S. HRG. 111–73

THE IMPACT OF ECONOMIC RECOVERY EFFORTS ON CORPORATE AND COMMERCIAL REAL ESTATE LENDING

HEARING

BEFORE THE

CONGRESSIONAL OVERSIGHT PANEL

ONE HUNDRED ELEVENTH CONGRESS

FIRST SESSION

MAY 28, 2009

Printed for the use of the Congressional Oversight Panel

THE IMPACT OF ECONOMIC RECOVERY EFFORTS ON CORPORATE AND COMMERCIAL REAL ESTATE LENDING

S. HRG. 111–73

THE IMPACT OF ECONOMIC RECOVERY EFFORTS ON CORPORATE AND COMMERCIAL REAL ESTATE LENDING

HEARING

BEFORE THE

CONGRESSIONAL OVERSIGHT PANEL

ONE HUNDRED ELEVENTH CONGRESS

FIRST SESSION

MAY 28, 2009

Printed for the use of the Congressional Oversight Panel

U.S. GOVERNMENT PRINTING OFFICE

51–603 WASHINGTON : 2009

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2104 Mail: Stop IDCC, Washington, DC 20402–0001

CONGRESSIONAL OVERSIGHT PANEL

PANEL MEMBERS

ELIZABETH WARREN, *Chair*

SEN. JOHN SUNUNU

REP. JEB HENSARLING

RICHARD H. NEIMAN

DAMON SILVERS

CONTENTS

THE IMPACT OF ECONOMIC RECOVERY EFFORTS ON CORPORATE AND COMMERCIAL REAL ESTATE LENDING

THURSDAY, MAY 28, 2009

U.S. CONGRESS,
CONGRESSIONAL OVERSIGHT PANEL,
New York, NY.

The Panel met, pursuant to notice, at 10:09 a.m. in the Rosenthal Pavilion at New York University, Elizabeth Warren, Chairman of the Panel, presiding.

Attendance: Professor Elizabeth Warren [presiding], Mr. Richard Neiman, Senator John Sununu, Damon Silvers, Representative Jerry Nadler, Representative Carolyn Maloney, Dr. Til Schuermann, Richard Parkus, Jeffrey DeBoer, Kevin Pearson, and Mark Rogus.

The Chair. The hearing of the Congressional Oversight Panel will now come to order. And is this mike turned on? Can we hear okay? Good. All right. Not good feedback.

Welcome to today's hearing, "The Impact of Economic Recovery Efforts on Corporate and Commercial Real Estate Lending."

My name is Elizabeth Warren, and I am the chair of the Congressional Oversight Panel. I would like to begin this morning by thanking my colleague Richard Neiman, who is the superintendent of banks of the State of New York. He and his staff put in extraordinary efforts to help us arrange this hearing, and we are very grateful for his time and for his expertise in pulling together this hearing.

I also want to thank Patrick McGreevy of the Congressional Oversight Panel staff who, once again, has done a wonderful job for us in being able to put one of these field hearings together.

And I particularly want to thank New York University School of Law for hosting us here, for giving us this space so we could have this hearing.

So with thanks to everyone, I want to start with Superintendent Neiman and ask him to make opening remarks.

STATEMENT OF RICHARD NEIMAN, MEMBER, CONGRESSIONAL OVERSIGHT PANEL

Mr. NEIMAN. Thank you very much, Chair Warren.

Good morning, and I thank you all for appearing here today at this important hearing of the Congressional Oversight Panel on corporate and commercial real estate lending.

I would also like to thank Congresswoman Maloney and Congressman Nadler for their participation here today. Although I am much more accustomed to being on the other side of the witness table when attending hearings with them, I am thrilled that they could fit today's hearing into their busy schedules.

Their roles on the House Financial Services Committee and Congresswoman Maloney's role as chair of the Joint Economic Committee make them both directly related to the topics we are discussing here today, and their attendance emphasizes the importance of the issues for New York.

Finally, I also would like to again thank New York University for providing this beautiful venue.

When we sometimes speak of the financial crisis, it is as if it were one event, when really it is a cascade of multiple crises that overlap and reinforce a downward trend. This panel has been seeking input on these various crises through field hearings across the country. In Nevada and Prince George's County, Maryland, we focused on the foreclosure crisis. Last month in Milwaukee, Wisconsin, we focused on small business lending.

