different payment, yield and maturity features) and is not subject to entity level federal income tax if it complies with the IRS rules governing REMICs.

To qualify as a REMIC, among other requirements, the entity's assets must consist primarily of a **fixed** (or static) pool of “qualified mortgages” (defined in the IRS regulations as obligations principally secured by interests in real estate). A REMIC generally cannot purchase new loans or sell existing performing loans. If a loan in a REMIC is modified, the loan may lose its designation as a qualified mortgage and/or be deemed to have been paid off and replaced with a new loan. This would violate the REMIC rules and could result in the entity becoming a taxable entity and the income from a deemed loan disposition being taxed at a rate of 100%.

Loan modifications resulting from the borrower's exercise of a unilateral option in its loan documents or by operation of provisions in the mortgage loan documents in effect at the time of the securitization, do not violate the REMIC restrictions. Generally, releases, substitutions, additions and alterations as to collateral can occur after securitization if the loan documents at securitization contain proper provisions. Collateral substitution, in the form of a defeasance is permitted, however, defeasance too is prohibited during the first two years after the securitization. The lender may require the borrower to obtain legal opinions from tax counsel stating that a proposed action or modification will not result in a REMIC violation.

The Definition of a REMIC

- ▶ **REMIC receives “pass through” federal income tax treatment**
 - The Trust owns loans secured by real estate
 - The Trust elects special REMIC tax treatment, and must comply with its rules
 - The Trust issues multiple classes of securities

- ▶ **REMIC is a passive investment vehicle**
 - The mortgage loans are “fixed” when deposited into the REMIC
 - The Trust can not make loans, buy new loans, or sell performing loans
 - The Trust must comply with IRS rules as to modification of performing loans

Loans Suitable for CMBS

Not All Commercial Mortgages or Properties Are Appropriate for Securitization:

Mortgages Suitable For Securitization	Mortgages NOT Suitable For Securitization
<ul style="list-style-type: none">• Properties with stabilized and regular cash flows	<ul style="list-style-type: none">• Turn-around assets where cash flow might change materially in the near-term or medium-term future• Properties that might need major reconfiguration• Properties with highly uneven cash flows
<ul style="list-style-type: none">• Generic/conventional property types (retail, office, multifamily)	<ul style="list-style-type: none">• Unconventional property types (nursing homes, hospitals, assisted living facilities, marinas, golf courses)• Operating businesses
<ul style="list-style-type: none">• Either fixed- or floating-rate loans, but probably not less than 5- or 7-year terms and preferably 10-year terms	<ul style="list-style-type: none">• Very short term loans, i.e., less than 3 years
	<ul style="list-style-type: none">• If a borrower wants to pre-pay the mortgage, be prepared for defeasance which can be costly and inefficient for small mortgages (i.e., under \$5mm)

Loans Suitable for CMBS

Not All Commercial Mortgages or Properties Are Appropriate for Securitization:

Mortgages Suitable For Securitization	Mortgages NOT Suitable For Securitization
<ul style="list-style-type: none">• Properties where no modification is necessary, or properties where modifications can be made pre-securitization (e.g., properties where the borrower can speed things up by providing all necessary information before the loan is sold into a securitization and requesting simultaneous review by all parties (servicer and, possibly, rating agency).	<ul style="list-style-type: none">• Properties with incomplete information or where information for the asset is difficult to consolidate or compile.
<ul style="list-style-type: none">• Properties and/or borrowers that are capable of and amenable to timely (quarterly) reporting to third parties on property performance, preferably electronically.	<ul style="list-style-type: none">• Properties and/or borrowers that do not lend themselves to regular and timely reporting.
<ul style="list-style-type: none">• Borrower has the flexibility to acquire ownership of the property in (or convey ownership to) a newly-formed entity, whose organizational documents contain single purpose bankruptcy remote and securitization friendly operating covenants.	<ul style="list-style-type: none">• Properties that can not easily or economically be acquired in or owned properties that can not easily or economically be conveyed to a new entity. For example, such a conveyance could trigger transfer tax liabilities.

Loans Suitable for CMBS

Not All Commercial Mortgages or Properties Are Appropriate for Securitization:

Mortgages Suitable For Securitization	Mortgages NOT Suitable For Securitization
<ul style="list-style-type: none">• Properties with extremely low probability that the borrower will want or need to release or further develop a material portion of the mortgaged property, expand current improvements or add property to the mortgage collateral, unless the borrower can anticipate such future requirements and negotiate loan document provisions to address and permit its needs. Loan assumptions in connection with property transfers are generally not problematic.	<ul style="list-style-type: none">• Properties with high potential for future development, out parcels, excess land and where borrower is unsure about prospects for future use and development of the property and cannot anticipate the criteria for future loan modifications or subordinate debt requirements.

CMBS 001 — Q&A

CMBS 001 — Appendix

More Information: Further Information about CMBS

Much More Information

- ▶ Glossary of CMBS Terms *(published by CMSA)*
- ▶ List of top loan contributors to CMBS *(published semi-annually in Commercial Mortgage Alert)*
- ▶ Typical Terms of a CMBS Loan *(provided as attachment from a major conduit issuer)*
- ▶ Details of CMBS Transactions *(published weekly in Commercial Mortgage Alert)*
- ▶ The MBA/CMSA "Borrower's Guide to CMBS" *(published by MBA and CMSA)*

Typical Terms for a CMBS Loan

Loan Amount Minimum:	\$3,000,000
Loan Amount Maximum:	Standard conduit maximum of \$30MM on large loan, however "stand-alone" execution is unlimited amount
Location:	Nationwide
Eligible Properties:	Multi-family, retail, office, industrial, as well as mobile home parks, self-storage and lodging considered in some conduit programs
Term:	<i>Fixed Rate:</i> 5–7–10-year maturities with balloon or 15–20-year fully amortizing <i>Floating Rate:</i> Up to 3–5 years with extension options
Amortization:	Maximum 30 years, sometimes shorter
Loan-to-Value:	Maximum 80%
Debt Service Coverage:	Minimum 1.20x
Interest Rate:	Fixed over Treasury or floating over LIBOR (subject to floor)
Prepayment:	<i>Fixed Rate:</i> Lock-out with defeasance option <i>Floating Rate:</i> Prepayable after 12 months with exit fee
Assumable:	Permitted subject to lender approval and 1% assumption fee
Loan Fee:	0% to 1% of loan amount depending on loan size and asset strength
Security:	First lien mortgage on completed and leased properties
Subordinated Debt:	Not permitted, though in some cases, may be structured in up front
Borrowing Entity:	Single asset or special purpose entity required in most cases
Third Party Reports:	Current engineering report and Phase I environmental reports meeting conduit specifications are required Seismic reports are required for California properties and other risk locations
Appraisal Report:	Current appraisal conforming to FIREA and USPAP guidelines required
Reserves:	Taxes and insurance resources required; replacement reserve, property specific reserves and deferred maintained reserves may be required

