Nomura Fixed Income Research

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October 2006 CMBS Monthly

November 7, 2006

In This Month's Issue…

Commercial Real Estate 2007 Preview

On October 19th, the Urban Land Institute and PricewaterhouseCoopers published their annual Emerging Trends in Real Estate® report for the year 2007.[1] This comprehensive report was compiled with the help of over 600 commercial real estate professionals spanning investors, developers, lenders, brokers, etc. While we would recommend that investors read the entire report, we provide a few of the highlights and major themes below:

No More Easy Money! Investors will have to refocus on operating performance to generate alpha, as the days of significant cap rate compression/property appreciation are likely over. However, positive fundamentals leading to decent income growth, and abundant capital (mainly from institutional sources) should keep returns slightly above historical averages during 2007.

Investment Prospects During 2007: From a total return standpoint, Asian private direct real estate investments were ranked #1 by the interviewees,[2] followed by U.S. private direct real estate investments, and international equities. CMBS and U.S. equities settled into the middle of the pack, while publicly traded homebuilders and U.S. High Yield Bonds brought up the rear.

Cap Rates: Respondents expect cap rates across all property types to rise, albeit modestly, by December 2007. The increases range from about 30 bps (R&D Industrial and Warehouse Industrial) to 70 bps (High Income Apartments).

Wall Street's Expanding Influence: A prolonged period of good performance has led to investors' perceptions of commercial real estate as a "must have" asset class, especially as equities and bonds have struggled. In addition to traditional vehicles, such as REITs, institutional advisors (some of whom are subsidiaries of Wall Street conglomerates) now offer core, value-add, and opportunistic CRE funds that are marketed to pension funds, high net worth individuals, 401k participants, etc. CMBS and Commercial Real Estate CDO issuers also offer another avenue of investing in the

[1] The Urban Land Institute (ULI) and PricewaterhouseCoopers LLP. *Emerging Trends in Real Estate 2007*. Washington D.C.: ULI – the Urban Land Institute, 2006.

[2] The report notes that having a local partner who is familiar with the rules and regulations of each locale is key to help mitigate the risk of foreign real estate investments.

This report and others are available online at Nomura's research website. To obtain a user id and password, please contact Diana Berezina at dberezina@us.nomura.com. The web address is **http://www.nomura.com/research/s16**

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property markets, and in the past two years have offered roughly $500 billion in securities globally. These also find their way into pension funds, endowments, and recently, to high-net worth investors. And even though, as the report says, many end investors have hardly a clue as to what properties ultimately back their holdings, this all adds up to additional capital in the market.

Property Types: Due to rising mortgage rates, positive demographic trends, and pricey housing all leading to more demand for rentals, multifamily stands as the number one investment from the standpoint of this year's respondents.[3] Full service hotels were ranked #2, down from #1 last year, as 2007 and perhaps even 2008 are expected to be strong years, but investors believe the market is at or near its peak. Potential overbuilding concerns are keeping limited service hotels in the middle of the pack, despite recent big revenue gains. Warehouse industrial, as usual, stays in high demand among investors, who love the long-term steady cash flows. Office properties improved based on the expectation that higher occupancies will lead to higher rents, while retail properties registered marginal declines because of concerns related to energy prices, the housing markets, and borrowing costs. In terms of location, 24-hour "global gateways," such as New York, Washington D.C., Los Angeles, San Francisco, and more recently, Seattle, are favored, while the Midwest may struggle.

Underwriting Standards: Roughly 69% of respondents believe that 2007 will bring tighter underwriting standards to the commercial/multifamily mortgage market.[4] The race for market share amid increasing competition has evolved from offering interest-only periods to weaker covenants (in some cases, even non-recourse loans), overly optimistic revenue projections and appraisals, higher leverage, lower debt service coverage, etc. While market players seem to agree that the market will be healthy in terms of credit during 2007 absent an exogenous shock, there is a sense that the reckoning is coming down the pike. Delinquencies and defaults "have nowhere to go except up," and refinancing recent and current vintage loans that are priced to perfection may be tough in a higher interest rate environment.

Risks: So what do market players see as the biggest risks for commercial real estate in 2007? In terms of economics, job growth rates, interest rates, inflation, income and wage growth, and energy prices are all seen as having "considerable importance" to the CRE sector. The threat of terrorism and immigration are the top two social/political issues mentioned, and material, land, and labor costs are the hot button topics as far as development goes. Indeed, thus far in the cycle, it is the high cost of material, land, and labor that has kept supply in check across most regional markets.

Recommendations and Opinions

- **U.S. CMBS Issuance will likely remain strong for 2007 -** given the additional issuers entering the market during the past few years, abundant capital, and the multitude of new buyers across the entire capital stack - with volumes comparable to the '05-'06 figures. $10-$15 billion per month could become the new "norm" for fixed-rate issuance. Worth noting also is the fact that the loans "rolling over" in the next few years will likely add more volume to the market than their current balances imply – for example:

  Let's say a $7 million loan originated in 1997 is rolling over in early 2007. At the time of origination, leverage of about 70% was the standard, putting the property value at ($7 mm / 70%) $10 million. Being somewhat conservative, assume the property value has increased to $12.5 million over the past 10 years. In the current environment, loans can get done at roughly 80% LTV, meaning that the new property would contribute $10 million worth of debt to a current deal – approximately 40% more volume than it contributed to the 1997 vintage deal.