Now we are here in New York to examine the effect of continuing market uncertainty on mid-size and large corporations, as well as the commercial real estate borrowers. The purpose of today's hearing is to assess both credit availability and the impact of the recession on borrower demand. And to do this, we will explore questions such as are banks continuing to lend to these important sectors, and how are their underwriting and other credit lending practices changing?

Is the credit contraction driven more by supply or by demand? How is the freeze in the securitization market affecting credit access, and to what extent can bank lending fill that gap? How will the markets adapt? What will be the new normal in credit markets? What will they look like? What is the impact that the Treasury and the Federal Reserve programs, such as TALF, having or are expected to have in restoring stability for corporate and commercial lending?

Can we expect to have a wave of defaults in commercial real estate lending? And if so, will it be another tsunami like residential subprime? And finally, what will be the ultimate impact of a slowdown in commercial lending? What impact will it have on our communities? What does this mean for jobs and for economic development opportunities?

These are difficult issues with moving parts, and we are fortunate to have a diverse group of leading experts here today to offer their testimony. On our first panel, we are going to have Til Schuermann, the vice president in risk management of the Fed, who will provide us a comparison to past recessions, as well as an overview of the exponential growth in non-bank credit and the impact of bank lending.

Richard Parkus from Deutsche Bank's analysts group will explore the drivers of default in commercial real estate lending, as well as the volume of loans at risk.

On our second panel, Kevin Pearson, executive vice president, M&T Bank, will be offering a lender's perspective on credit trends and the unique role that regional banks play in this sector.

Jeffrey DeBoer, the CEO of the Real Estate Roundtable, will discuss the impact of the credit contraction and the recession on real estate borrowers and developers.

And then Mark Rogus, senior VP and treasurer of Corning, will also provide insight into the impact on large corporations, as well as the reduced credit access of the impact of their customers and suppliers.

So I want to thank each of you for your participation this morning and look forward to hearing your perspective and thoughts on the issues we will be discussing this morning.

The corporate and commercial real estate lending markets are facing serious challenges. However, unlike the subprime crisis in residential mortgages, in this case, we have the opportunity to anticipate what is coming and address the issues before it becomes an even bigger crisis. We have a narrow window in which we can take action and avert the worst. Time is of the essence.

Through this hearing, I am hopeful that we will gain a much deeper understanding of the complexities and the scope of the issues impacting corporate and commercial lending. We all hear that commercial real estate is the next shoe to drop, but what we want to know here is how big is that shoe and how big a dent is it going to make?

And I am particularly interested in measuring the effectiveness of Treasury's programs to date. So, building on that assessment, we must begin exploring the additional steps Treasury and Congress can take to mitigate the developing problem and ensure that these sectors continue to fuel our economy.

So thank you, and I look forward to hearing from both our distinguished witnesses.

[The prepared statement of Mr. Neiman follows:]

CONGRESSIONAL OVERSIGHT PANEL

Elizabeth Warren, Chair | Sen. John E. Sununu | Rep. Jeb Hensarling | Richard H. Neiman | Damon Silvers

Opening Statement of Richard H. Neiman

Congressional Oversight Panel Field Hearing on the Impact of Economic Recovery Efforts on Corporate and Commercial Real Estate Lending

May 28, 2009

Good morning, and thank you all for appearing today at this hearing of the Congressional Oversight Panel on corporate and commercial real estate lending.

I would also like to thank Congresswoman Maloney and Congressman Nadler for their participation today. Although, I am much more accustomed to being on the other side of the witness table when attending Hearings with them, I am thrilled that they could fit today's hearing into their busy schedules. Their roles on the House Financial Services Committee and Congresswoman Maloney's role as Chair of Joint Economic Committee make them both directly related to the topics we are discussing today. And, their attendance emphasizes the importance of these issues for New York.

Finally, I want to thank New York University for providing this wonderful venue.

We sometimes speak about "the financial crisis" as if it were one event, when really it is cascade of multiple crises that overlap and reinforce a downward trend. This Panel has been seeking input on these various crises through field hearings across the country- in Clark County, Nevada and Prince George's County, Maryland on the foreclosure crisis, and in Milwaukee, Wisconsin on small business lending. Now we are in New York City, to examine the affect of continuing market uncertainty on midsize and large businesses, as well as commercial real estate borrowers.

