



Best Practices in Pricing and Acquisitions of Portfolios

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**MBA's Commercial Real Estate Finance/
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Market Overview & Valuation Considerations

Commercial Servicing Right Commercial Whole Loans



Market Overview & Valuation Considerations

Overview of 2005 Servicing Market

- Values for seasoned CMBS, FNMA, FHLMC, GNMA & FHA servicing rose approx. 10-15%.
- Prices on new issue CMBS servicing was strong in 2005. Approx. half of all new CMBS servicing is competitively bid in regular dealer auctions.
- Agency MSR portfolio sales volume was light in 2005.
- Most Portfolio owners continue to hold on to MSRs not wanting to sever relationships with their borrowers.
- M&A activity was lighter in 2005 than 2004. However, consolidation is continuing at a modest pace.



Market Overview & Valuation Considerations

Commercial MSRs -Market Dynamics

- Most of servicing growth over the past five years is through either new master and primary CMBS purchases or through corporate acquisitions.
- Servicers are continuing to specialize in product niches such as GNMA/FHA, FNMA DUS, CMBS, Life Company and Special Servicing.
- Servicing income continues to be viewed as a hedge against a decrease in origination income & vice versa.
- Default rates are creeping upwards and could decrease the overall attractiveness of the asset.
- Technology is lowering the cost to service commercial loans resulting in rising servicing values.



Market Overview & Valuation Considerations

Commercial MSRs -Valuation Considerations

- Each loan has its own unique servicing cash flow and should be valued individually.
- Difficult to do a apples-to-apples comparison of servicing even within the same investor type.
- FHA, GNMA, and FNMA DUS loans consistently produce the highest positive servicing cash flows due to a combination of high servicing fees, high replacement reserve balances and longer average life.
- CMBS servicing generally produce the lowest positive cash flows due to their lower servicing fees, lower net escrow earnings and shorter average life.



Market Overview & Valuation Considerations

Commercial MSR's - Major Valuation Factors

- Prepayment Speeds
- Earnings Rates on Escrows and P&I Float
- Discount Rate or Required Yield
- Earnings Spread on Replacement Reserves
- Cost to Service
- Draw Rate of Replacement Reserves
- Float Days for P&I Remittance
- Default Rates



Market Overview & Valuation Considerations

Commercial MSR's - Trends for 2006 and Beyond

- The overall supply of servicing for sale should drop due to a decrease in new CMBS issuance.
- Prices for all Commercial MSR portfolios will continue to stay strong as higher short term earnings rates improve returns.
- Demand for MSR portfolios will continue to outpace the supply.
- Overall Industry consolidation will continue to escalate in the foreseeable future.
- Servicing efficiency levels will continue to be redefined.



Market Overview & Valuation Considerations

Commercial MSR's - Trends for 2006 (Cont.)

- Servicing platforms will expand into new product types and geographical markets.
- Regulation AB compliance will increase the pressure on small primary servicers.
- Servicing is transitioning from the back office to a business- the costs, work, legal and risks associated with servicing are play a increasing role.
- Barrier to entry- technology and operational costs of portfolio due diligence favor the larger more well capitalized companies.



Market Overview & Valuation Considerations

Overview of 2005 Commercial Whole Loan Market

- Market is growing rapidly based on number of sellers, transactions, and asset value.
- Actual trading is still in nascent stages with 2-3 year buy sell cycle.
- Each loan has its own unique cash flow and should be valued individually.
- Difficult to do a apples-to-apples comparison of loans even within the same property type or geographical market.
- Performing loan values are financial factor driven which has capital markets implications.
- Non Performing and Sub Performing loans are collateral driven which means local knowledge or interest impact pricing.



Market Overview & Valuation Considerations

Commercial Whole Loans – Valuation Considerations

Common Reasons Institutions sell:

- Concern about weakening sectors or markets,
- Anxiety about analysts expectations and earnings,
- Time allocated to unimportant or slow workouts,
- Impact of Basel II on valuations and profitability,
- Risk concentrations, and
- Transparency.



Market Overview & Valuation Considerations

Commercial Whole Loans – 2006 trends

- Offering size continues to drop.
- Increasing granularity within offerings, i.e. match risk to best buyer.
- Increasing standardization.
- Increasing frequency sales.
- Building the foundation for active portfolio management.