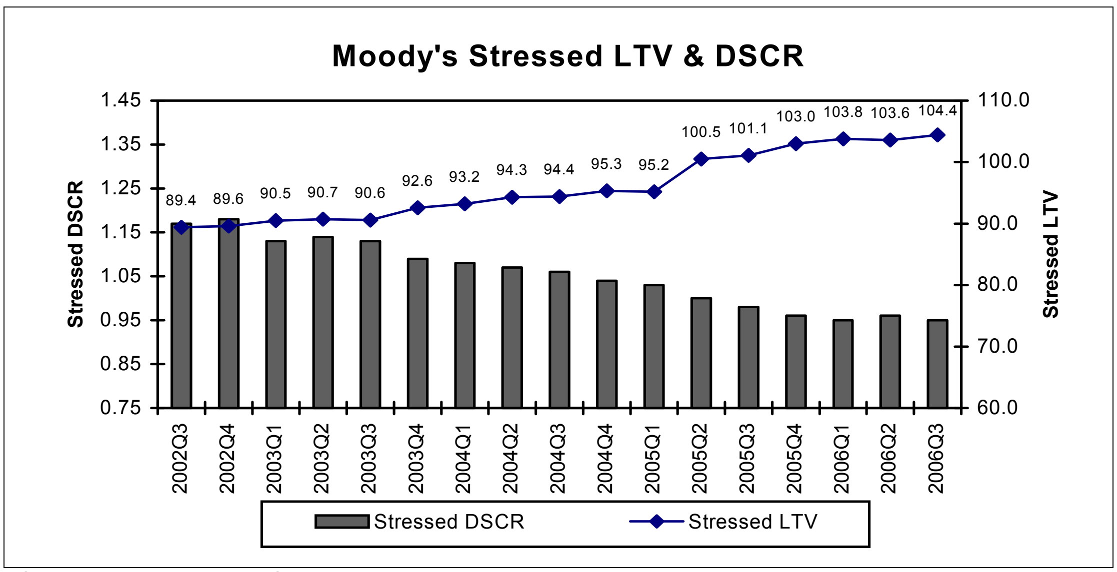
- **Some Thoughts on CMBS Relative Value Across the Stack**
  - Overall, with roughly $35 billion in fixed-rate supply expected during the next two months, and the annual liquidity crunch (Thanksgiving/Christmas/Hanukkah) season a few weeks away, CMBS spreads may soften up a bit from their recent steady performance. That being said, we believe buyers will emerge on any significant widening, and see a +25/26

[3] Moderate income rentals were #1, while high income rentals were ranked #3.

[4] 25% of respondents believe underwriting standards will remain unchanged, and 6% believe they will be less stringent.

backstop on 30% classes. A positive for CMBS spreads is that spreads on mortgages and corporates appear to be hanging around their recent tights.

- Our inclination is that 30% classes, based on their perceived safety (e.g. at 40% loss severity, 75% of the pool would have to default in order for the class to incur a principal loss), *should* probably trade tighter than they do – however, from a buyer's standpoint, is there any reasonable upside if they start trading at or inside of S+20?
- In terms of 10-year AAAs, we like AMs the best (+25), followed by 30% classes (+22), and AJs (+28)
- AAs at +6 versus AJs are moving towards fair value - remember, earlier this year they traded at +2 versus AJs - but still aren't quite there yet. +8-10 seems more reasonable, similar to the spread pick-up currently available between AAs (+34-35) and single-As (+44-46)
- Consider the following: In the new issue market, an investor currently picks up 6 bps moving from 30% to 12% credit enhancement (30% to AJ). The same pick-up of 6 bps is available by moving from 12% to 10% C/E (AJ to AA). Intuitively, this appears to be a mis-pricing of the risk/reward profile…
- New issue BBB and BBB- classes trading at 80 and 95 bps over Swaps seems aggressive, given current subordination levels, and the fact that stressed LTVs continue to rise and stressed DSCRs continue to fall (see Moody's 3Q 2006 report[5]). Default and loss studies have repeatedly shown that the levels of DSCR and LTV are strongly correlated to the credit performance of CRE loans. We would especially urge caution to cash and synthetic CDO investors buying deals backed by this type of collateral, as the CDO issuers must effectively be "financing/selling" these assets at even tighter levels in order to make it worth their while. Our advice is: Stay up in credit!



Source: Moody's Investor Service

- At current spread levels, the bottom (first-loss) class of the synthetic resecuritization of triple-A-rated tranches looks attractive compared with fusion CMBS pricing. It offers a nice spread pick-up to triple-B and triple-B-minus classes from new fusion CMBS deals. Due to lax underwriting and low credit enhancement levels in a new issue CMBS, we believe that the bottom class of the re-securitization is likely safer, from a credit perspective, than a BBB- fusion position. Note, however, that tight spreads in AAAs may make these deals hard to find right now.
- Levered/Support IO Classes – Positive credit performance and the expectation that many loans in the current vintages will extend - producing a windfall for the levered/companion IO classes - has pushed spreads on these securities into very tight levels, in some cases, Treasuries +100 or lower! We don't see significant upside here, and would urge investors to undertake extensive scenario analysis in order to measure the positive yield effects of speeds less than 100 CPY and extensions versus the negative effects of defaults.

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[5] Philipp, Tad, P. Obias & P. Dent, "US CMBS and CRE CDO 3Q 2006 Review: The Double-A Environment – Ambivalence and Anxiety," Moody's Investors Service, October 31, 2006.