The purpose of today's hearing is to assess both credit availability and the impact of the recession on borrower demand. To do this, we will explore questions such as-

- Are banks continuing to lend to these sectors, and how have their underwriting and other lending practices changed? Is the credit contraction driven more by supply or by demand issues?
- How is the freeze in securitization affecting credit access, and to what extent can bank lending fill the gap? How will the markets adapt?
- What is the impact that Treasury and Federal Reserve programs such TALF are having, or are expected to have, in restoring stability?
- Can we expect a wave of defaults in corporate and commercial real estate lending and, if so, will it be another tsunami like residential subprime?

- And, finally, what will be the ultimate impact of a slowdown in the commercial space on our communities- what does this mean for jobs and economic development opportunities?

These are difficult issues with many moving parts, and we are fortunate to have a diverse group of leading experts here today to offer their testimony.

On the first panel:

Til Schuermann, the Vice President in Risk Management from the Federal Reserve Bank of New York will provide us with a comparison to past recessions, as well as an overview of the exponential growth in non-bank credit and the impact on bank lending.

Richard Parkus, the Head of Commercial Mortgage-Backed Securities Research, Deutsche Bank – Americas, will explore the drivers of default in commercial real estate lending as well as the volume of loans at risk.

On our second panel:

Kevin Pearson, the Executive Vice President of M&T Bank, will be offering a lender's perspective on credit trends and the unique role that regional banks play in this sector.

Jeffrey DeBoer, CEO of The Real Estate Roundtable, will discuss the impact of credit contraction and the recession on real estate developers and borrowers.

Mark Rogus, Senior Vice President and Treasurer of Corning, Incorporated, will also provide insights into the impact on larger corporations, as well as the effects of reduced credit access on their customers and suppliers.

I thank each of you for your participation and look forward to hearing your perspective and thoughts on the issues we are discussing this morning.

The corporate and commercial real estate lending markets are facing serious challenges. However, unlike with the subprime crisis in residential mortgages, in this case we have the opportunity to anticipate what is coming and address the issues before it becomes an even bigger crisis. We have a narrow window in which we can take action and avert the worst. Time is of the essence.

Through this hearing, I am hopeful that we will gain a much deeper understanding of the complexities and the scope of the issues impacting corporate and commercial lending. And, I am particularly interested in measuring the effectiveness of Treasury programs to date.

Building on that assessment, we must begin exploring the additional steps Treasury and Congress can take to mitigate this developing problem and ensure that these sectors continue to fuel our economy. Thank you.

The CHAIR. Thank you, Superintendent Neiman.
Senator Sununu.

STATEMENT OF HON. JOHN E. SUNUNU, MEMBER, CONGRESSIONAL OVERSIGHT PANEL

Senator SUNUNU. Thank you, Madam Chair.

And thank you, Richard, and your staff, for helping to put together the hearing today. I know it took a lot of work and a lot of cooperation from the staff in Washington working with you, and pleased to have that.

We have got really three terrific panels, beginning with Congressman Nadler and Congresswoman Maloney, who I know have done a tremendous amount of work on these issues. Not just since the initiation of the current financial crisis, but these are issues that they are familiar with, that they have worked on before because they represent what is still the financial capital of the world and what we certainly hope remains the financial capital of the world.

I think this hearing is particularly important because while we read about the residential mortgage crisis in the newspapers every day, falling asset prices and foreclosures, we really don't hear as much about problems and challenges in the commercial and industrial and commercial mortgage-backed securities markets. It hasn't been quite as visible in part because a lot of the problems that people expect to emerge and anticipate emerging really haven't been forced to the surface.

And I think we will hear about some of the reasons for that today. We will get a better understanding of the risks that exist in the marketplace and, I hope, explore some of the ways in which the TARP programs that have been put into place might help to deal with those risks and uncertainties.

I think it is essential that we have strong, accurate, clear data and information for the panel to work on in preparing its assessments for Congress and the Treasury because we can't just work on anecdotal information. Even when stories do appear and there is discussion in the mainstream press about challenges in the commercial and industrial markets, we can't just try to collect a bunch of news stories and assume that that really represents the precise state of the market.

