BUYER BEWARE
OR FULL STEAM AHEAD

WEBINAR HOSTED BY 1ST SERVICE SOLUTIONS

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AGENDA

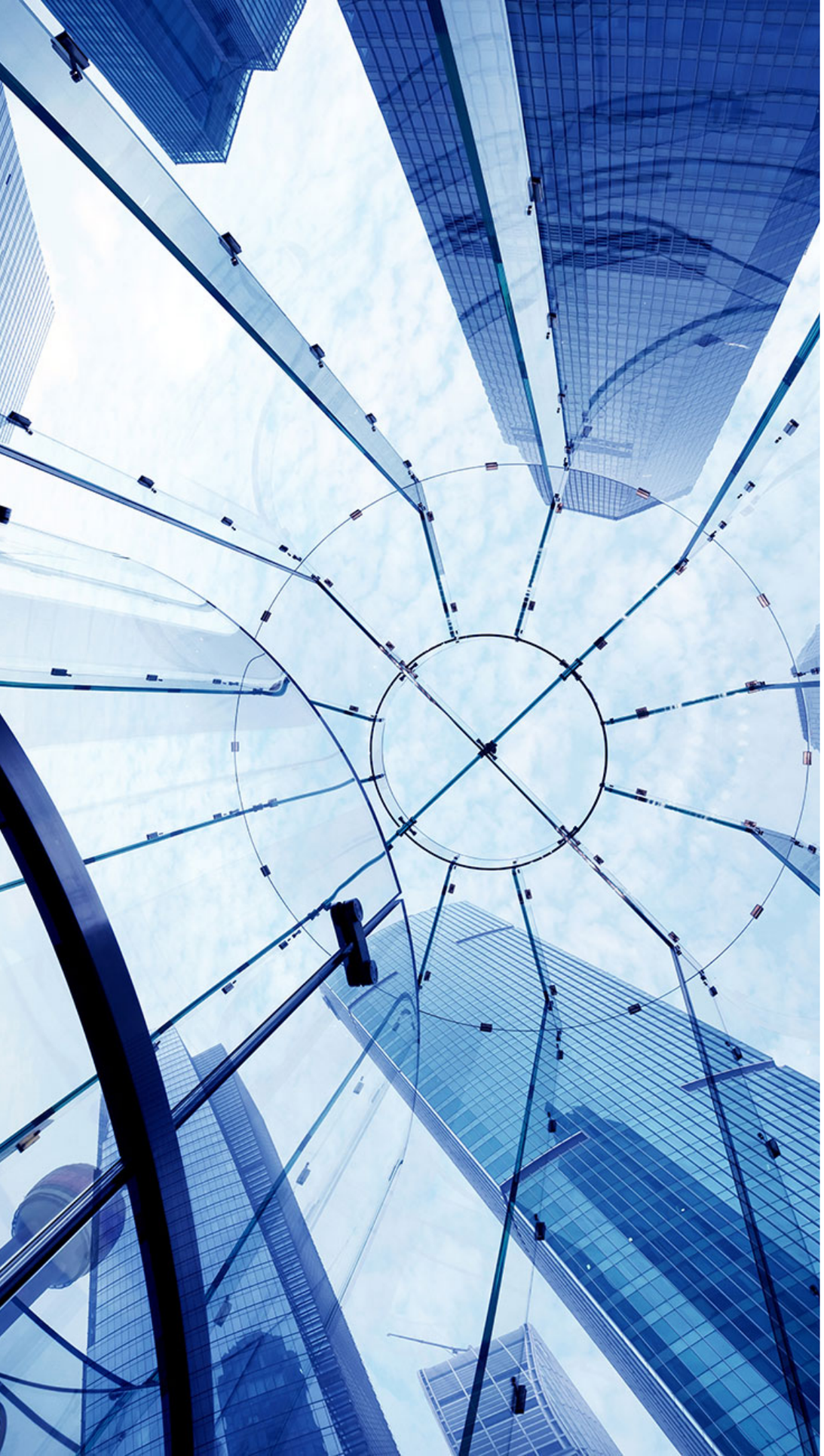
CMBS Structure Overview ..... *5 minutes*