Miscellaneous Items

Senior Loan Officer Opinion Survey

In the most recent Senior Loan Officer Opinion Survey released by the Federal Reserve Board, 40% of respondent banks indicated that they had tightened standards on commercial mortgage loans, up from 23.2% last quarter. In addition, about 31% of respondents saw reduced demand for CRE loans this survey, versus roughly 16% in July. The trend of tightening standards is in agreement with comments made in the ULI/PWC report about life insurance companies. Market players agreed that they have definitely seen these investors becoming more conservative, for example, by avoiding bids against conduit lenders (who are willing to offer more borrower-friendly terms) on large loans. However, life insurance companies continue to invest in CMBS, which means that they still have exposure, albeit shared, to these loans - just at presumably lower risk levels (higher on the capital structure).

CMBX BB Tranche

During the week of October 25th, when the 2nd series of the CMBX was launched, there was a decent amount of trading in the AAA and BBB- indices. The eagerly awaited BB class initially tightened, and closed at 160 on the 26th of October, but has since widened to 174 bps (as of 11/6/2006), as activity dropped off.

Meanwhile, the 1st series of the BBB-, which likely contains deals with relatively stronger underwriting than series 2 (it trades at about a 11 basis point premium to the Series 2 BBB- class, although some of that premium may be based on liquidity & the recent trouble with MSC 2006-IQ11 – see below), continues to tighten, from 98.2 bps on October 2nd, to 70.0 bps on November 6th. The strong CDO bid is likely responsible for this, as BBBs and BBB- bonds in recent deals priced at all-time tights.

In other news, earlier in October, Derivatives Week reported that dealers are getting closer and closer to tranching the ABX index baskets (perhaps by year-end 2006), similar to trades currently available off of the corporate CDS indices. Perhaps the CMBX indices are next?

FAS 155 Wrap-up[6]

On October 25th, FASB decided to offer a limited scope exception for discount MBS/ABS/CMBS subject to prepayment from the requirement to either bifurcate the embedded prepayment derivative or mark-to-market the entire security through earnings.

The proposed limited scope exception applies to securitized interests that (1) **only** contain an embedded derivative that is tied to the prepayment risk of the underlying prepayable financial assets, and (2) the investor does not control the right to accelerate the settlement. If the security contains any other embedded derivative (e.g. an inverse floater), then it would be subject to the bifurcation tests in FAS 133, as would securities purchased at a significant premium.

The board plans to expose the guidance for a 30-day comment in the form of a FAS 133 Derivatives Implementation Issue in early November. After the 30-day comment period, re-deliberations would occur in mid-December and a final document would be issued in early 2007, in time for initial adoption of FAS 155 for most companies. For companies that have early adopted FAS 155, the guidance would be available in time to be reflected in their year-end financial statements.

LeNature's Pushed into Chapter 7

According to the Wall Street Journal, LeNature's Inc., the sole tenant on a $62.3 million loan in MSC 2006-IQ11, was pushed into a Chapter 7 bankruptcy proceeding on November 1st. The company is under investigation by federal prosecutors for allegedly falsifying financial statements. At first glance, the property in question (an industrial loan in Phoenix, Arizona) appears to be brand new and located near to the airport, which may limit the loss severity. However, working against the loan is that bankruptcy proceedings often take quite a bit of time to shake out, and even a 35% loss severity would wipe out 1.35% of the deal (up to a partial hit on the B+ rated class). Thus far, we have found one re-securitization with exposure to the bonds, Crystal River Resecuritization 2006-1 (only about $2 million total at the BB- to BB+ rating level). Of potentially further interest to investors is that the IQ11 deal is in the 2nd series of the CMBX, launched on October 25th. Spreads on the series 2 BBB, BBB- and BB indices have widened recently on the news.

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[6] The summary regarding FAS 155 was prepared by Martin Rosenblatt at Deloitte.

ISSUANCE TRENDS

Last 10 Conduit Deals													
Name	Px Date	Deal Size ($mm)	5yr AAA	10yr AAA	A-J	AA	A	BBB	BBB-	PAC IO	SUP IO	AAA Sub.	BBB- Sub.
MSC 2006-HQ10	11/01	1,491.0	19	22	28	34	44	80	95	N/A	N/A	12.00%	2.75%
CD 2006-CD3	10/23	3,571.4	18	22	29	35	46	80	100	N/A	N/A	11.75%	2.75%
WBCMT 2006-C28	10/19	3,595.2	17	23	29	35	45	80	95	N/A	N/A	12.25%	3.13%
BSCMS 2006-T24	10/18	1,534.7	16	21	27	33	43	70	90	70	125	10.38%	2.63%
GSMS 2006-GG8	10/17	4,242.9	17	22	28	33	43	80	95	N/A	N/A	12.88%	3.63%
BACM 2006-5	9/28	2,243.3	17	24	30	35	46	80	100	70	N/A	12.00%	2.88%
JPMCC 2006-LDP8	9/22	3,066.0	15	24	28	36	46	80	105	N/A	100	11.50%	3.00%
MLCFC 2006-3	9/22	2,425.0	15	25	32	36	46	80	105	71	150	12.13%	3.13%
LBUBS 2006-C6	9/22	3,115.1	15	23	31	34	43	80	105	70	135	12.50%	2.50%
CSMC 2006-C4	9/21	4,273.1	16	25	32	37	45	80	N/A	75	135	12.00%	2.88%

Source: Commercial Mortgage Alert, spreads for the IOs are to Treasuries, the rest are to Swaps.