So having witnesses from the Fed, having witnesses from industry, having witnesses from the commercial banking sector is absolutely important and essential for the panel to be able to do its job effectively. As the chair is fond of saying, the plural of anecdote is not data. And——

Senator SUNUNU [continuing]. If nothing else, I have incorporated that into my own lexicon because we have seen time and time again, whether we are dealing with the consumer markets, credit card markets, small business lending, we need to make sure we are all working from accurate information and accurate data if we are going to be able to draw a reasonable conclusion.

So, again, I appreciate all the staff work necessary to put together a strong field hearing, and I look forward to the testimony this morning.

Thank you, Madam Chair.

The Chair. Thank you, Senator.
Mr. Silvers.

STATEMENT OF DAMON SILVERS, DEPUTY CHAIR, CONGRESSIONAL OVERSIGHT PANEL

Mr. SILVERS. Thank you, Madam Chair.

Good morning, and like my fellow panelists, I want to express my thanks to New York University for providing us with this beautiful space, to the staff for their hard work in what promises to be a highly informative hearing, and in particular, to my fellow panelist Richard Neiman, who put a great deal of time and energy into putting this hearing together here in his home State.

We are honored today by the presence of two leaders from New York's congressional delegation—Representative Carolyn Maloney, the chair of the Joint Economic Committee of Congress, and Jerry Nadler, the representative from here in Manhattan, who has been a leading voice on behalf of the public interest in commercial law in the Congress of the United States.

This hearing is unusual in the brief history of the Congressional Oversight Panel. In each of our past field hearings, we have heard from American families, from homeowners, from small business people, and community bankers who have done much to educate this panel as to the impact of the financial crisis and the Emergency Economic Stabilization Act, known to most Americans as the financial bailout.

But today, we hear from an S&P 500 company, one of our 25 largest banks, the Real Estate Roundtable, and the Federal Reserve Bank of New York. Yet this witness list is entirely appropriate.

One key measure of whether our financial system is functioning is whether large-scale enterprises, be they firms or real estate development projects, can obtain financing on reasonable terms in relation to the risks those projects represent.

If such financing is not available, then existing jobs disappear, and new ones are never created. Innovation does not happen. Urban centers turn into parking lots and vacant lots. Investors liquidate and take losses on what should have been viable investments, adding to the downward pressure on our economy and our capital markets.

The financial crisis poses two threats of this kind. As my colleague Richard Neiman alluded to, the financial crisis is not a single thing. It is a complicated set of intertwined phenomenon.

The first type of threat it poses is the threat of a general loss of confidence in financial institutions and financial markets. We faced an acute threat of this type in September and October of last year, and judging by a number of measures, such as the persistence of historically high short-term credit spreads and the prolonged freeze in asset-backed securities markets, fear of this type has not entirely gone away.

And this type of generalized fear can lead both to skyrocketing credit costs and the simple disappearance of liquidity from credit markets such that credit is not available at any price. However, thanks in part, I believe, to the actions taken under the Emergency

Economic Stabilization Act, the threat of systemic breakdown has eased significantly.

The second threat, though, is much more specific. It is the threat posed not by a general loss of confidence, but by the actual weakness of key large financial institutions. This problem is more insidious because, unlike a general credit crisis, it can be hidden—hidden by accounting tricks, hiding by compliant regulators, hidden even by well-meaning policymakers.

But weak financial institutions in survival mode will not provide credit directly and will not participate in asset-backed securities markets to the extent that our economy needs. The possible resulting downward pressure on markets such as commercial real estate can lead to further weakening of bank balance sheets, resulting in a long-term banking crisis feeding economic stagnation, such as occurred in the 1990s in Japan.

And while we have seen the stress test results and the debates associated with those results, in a way, the real measure of the health of the banks is are they playing their role in the credit system appropriately?

What makes answering this question such a challenge is determining what constitutes appropriate credit provision in the context of a burst credit bubble and rapidly declining demand for credit. Appropriate credit provision is not the same thing as maintaining or reviving a bubble fueled by the collapse of underwriting standards.