CMBS Maturities & Borrower Options ..... *20 minutes*

CMBS 2.0 Loan Document Terms ..... *15 minutes*

CMBS Trends ..... *15 minutes*

- Oil affected properties
- Assumption conditions on newly originated loans
- Dodd Frank risk retention



CMBS

STRUCTURE

PARTIES IN A CMBS STRUCTURE

Loan Funded	Investment Banking Firm Creates Pool	Rating Agencies	Bonds are Sold	Special Servicer is Assigned
Borrower Lender	Loan contributed to Pool	Bonds are rated: AAA AA A BBB BB B UR Rated Master Servicer is assigned to Pool	Bonds are sold: AAA AA A BBB Investment Grade BB B UR Non-Investment Grade "B pieces"	B piece owner becomes Controlling Class Certificate Holder "CCR" "CCR" selects Special Servicer

EFFECT OF LOSSES ON SPECIAL SERVICERS

Current CCR appoints special servicer

Losses hit lowest tranches of bonds first

As losses wipe out a class of bondholder, CCR changes

Example
$100 pool

	Original Face Amount of Bond	Losses	Current Amount of Bond
AAA	50	—	50
AA	20	—	20
A	10	5	5 (CCR)
BBB	10	10	0
B	6	6	0
UR	4 (CCR)	4	0

CMBS

MATURITIES

MATURITIES

2015 maturity payoff rate = 85%

- Higher than expected
- Low interest rate environment
- Abundance of high leverage capital