Four new conduit and three floating rate deals, representing $12.9 Billion and $5.4 Billion respectively, were priced in October. This new supply brings year-to-date CMBS issuance up to $151.8 Billion, ahead of last year's pace ($133.7 Billion through Oct 2005). As we anticipated in our last edition, spreads tightened initially with the GG8 and T24 deals but then widened out again toward the end of the month and into November. In fact, the BBB/BBB- classes off the BSCMS 2006-T24 deal priced at all-time tights, reinforcing that the CDO bid shows no sign of easing. Should the CRE CDO market experience a downturn, the spread on the BBB/BBB- classes will likely widen significantly, to more "natural" levels. Consequently, we recommend caution where spreads drift too far astray from fundamentals.

CMBS/CRE CDO Pipeline			
Dealer(s)	Type	Amount (mil)	Timing
Lehman Brothers, Dillon Reade	Fusion	3,500	November
B of A, Bear Stearns, Bridger	Fusion	3,000	November
LaSalle Bank, Citigroup, PNC	Fusion	2,900	November
CWCapital, Wachovia, Deutsche, Citigroup, Artesia	Fusion	2,500	November
IQ brand (La Salle, Morgan Stanley, SunTrust, Mass Mutual)	Fusion	2,500	November
J.P. Morgan Chase, CIBC	Fusion	2,500	November
Merrill Lynch, Countrywide, IXIS	Fusion	2,500	November
Credit Suisse	Large Loans (Flt)	1,200	November
J.P. Morgan Chase	Large Loans (Flt)	1,200	November
Washington Mutual	Small Balance - Fixed	500	November
Deutsche, Barclays, B of A, GE Real Estate)	Fusion	4,500	December
Credit Suisse, KeyBanc	Fusion	3,500	December
LDP brand (J.P. Morgan, UBS, IXIS, others)	Fusion	3,500	December
Wachovia, Artesia	Fusion	3,200	December
PWR brand (Bear Stearns, Morgan Stanley)	Fusion	2,000	December
RBS Greenwich Capital	Large Loans (Flt)	1,500	December
LaSalle Bank	Small Balance - Fixed	500	December
CDO Pipeline	**Deal**	**Amount (mil)**	**Timing**
Merrill Lynch	Calculus 2006-SCRE CDO	800	N/A

Source: Commercial Mortgage Alert

Aside from the HQ deal, which priced early this month, seven more fusion deals are scheduled for pricing in November. If all of the deals in the pipeline price as planned, November will see over $20 Billion of new fixed-rate supply, and full-year issuance may test the $190-$200 billion range. Four CRE CDOs priced in October and we see one more planned for this month. Containing untraditional collateral and exhibiting various credit enhancement structures, it is difficult to compare and contrast CRE CDOs. However, as this market becomes increasingly more standardized and surveillance by rating agencies improves, investors likely will grow more comfortable with this investment product. Investors enjoy the exposure they gain to certain assets through CRE CDOs, which they could not otherwise attain through traditional cash CMBS. At the same time, in its recent quarterly report, Moody's warns that CRE CDOs have about half the diversity of CMBS conduits, urging investors to be extremely diligent in reviewing the underlying collateral. We urge the same practices, as all deals, issuers, and collateral pools are certainly not alike…

Non-US CMBS issuance was weak in October, with only $3 Billion in new supply. Year-to-date, $64.7 Billion CMBS has been issued in the non-US market, up from $57.4 Billion the same period last year. According to a survey of European institutional investors conducted by Citigroup[7], the majority of the investors were optimistic about the evolving securitization market. Those surveyed indicated that they expect spreads to remain at or close to their historical lows but not tighten in any further.

Average Deal Size and Number of Loans, 2002-2006 YTD Conduit Deals Only

	Average Deal Size	Average # Loans / Deal	Average % MF Loans	Average % RT Loans	Average % OF Loans	Average % LO Loans	Average % IN Loans	Average Top 10 %	% Full IO Loans	% Partial IO Loans
2006*	$2.43 bn	184	14.2%	32.0%	32.5%	11.0%	5.3%	40.0%	27.9%	45.7%
2005	$2.10 bn	170	16.0%	32.6%	33.5%	7.7%	3.8%	39.2%	26.4%	39.5%
2004	$1.26 bn	115	16.4%	36.2%	32.2%	3.1%	4.2%	43.8%	14.3%	30.7%
2003	$1.16 bn	126	18.8%	38.5%	29.2%	2.7%	5.4%	41.9%	8.5%	18.3%
2002	$1.00 bn	125	22.9%	36.5%	25.4%	1.8%	7.8%	38.2%	2.0%	8.5%

Sources: Trepp LLC, Nomura Securities International
*** 2006 data includes some deals that are currently in the market but not yet priced.**