The written testimony we have received for this hearing, which is very thoughtful, nonetheless presents something of a paradox. On the one hand, we have the cautious optimism expressed by the written testimony of Mr. Schuermann from the Federal Reserve Bank of New York. On the other hand, we have somewhat urgent warnings in relation to the commercial real estate market coming from the analyst reports of Mr. Parkus of Deutsche Bank and, to a lesser degree, from Mr. DeBoer from the Real Estate Roundtable.

And the Treasury Department's most recent bank lending survey, conducted in March, shows continuing contractions in bank lending, both commercial and industrial and in commercial real estate.

Anecdotally, although as my colleague Senator Sununu says, it is not data, we still have anecdotes. I hear from people in the real estate business that credit remains simply not available for large new projects or for refinancings.

I also read stories like the account in the New York Times recently of the fate of Hartmarx, a significant New York State employer and the manufacturer of President Obama's suits. Wells Fargo, a major TARP recipient, was reported to be in a mode of favoring the certain lower returns and job losses associated with liquidation over the less certain higher returns and job preservation associated with a sale to a continuing operator.

I hope that this hearing will sort out these paradoxes and help our panel better understand the current state of business and commercial real estate credit markets and the role played in those markets by TARP recipient institutions, both directly and indirectly through the asset-backed securities markets.

I look forward to our witnesses' testimony.

[The prepared statement of Mr. Silvers follows:]

CONGRESSIONAL OVERSIGHT PANEL

Elizabeth Warren, Chair | Sen. John E. Sununu | Rep. Jeb Hensarling | Richard H. Neiman | Damon Silvers

Opening Remarks of Damon Silvers

Congressional Oversight Panel Field Hearing on the Impact of Economic Recovery Efforts on Corporate and Commercial Real Estate Lending

May 28, 2009

Good morning. First let me express my thanks to New York University for hosting us today, to the staff for putting together what promises to be another highly informative hearing, and to my fellow panelist Richard Neiman for his hard work in putting this hearing together here in his home state.

This hearing is unusual in the brief history of the Congressional Oversight Panel. In each of our past field hearings, we have heard from American families—from homeowners, from small business people and community bankers, who have done much to educate the Panel as to the impact of the financial crisis and the Emergency Economic Stabilization Act, known to most Americans as the financial bailout. But today we hear from an S&P 500 company, one of our 25 largest banks, the Real Estate Roundtable, and the Federal Reserve Bank of New York.

Yet this witness list is entirely appropriate. One key measure of whether our financial system is functioning is whether large scale enterprises—be they firms or real estate development projects—can obtain financing on reasonable terms in relation to the risks they represent. If such financing is not available, then existing jobs disappear and new ones are never created. Innovation does not happen. Urban centers turn into parking lots and vacant lots. Investors liquidate and take losses on what should have been viable investments, adding to the downward pressure on our economy.

The financial crisis poses two threats of this kind. The first is the threat of a general loss of confidence in financial institutions and financial markets. We faced an acute threat of this type in September and October of this year, and judging by a number of measures, such as the persistence of historically high short term credit spreads, and the prolonged freeze in asset backed securities markets, fear in this area has not entirely gone away. This type of generalized fear can lead to both skyrocketing credit costs and the simple disappearance of liquidity from credit markets such that credit is not available at any price. However, thanks in part I believe to the actions taken under the Emergency Economic Stabilization Act, the threat of systemic breakdown has eased significantly.

The second threat though is much more specific. It is the threat posed not by a general loss of confidence, but by the actual weakness of key large financial institutions. This problem is more insidious because unlike a general credit crisis, it can be hidden—hidden by accounting tricks, hidden by compliant regulators, hidden even by well-meaning policymakers. But weak financial institutions in survival mode will not provide credit directly, and will not participate in asset backed securities markets. The resulting downward pressure on markets such as commercial real estate can lead to further weakening of bank balance sheets, resulting in a long term banking crisis feeding economic stagnation such as occurred in the 1990's in Japan.

And while we have seen the stress test results and the debates associated with those results, in a way, the real measure of the health of the banks is—are they playing their role in the credit system appropriately? What makes answering this question such a challenge is determining what constitutes appropriate credit provision in the context of a burst credit bubble and rapidly declining demand for credit. Appropriate credit provision is not the same thing as maintaining or reviving a bubble fueled by the collapse of underwriting standards.