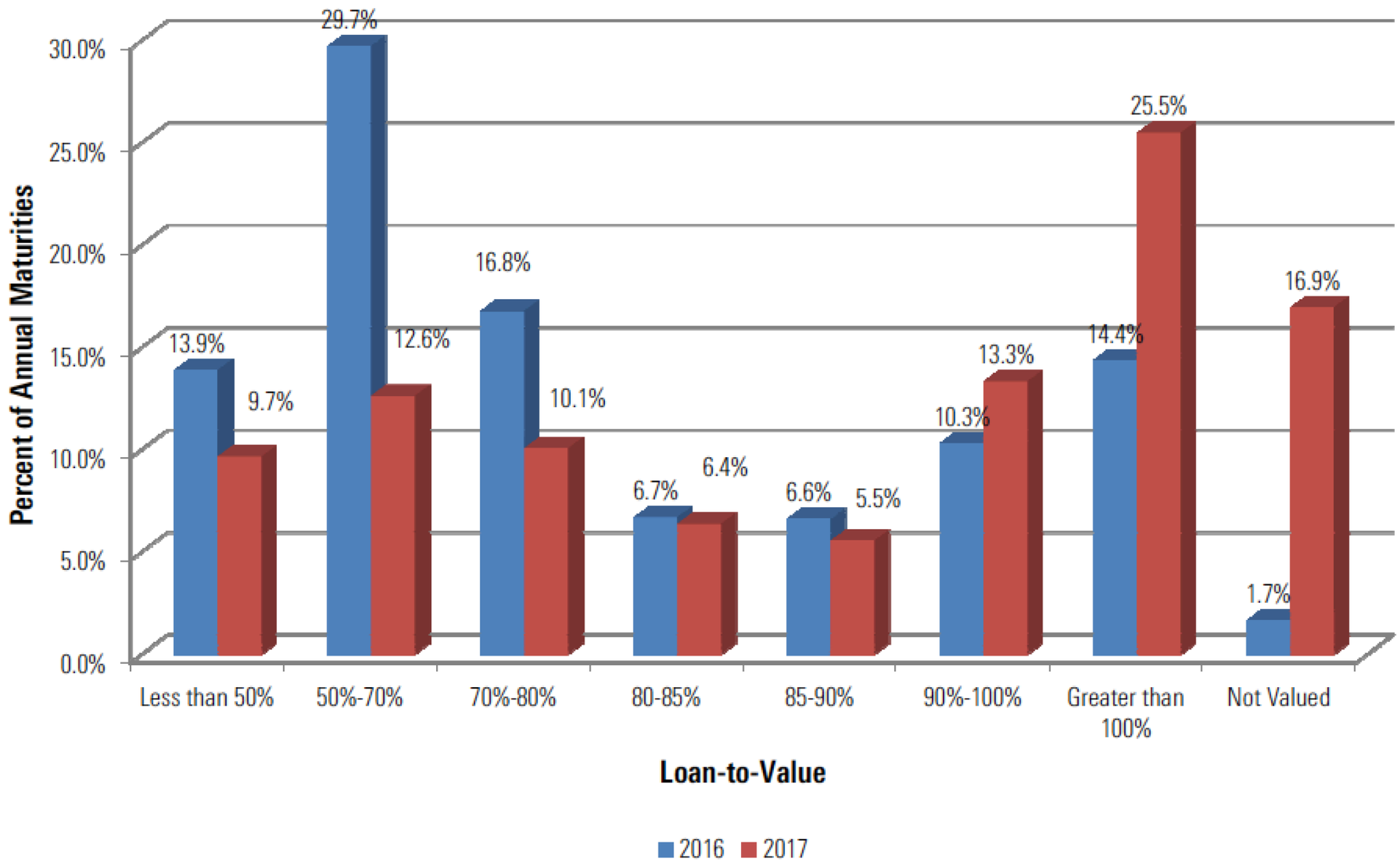
2016 maturity volume = $80 billion

- Morningstar anticipates a payoff rate of 65 – 70%

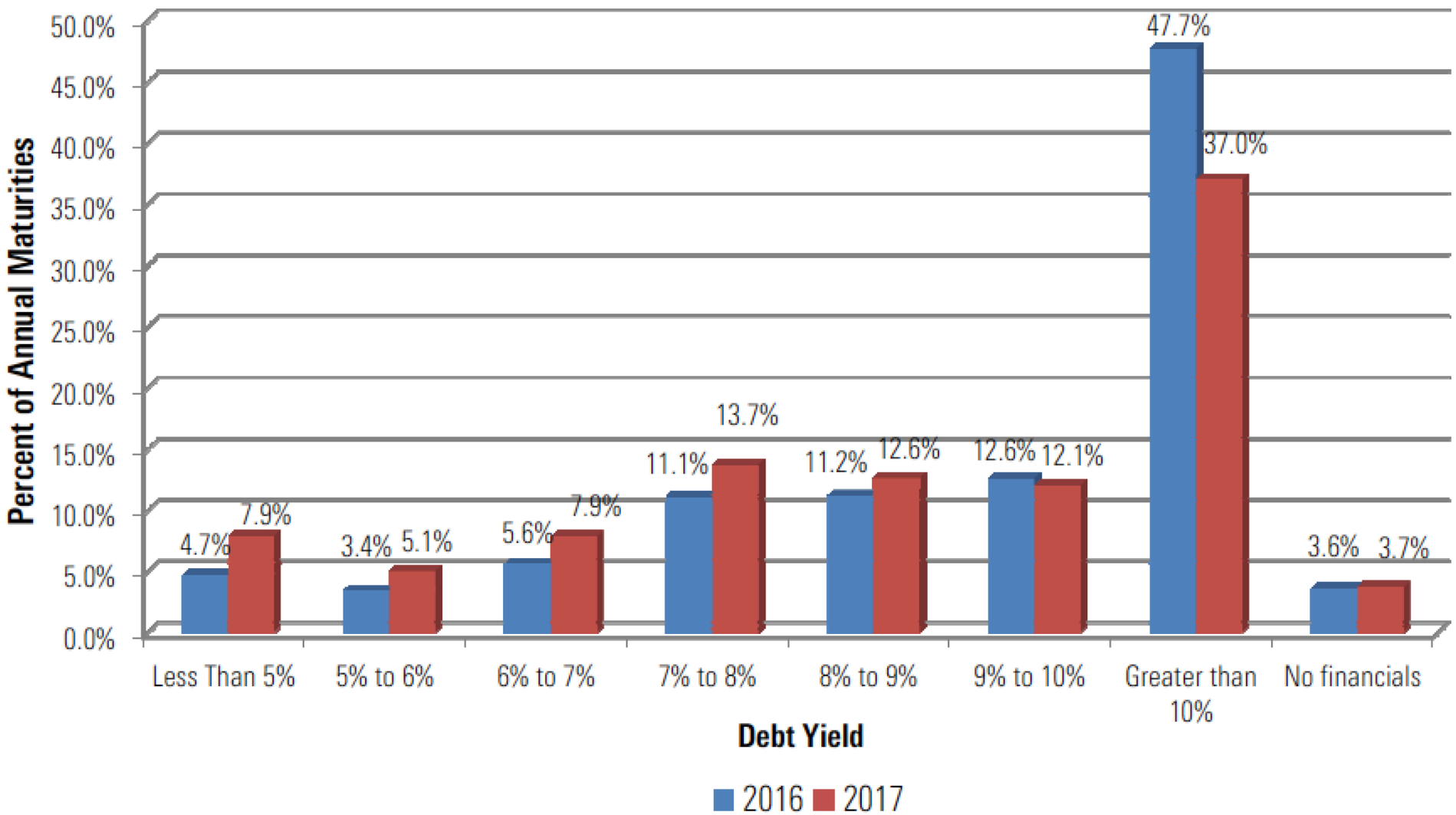
2017 maturity volume = $103 billion

- Morningstar anticipates a payoff rate of 50%
- Lowest payoff rates for retail and office

LOAN-TO-VALUE RATIOS: 2016 AND 2017



CURRENT DEBT YIELD: 2016 AND 2017



BORROWER OPTIONS

Payoff

- Refinance
- Sell

Extend

- Cost
- No pretending
- Length of time
- LTVs that qualify

Negative Equity

- Discounted payoff
- Short sale

Hand Property Back