Selected Conduit/Fusion CMBS Deal Statistics

Quarter	Avg Deal Size ($ BN)	% in Top 25 MSAs	% in MSA 26-50	UW LTV >= 80%	Full IO %	Partial IO %	5yr Term %	7yr Term %
4Q 2006*	$2.75	63.5%	13.1%	6.6%	40.7%	41.0%	15.7%	1.8%
3Q 2006	$2.33	62.6%	14.8%	4.4%	34.0%	42.4%	8.6%	3.8%
2Q 2006	$2.19	61.6%	13.8%	5.2%	22.8%	47.4%	7.7%	3.2%
1Q 2006	$2.47	59.5%	16.7%	5.4%	23.1%	48.1%	12.8%	4.7%
4Q 2005	$2.48	62.5%	14.3%	6.1%	24.4%	44.6%	10.8%	6.8%
3Q 2005	$2.18	57.4%	16.1%	7.8%	32.2%	36.6%	19.6%	8.0%
2Q 2005	$1.85	58.6%	16.3%	7.8%	27.3%	37.9%	18.7%	11.1%
1Q 2005	$1.77	55.6%	16.9%	6.3%	21.8%	34.6%	19.1%	10.1%
4Q 2004	$1.32	51.7%	19.7%	6.5%	17.7%	34.4%	17.1%	14.5%
3Q 2004	$1.23	55.7%	14.3%	5.5%	9.2%	31.0%	16.9%	8.6%
2Q 2004	$1.16	54.5%	18.1%	3.2%	16.6%	28.1%	16.9%	12.7%
1Q 2004	$1.26	53.6%	18.1%	4.3%	11.0%	27.9%	12.2%	11.3%
4Q 2003	$1.30	56.2%	16.3%	5.3%	11.3%	24.2%	14.4%	16.0%
3Q 2003	$1.13	54.1%	17.1%	3.5%	7.8%	13.0%	11.5%	5.8%
2Q 2003	$1.11	56.7%	16.7%	2.7%	5.7%	16.8%	12.1%	6.5%
1Q 2003	$1.06	58.2%	15.4%	2.4%	8.5%	18.2%	11.3%	4.1%
4Q 2002	$1.04	53.1%	17.2%	3.2%	3.5%	8.2%	8.2%	4.1%
3Q 2002	$1.09	48.6%	17.5%	4.8%	0.1%	13.2%	6.6%	4.4%
2Q 2002	$0.86	49.2%	21.2%	3.2%	1.4%	4.9%	5.5%	5.0%
1Q 2002	$0.88	52.0%	21.1%	1.7%	1.7%	8.3%	1.8%	3.2%

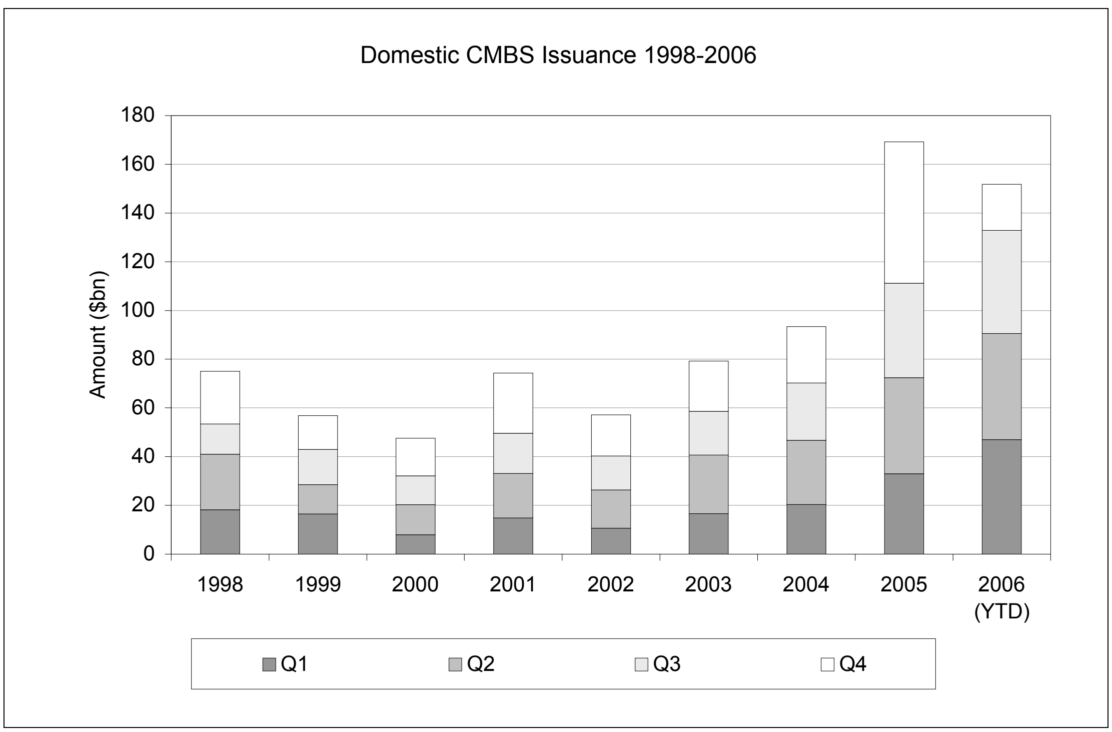
Sources: Trepp, Nomura Securities International
*** 4Q2006 data includes some deals that are currently in the market but not yet priced.**

[7] *Asset Securitization Report*, November 6, 2006.

Based on the deals that have priced thus far in 2006, the average deal size as well the number of loans included in conduit transactions appear to be growing. Although the share of the ten largest loans (40%) increased slightly from 2005, the Moody's Herfindahl score grew as well, indicating improved conduit loan diversity. After two quarters of subdued presence, the share of 5-year term loans grew to almost 16% in the new CMBS deals. Meanwhile, 7-year term loans represent merely 1.8% of the new underlying commercial mortgage pools. The percentage of loan pools with loan to value ratios (LTV) equal or greater to 80% has risen to 6.6% so far this quarter. Likewise, in its quarterly report, Moody's revealed that its stressed LTV for US conduit loans grew to an all-time high of 104.4% while its DSCR dropped to 0.95 in 3Q2006.