The written testimony we have received for this hearing presents something of a paradox. On the one hand, we have the cautious optimism expressed by the written testimony of Mr. Schuermann from the Federal Reserve Bank of New York. On the other hand, the somewhat urgent warnings in relation to the commercial real estate market coming from Mr. Parkus at Deutsche Bank and to a lesser degree from Mr. DeBoer from the Real Estate Roundtable. And the Treasury Department's most recent bank lending survey, conducted in March, showed continuing contractions in bank lending in both commercial/industrial and commercial real estate.

Anecdotally, I hear from people in the real estate business that credit remains simply not available for large new projects or for refinancings. I also read stories like the account in the New York Times recently of the fate of Hartmarx, a significant New York state employer and the manufacturer of President Obama's suits. Wells Fargo, a major TARP recipient, was reported to be in a mode of favoring the certain lower returns and job losses associated with liquidation over the less certain higher returns and job preservation associated with a sale to a continuing operator.

I hope this hearing will sort out these paradoxes and help our Panel better understand the current state of business and commercial real estate credit markets and the role played in those markets by TARP recipient institutions both directly and indirectly through the ABS markets. I look forward to our witnesses' testimony.

The CHAIR. Thank you, Mr. Silvers.

STATEMENT OF ELIZABETH WARREN, CHAIR, CONGRESSIONAL OVERSIGHT PANEL

The advantage of going last in the opening statements is that I have the privilege of agreeing with my colleagues. And I cannot let the moment pass without agreeing with Senator Sununu about the importance of accurate and detailed information.

Data are critical not only because we can't design programs accurately if we don't know what is going on. It is really the case that we can build a meaningful recovery only if we build it on reality. So I hope that is an important part of this hearing today.

I also want to agree with Superintendent Neiman and with Mr. Silvers about the point about the interconnected economy here. This crisis may have begun with subprime mortgage lending. What that meant, as people defaulted on their mortgages was that banks got into a great deal of trouble and started to stumble. They cut back on their lending. That, in turn, meant that businesses cut their inventories and their employees, which, in turn, meant that there were fewer people who could afford to pay their mortgages.

This is something that economists call an adverse feedback loop, thus proving that they deserve tenure. The rest of us just call it a vicious cycle. But either way, it means a lot of suffering for a lot of people.

So today, what we are going to talk about is a continuation of a series of field hearings we have had, the current state of corporate and commercial real estate lending. And what I really want to focus on here today is how this slowdown in lending affects even those of us who have never owned a business, never leased a building, and never made a loan. We all should care enormously about the data that we will talk about today and what comes out of this hearing.

[The prepared statement of Ms. Warren follows:]

CONGRESSIONAL OVERSIGHT PANEL

Elizabeth Warren, Chair | Sen. John E. Sununu | Rep. Jeb Hensarling | Richard H. Neiman | Damon Silvers

Opening Remarks of Chair Elizabeth Warren

Congressional Oversight Panel Field Hearing on the Impact of Economic Recovery Efforts on Corporate and Commercial Real Estate Lending

May 28, 2009

In the fall of 2008, Congress established this Panel to oversee the expenditure of $700 billion from the so-called Troubled Asset Relief Program, or TARP. It is our job to assess the impact of the Treasury's Departments efforts to restart the economy through the TARP program.

No aspect of our economy operates independently. This crisis may have started with homeowners defaulting on sub-prime mortgages, but the instability quickly worked its way through the entire financial system. Financial institutions that had been making money by trading those mortgages and other consumer loans began to stumble, pulling back credit to businesses. In turn, those businesses reduced inventories and laid off employees, creating an even larger group of people who could not pay their mortgages. Economists call this an "adverse feedback loop." The rest of us call it a "vicious cycle" with no end in sight.

In order to understand the scope of the problem, and the impact of the government efforts to fix those problems, it is essential to study the different elements of the problem. Last month we looked at Treasury's efforts to restart lending to small businesses and consumers.

Today, we are here to examine another critical component of our economy – corporate and commercial real estate loans. Like small business and consumer credit, these loans are essential for businesses to function – and they provide an excellent barometer of our collective economic health.
We are here today to learn more about the current state of corporate and commercial real estate loans and to examine how a slowdown in lending affects even those of us who have never owned a business, leased a building, or made a loan. What we learn today will shape the Panel's future questions and inform its future work.