MATURITY DATE EXTENSION

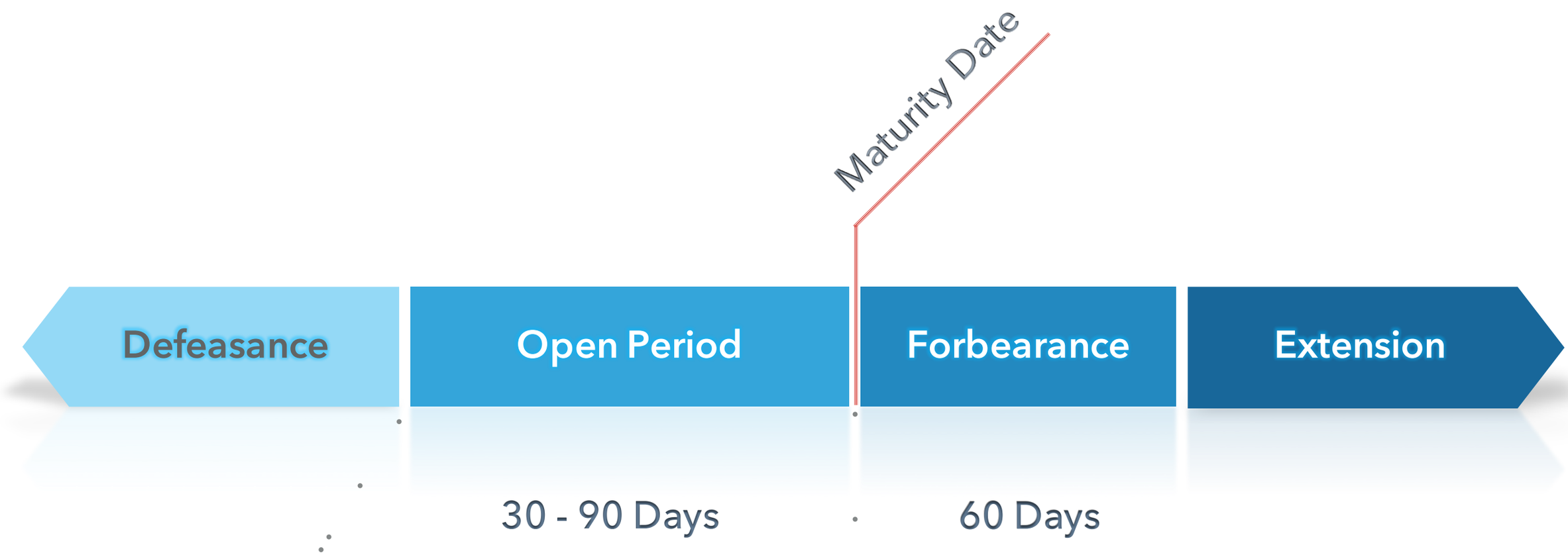
Performing loans only

Borrower must make pay down at time of extension (Typically 10%)

Cost = 1% per 12 month extension

All PSA's have outside date for extensions (Typically 2 - 3 years)

MATURITY DATE = PAYOFF DATE



CMBS 2.0/3.0

LOAN DOCUMENTS

CMBS 2.0 LOAN DOCUMENTS

Calculation of DSCR

- Springing cash management if DSCR drops below 1.5 for 2 consecutive quarters - BUT DSCR calculation is made by servicer and they can normalize rental income, management fees, etc.

