

Global CMBS Newsletter

Volume 3, Issue 2, January 18, 2008

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WHAT A DIFFERENCE A YEAR MAKES!

At the 2007 CMSA Investors Conference in Miami last January, everyone was manic coming off a record year of issuance in 2006. At that conference, some people (not many) thought that there might be stormy weather ahead, but they were mostly overshadowed by those who saw nothing but smooth sailing and clear skies. The 2008 CMSA Investors Conference had a very different tenor, with the shared perception of a market slowdown – the only question being, How slow and for how long?

Even though no one at the 2008 CMSA Investors Conference in Miami earlier this month thought the sector would implode, the general sentiment was that 2008 U.S. issuance would be in the range of \$100 billion to \$120 billion, roughly half of 2007 issuance, harkening back to 2004, when underwriting was based on cash flows, real estate fundamentals and exit strategies. To paraphrase power borrower Jay Weaver, principal at Walton Street Capital, LLC, in the “What Happened to the Three Martini Lunch?” panel, which was made up of the most prominent borrowers in the sector, hope and optimistic financing are gone. The consensus this year is that the fast money is gone (at least for now), leaving the traditional players in the market – traditional buyers who want to be able to invest in solid real estate assets and traditional issuers who want to be able to sell the entire deal.

Last year, we were talking about the need to watch out for overbuilding and overvaluation; this year we were trying to shake the contagion of the subprime market, which with its broad brush has tarnished anything mortgage related. Although not directly infected, the CMBS market does exhibit exposure to similar strains of indiscriminate loan origination. Perhaps it is this exposure that precludes our participation in the flight to quality. Tony Premer, vice president of Real Estate Finance at Pacific Life Insurance Company, equated the current market to the Revenge of the Nerds in that his team of originators is hoping to get back to sound (some might say nerdy, boring, unimaginative) underwriting standards when bidding on loans. He expressed another theme that found consensus among others as well – not trying to hit home runs on deals nor trying to strike out, but rather trying to stay consistent with singles and doubles.

At the 2007 conference, some people were espousing the theory that rating agencies had been too conservative in the previous year (i.e., that the performance of the sector justified even lower subordination levels). Ironically, at the 2008 conference, as the credibility of the big rating agencies was repeatedly questioned, they seemed to be fighting each other over which one was first to adjust its methodologies to a more conservative nature (i.e., calling for higher subordination levels).

At last year’s conference, we felt like we were sailing on the high seas with some avoidable hazards on the horizon and an uncertain weather forecast; this year, however, we are a ship on the rocks unsure of whether the tide is coming in (to help restore the market) or the tide is going out (forewarning more rough times ahead). The industry may not be as euphoric and heady as we felt coming out of last year’s conference, but it is still a sound market for investing capital. As Larry Duggins, executive managing director of Centerline Capital Group, so eloquently said in the Investor Forum: “I am deploying capital. Why not you?”

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