Loans on lodging properties remain elevated in 2006 deals as a result of improving sector fundamentals. According to Smith Travel Research (STR), RevPAR (revenue per available room) has risen 6% from the same period last year due largely to a 7% increase in the ADR (average daily rate) while occupancy is up 1% y/y. In addition, the ULI/PWC annual report points out that hotel conversions into condominiums have shrunk supply in a time of booming demand by corporate travelers and aging baby boomers. The same report warns however that as construction picks up in 2007 and 2008 and demand remains extremely dependant on economic factors, any sign of recession could potentially lead to problems for the sector. The share of office loans remains high as the sector enjoys a prosperous run. Judging by high employment, dropping vacancies, limited new supply and growing rents, the office sector is poised to perform well in the coming year. The percentage of loans on properties located in the top 25 MSAs is steadily rising, representing a positive credit phenomenon for the market.

The percentage of loans with IO periods (either full or partial) is now 75.9%, according to Moody's. We continue to view this as a concerning trend, increasing balloon risk at a time when property valuations are at or near their recent highs.



Sources: Commercial Mortgage Alert, Nomura Securities International

PRICING SPREADS

CMBS Spreads (November 3, 2006)													
		3mo				6mo				1yr			
	Last	Mean	Wide	Tight	Range	Mean	Wide	Tight	Range	Mean	Wide	Tight	Range
5-yr AAA / Swaps	20	18	20	16	100%	17	20	14	100%	20	27	14	46%
10-yr AAA / Swaps	25	25	27	24	33%	25	27	24	33%	28	33	24	11%
AA / Swaps	35	35	36	33	67%	35	36	33	67%	39	50	33	12%
A / Swaps	45	44	46	43	67%	44	46	42	75%	49	60	42	17%
BBB / Swaps	80	81	83	75	63%	80	83	75	63%	94	125	75	10%
BBB- / Swaps	95	105	110	95	0%	110	125	95	0%	137	185	95	0%
BB / Swaps	238	235	238	231	100%	234	240	230	80%	236	240	230	80%
B / Swaps	648	645	648	641	100%	644	650	640	80%	646	650	640	80%
5yr Floating AAA	8	9	11	6	40%	11	13	6	29%	14	18	6	17%
5yr Floating AA	22	23	29	21	13%	25	29	21	13%	28	33	21	8%
5yr Floating A	33	36	38	33	0%	36	40	33	0%	41	50	33	0%
5yr Floating BBB	73	78	85	73	0%	81	90	73	0%	94	115	73	0%

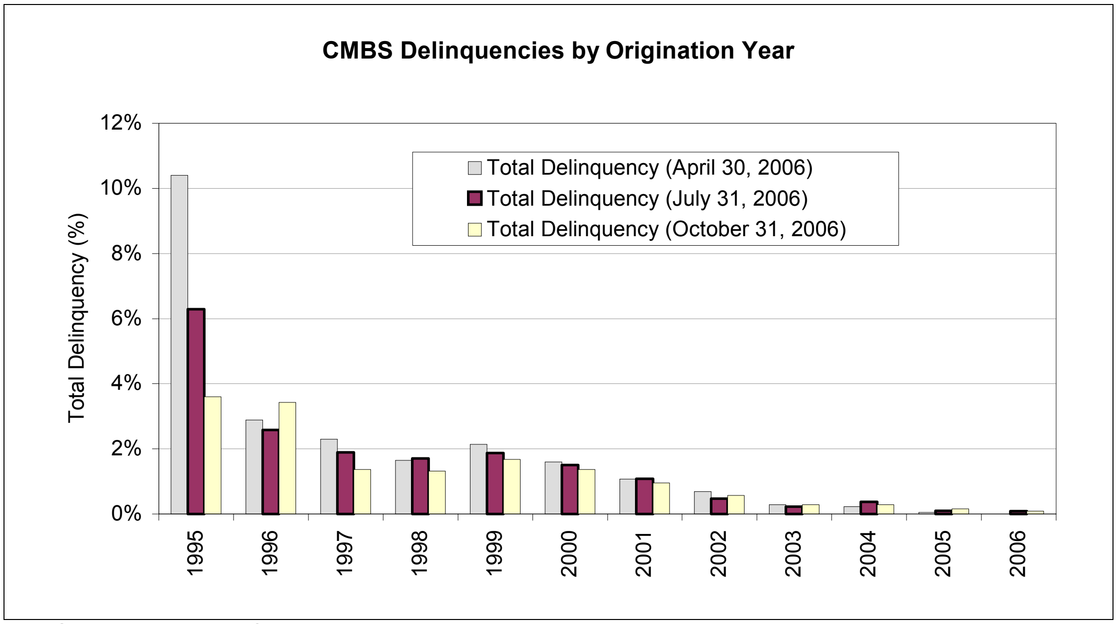
Sources: Bloomberg, Nomura Securities International. "10-year AAA" represents a blended spread.

The 5-year AAA class off the October deals experienced some widening and is now at its widest level in six months. This is likely due to increased supply and the U-shaped yield curve – as we noted earlier, the share of 5-year term loans in the new deals jumped to 15.7% in the deals starting off the fourth quarter, up from 8.6% the quarter before. The opposite is happening in the lower echelons of the capital structure as the BBB- class continues to price at historically tight levels. Despite the excellent credit performance and increasing liquidity in the CMBS market, we might still see some softening investor demand as we get closer to year-end, potentially widening out spreads.