Material Lease Definition

- Flexibility only

Late Fee

- Applies to balloon payments

Replacement & Seasonality Reserves

- Lender can reassess need at any time and increase the amount paid into the reserve account

Assumptions

- Allowed one time only

CMBS 2.0 LOAN DOCUMENTS (Continued…)

Environmental Issues

- Upon lender's request *and for no reason,* borrower has to get a phase I

Modifications at Securitization

- Borrower is agreeing to modify its loan at securitization so the lender can get the highest proceeds at securitization and they are agreeing to pay all costs

Franchise

- Requirement that it be in place at all times - possible recourse

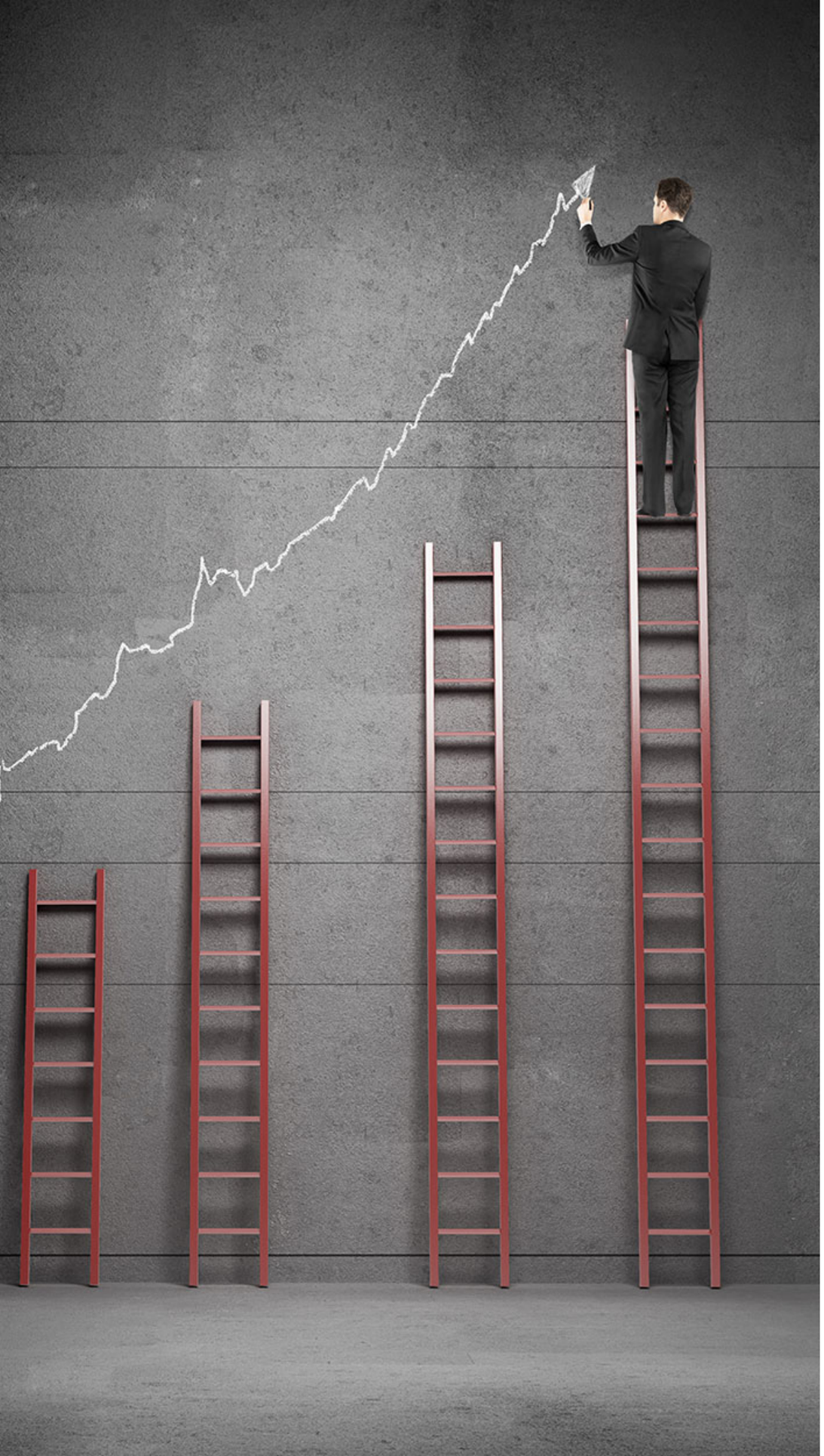
Fees for Late Financing Reporting

- Large fees ($10K or more) are now being added for late financial reporting

Independent Director

- Must have an Independent Director that has a nationally recognized name

Cash Management



CMBS

TRENDS

IMPACT OF THE DECREASE IN OIL PRICES

The closer you are to the drill, the more sensitive your job is to the price of oil

To date, the majority of job losses have occurred closest to the oil fields

- By November 2015, 250,000 jobs were lost globally in the energy sector
- Over 45,000 jobs lost in the United States since the beginning of 2016

North Dakota's oil-producing region was only the first casualty as the high cost of extraction versus Middle Eastern oil resulted in a reduction of drilling rigs

- The oil boom led to a housing boom that resulted in some of the highest multifamily rents in the country and a sharp increase in single-family housing construction
- Fully furnished apartments in the Williston area leased for over $4,000 per month
- In 2015, RealtyTrac reported a 387% increase in foreclosure activity in North Dakota in 2015

West Texas and Oklahoma

- 36% increase in foreclosures

ENERGY MARKET EXPOSURE

Houston: 1,280 loans, $17.4bil | Oklahoma City: 117 loans, $1.2bil | Tulsa: 81 loans, $734m

- Exposure in these markets ranges from 40% to 50% multifamily and 15% to 25% office

North Dakota has $698.6 million in CMBS exposure with 19% of those loans either delinquent or specially serviced