I look forward to the conversation we will have today with our distinguished panels of witnesses.

I want to start this morning with Congressman Nadler. It is a great privilege to welcome you here. I have known Congressman Nadler for a very long time and hold his work, particularly in the area of family and small business economic security, in the highest regard. And so, I ask you if you would make some remarks, please, sir.

STATEMENT OF HON. JERRY NADLER, U.S. REPRESENTATIVE FROM NEW YORK

Representative NADLER. Well, thank you very much. And thank you for holding this important hearing and for inviting me to testify.

I first want to welcome you to the 8th Congressional District, which includes Wall Street, the physical and symbolic center of the Nation's financial services industry. The district stretches from the Upper West Side of Manhattan through downtown into Coney Island and the neighborhoods of Southwest Brooklyn. All of these communities have, whether directly involved with Wall Street or not, felt the current financial crisis acutely.

I also want to thank, as members of the panel have, NYU Law School, not only for arranging these facilities for us this morning, but for hosting my son as a student at the law school.

Today, we are here to look into the real-life impact of the crisis and how Federal legislators can do better to guide the recovery process, make it more efficient and transparent, and maximize its success. Congress created this panel to ensure that there would be an independent watchdog able to account for $700 billion that Congress made available to stabilize the financial system.

It is critical that we understand whether this money is really making it easier for families and businesses to obtain credit on fair terms. If financial institutions are saved, but families and businesses continue to founder, then the TARP legislation will have been a failure. The need for this panel and its work are vital.

I would urge the panel to continue to fulfill its entire mandate as set out in Section 124 of the bill that established it, which requires that, in addition to monitoring the use of the funds made available by Congress, the panel should analyze "the current state of the regulatory system and its effectiveness at overseeing the participants in the financial system and protecting consumers and provide recommendations for improvement, including recommendations regarding whether any participants in the financial system markets that are currently outside the regulatory system should become subject to the regulatory system, the rational underlying such recommendation, and whether there are any gaps in existing consumer protections."

These are important questions, and Congress added them to your legislative mandate for a reason. The fact is that while the TARP funds may have begun to stabilize the financial system, a vitally important purpose of the law, it is clear that the benefits are not going to all of the players in our credit markets.

As your reports have rightly pointed out, consumers and small businesses are not experiencing the kinds of benefits that Congress had intended. As was said a moment ago, loan credit is still in a contractionary situation. And despite Senator Sununu's abjuration about the use of anecdotes, I will provide one anecdote from very near here.

A few weeks ago, I was talking to the executive director of the LGBT Center, which is a few blocks from here. The LGBT Center is a charitable institution. It is a nonprofit institution and gets a considerable amount of funding from earmarked funds from State and local governments. And putting the controversy over earmarks aside, it gets these funds earmarked by name to the LGBT Center on West 13th Street in the State budget that passes by April and in the city budget that passes by June.

So it gets $4 million or $5 million a year, something on that order of magnitude. And the funds are not available from the budgets that are passed in April and June until November or December. And they typically take out bridge loans, bridge loans against city and State receivables guaranteed by name in the budget, and can no longer do so.

This institution tells me they can no longer get bridge loans suddenly for no reason against earmarked funds in the city and State budget for a period of six months. That tells me something is very wrong with the credit market. It is not real estate, but something is very wrong with the credit market when a nonprofit institution cannot get a bridge loan against a receivable earmarked in the budget by name, guaranteed by law, guaranteed within the fiscal year by law, unless the city or the State goes bankrupt.

So we have some work to do on getting the banks to extend credit on reasonable terms in reasonable situations. And I hate to generalize from that, but that seems a very apropos anecdote.

In some cases, further legislative action has been necessary. For example, the recent enactment of the Credit Card Accountability, Responsibility, and Disclosure Act of 2009, principally sponsored by my colleague sitting to my left, Ms. Maloney, was a response to the increasing hardships imposed by the credit card industry on borrowers.

It is unconscionable that the industry should be the recipient of billions of funds in taxpayer assistance while at the same time making things even harder on consumers. In the future, Congress must continue to act if taxpayers are not realizing substantive benefit from these expenditures.