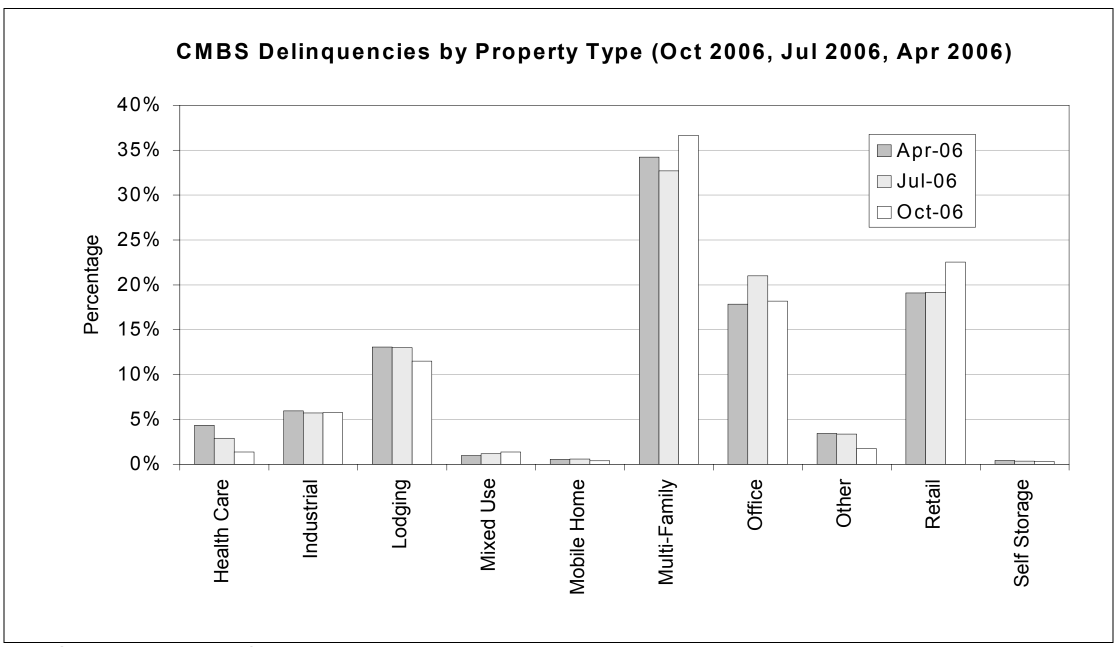
Pricing on Recent CMBS & CRE CDOs, (Spread to Libor, except where indicated)								
	Px Date	**Asset Type**	**Amount ($mm)**	**AAA C/E**	**AAA (front)**	**AA**	**A**	**BBB**
Ansonia CDO 2006-1	10/25	CMBS	806.7	63%	S+40	S+50	S+75	S+185
AMAC – I	10/18	CRE	400	37%	27.5	38	58	130
RAIT CRE CDO I	10/17	CRE	1,000	54%	35	45	70	170
Dillon Read Capital Mgmt*	10/4	CMBS	1,000	35%	35	45	70	175