- Of the $293.8 million in the Bakken Region, 40% is delinquent or specially serviced, almost all in multifamily and hotels
- According to Morningstar's Monthly Delinquency Report, the national CMBS default rate is 3.1%
- The high default rate is the result of the property boom and overvaluation of assets in the region

We have observed only localized defaults in Permian Basin and Eagle Ford in Texas

- Small number of hotel defaults in smaller cities like San Angelo, Cotulla, and Snyder
- Larger cities such as Waco, El Paso, and Lubbock are supported by other industries such as education and health care

ASSUMPTION CONDITIONS / RESERVES

TI-LC Needs Through Maturity

- Assume 60% renewal rate
- Market TI-LC costs

DSCR

- 6-12 months
- Based on trailing 12 month NOI

Cash Management

- In place today
- Sprung
- Buyer past credit history

EXAMPLE

Retail deal originated 11/2015

Maturity date 11/2025

Minimum TI, LC reserves required at origination due to low LTV

Borrower is selling his property and buyer is assuming existing loan

Servicers will re-look at reserves accordingly

- Total square feet rolling between now and 11/2025
- Assume 40% of that square footage does NOT renew
- Assume 60% of that square footage does renew but for a 4 – 5 year term
- Total square feet has some roll before maturity
- Market TI and LC will be required

DODD FRANK RISK RETENTION

The new risk retention rules mandated by Dodd-Frank will require issuers to retain a 5% slice of a CMBS transaction

- If the risk retention is sold to a third-party investor
  - The buyer must hold that piece for five years
  - The buyer must finance the risk retention with cash equity rather than debt

This could reduce profitability of CMBS issuance and increase the cost of funds

- Lenders that have to retain the first-loss class on their books may be wary of exposure to energy companies, especially those with near-term lease expiration
- If capital is available, borrowers with energy exposure may be asked for stronger loan structures, including upfront reserves, letters of credit or amortization

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