Sources: IFR, MCM, and Bloomberg
***Synthetic Transaction**

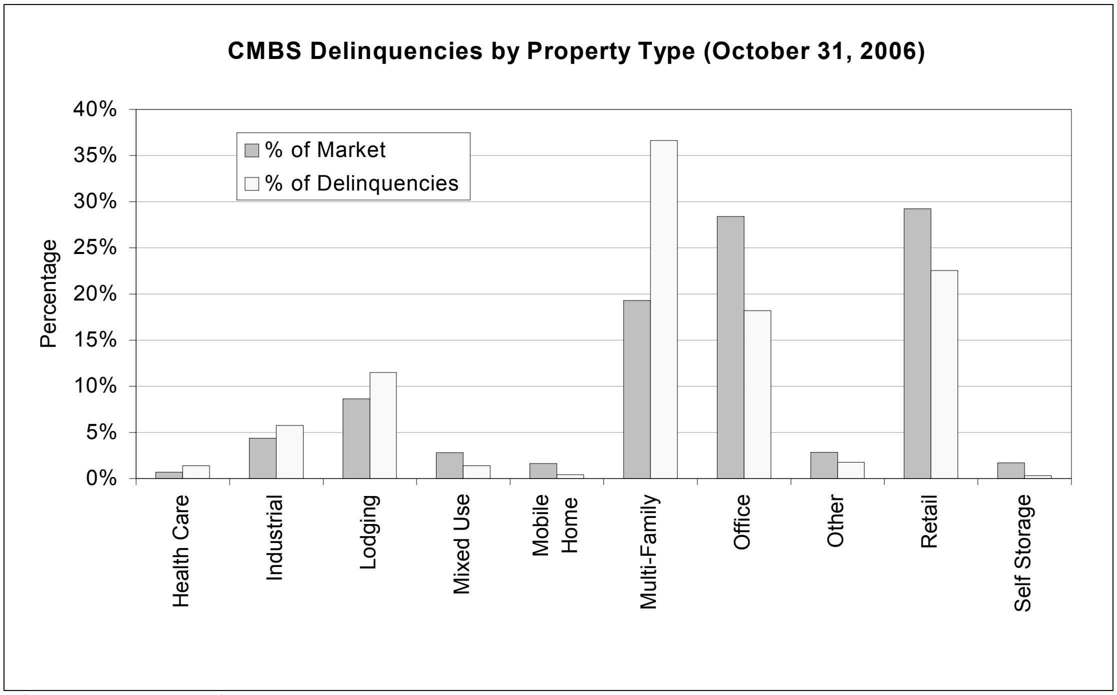
CREDIT



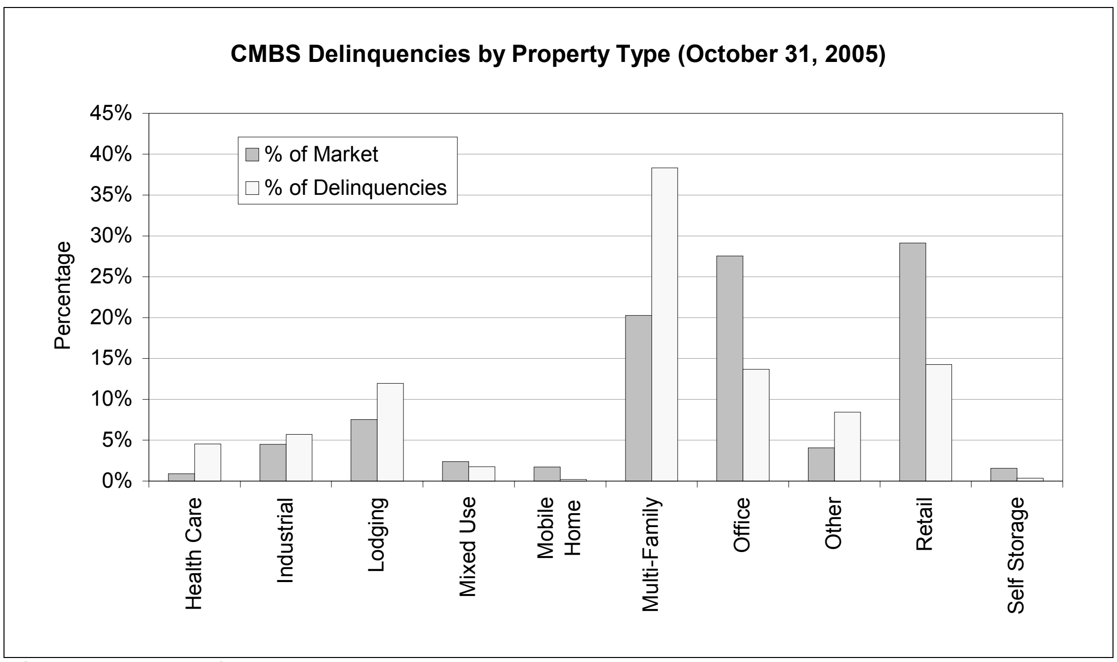
Sources: Trepp LLC, Nomura



Sources: Trepp LLC, Nomura



Sources: Trepp LLC, Nomura



Sources: Trepp LLC, Nomura

Credit performance in the CMBS market is as strong as ever, with a delinquency rate of merely 0.53% and a core (60+) delinquency rate of 0.43% – compared to 1.25% and 0.94%, respectively, a year ago. This stellar credit performance is attributable to multiple factors, namely property appreciation, healthy investor demand, heightened defeasance activity, burgeoning supply and increasing liquidity. Of the nearly $700 Billion CMBS currently outstanding, only $3 Billion is more than 60 days delinquent.

After showing some signs of recovery amidst "housing bubble" fears, the multi-family sector remains troubled, accounting for 36.6% of market delinquencies. Signaling improving fundamentals, REIS, Inc. reports that year-to-date asking and effective rents grew 3.1% and 3.4%, respectively. The REIS quarterly report also reveals that out of 75 metro areas, 60 markets experienced positive absorption and 55 recorded falling vacancies. The issue regarding abandoned condominium conversion projects returning to the rental market remains a concern. Consequently, REIS projects that while in 2006 effective rents will grow by 4.2%, increased competition fueled by the return of units, previously slated for conversion, will slow rent growth down in 2007 to 3.6%.

With its market share expanding and delinquency rate falling, the lodging sector has seen impressive credit improvement thus far in 2006. As we mentioned earlier in this report, favorable supply and demand conditions have been driving occupancy and revenues higher.

The office sector is having a good credit year as well. According to REIS, the gap between asking and effective rent has narrowed substantially as landlords cut back on concessions. Also, effective rent growth has almost tripled from the same period last year to 6.5%, from 2.2% in the first three quarters of 2005. Office vacancies slipped for the tenth consecutive quarter to 13.5%, implying that absorption continues to outpace new construction. However, REIS warns that construction activity will pick up speed in the fourth quarter from averaging 8.9 million sq feet in the previous three quarters to $20 million sq feet. This coupled with an expected slowdown in absorption leads REIS to project a drop in effective rent growth in 2007 to 4.4%.

Elevated gasoline prices, rising interest rates and slowing home price appreciation have taken a toll on the retail sector this year. With its market share virtually unchanged (at 29%), loans backing retail properties now make up 22.5% of the delinquent CMBS universe – compared to 14.2% the same time last year. According to Real Capital Analytics, transaction volume of retail properties fell for the fourth consecutive quarter with sales of significant properties totaling $9.2 Billion, 18% lower than a year ago. REIS reports that vacancies rose in 2006 as absorption (at its lowest level since 1Q2004) failed to keep up with new retail construction. As more completions are scheduled for 2007, we suggest caution concerning this sector.

All in all, we do not foresee any major credit events for the CMBS market over the next three to six months, barring any natural or manmade disasters, until more recent loans, aggressively underwritten due to high lender competition, have a chance to season and potentially encounter difficulties.

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