I would also urge this panel to continue to look at the effectiveness of foreclosure mitigation efforts and the effectiveness of the program from the standpoint of minimizing long-term cost to the taxpayers and maximizing the benefits for taxpayers—that is a direct quote—as required under Section 125. It is a great disappointment to me that Congress has so far failed to reform the bankruptcy code to allow individual debtors to modify mortgages secured by their family homes, just as the owners of vacation homes, investment properties, factories, and family farms may now do.

So far, the voluntary system of mortgage modification has been a stunning failure. Recently, Congress established a number of programs that would use taxpayer funds to help modify mortgages. There is no reason why the cost of a bad loan should not be apportioned among the parties to a transaction gone bad.

Nonetheless, since 1978, families have been singled out in bankruptcy as the only debtors for whom modification is categorically unavailable. Union contracts can be modified. Other secure debts can be modified, but not mortgages.

In view of the aid the banking industry has been receiving, from cash to increased deposit insurance to a variety of other goodies, I believe it is unacceptable for us to continue to allow this anomaly to continue.

Now I want to talk a bit more broadly. I do not believe that the current plan that has been advanced under the TARP legislation, I do not believe it will work to get the credit flowing. I will associate myself with the criticisms of that plan by economists such as Paul Krugman, Joe Stiglitz, Bob Kuttner, and James Galbraith, and others who say the plan simply will not work.

To quote from a recent article by Bob Kuttner, “Instead of closing or breaking up failed banks, dividing the losses between taxpayers and bondholders, and getting the successful banks quickly back to health, the Treasury is propping up the incumbent banks. Worse, it is doing so with convoluted schemes backed by loans from the Federal Reserve and guarantees against losses from the Treasury. The hope is that the speculators will bid up the value of toxic securities on banks’ books. This policy is likely to prolong the agony and leave a still-wounded banking system dragging down the real economy.”

I believe that to be accurate. I don’t see how this plan—unless you assume that the toxic assets are worth a lot more than they seem to be, I don’t see how this plan can work. What we should do instead—and I want to advance two propositions—is, one, either, as has been urged—I am not going to go into it because all of these economists have urged it at great length—we should do what the FDIC normally does and as I quoted from Bob Kuttner a moment ago. This has been called nationalizing the banks, though that is a misnomer. But doing what was normally done, we are still doing every day today with smaller banks so as to get credit flowing again.

Alternatively, if we are to insist on continuing on the path we are on, I want to suggest one of two alternative paths of action in addition to what we are currently doing because I believe that doing what we are doing is going to continue with weak banks for a long time, not advancing credit, and stymieing the economy.

If we are going to continue doing that, we ought to do something in addition. And what we ought to do in addition is either one of the two following things. One, take a large amount of money, and I am just taking this figure out of the air, $100 billion—but that order of magnitude—and form brand-new banks.

Or two, announce that the Federal Government is going to capitalize brand-new banks, invite the private sector in for private investments. There is plenty of available capital now. There is a shortage of investment opportunities. The savings rate is suddenly sky high after about 30 years when that wasn’t true.

Invite in private capital. I would anticipate that the private capital might exceed the Government capital by a factor of 4 or 5. These banks can then, unburdened by toxic securities, lend at a ratio of perhaps 10 or 12 to 1, as they normally do. You can get credit flowing in the economy again. I have not analyzed the effect that that would have on the existing banks, but at least it would get credit flowing again.

And the Federal Government and the banking system, the State banking systems, could give help in setting up those new private banks. And after an appropriate period of time, the Federal Government could sell its capital for presumably a profit, but the economy will not be hamstrung by lack of credit because these new banks will not have to worry about the problems inhibiting the existing large banks from functioning. That is from functioning as sources of credit.

Alternatively, if that is too radical a suggestion, take a very large amount of money—$50 billion, $100 billion—and fund existing, fund 100 or 200 existing. I have no idea what those numbers should be. It is off the top of my head. But fund existing small and regional banks that have not engaged in the orgy of speculation and the derivatives and don't have the toxic assets on their books, banks that have done the traditional boring banking and let them continue to do traditional boring banking, but with a larger capital base and much greater penetration.

So that these banks, which are functioning now, which are profitable, which are good banks, can become bigger banks with an infusion of Federal dollars that can then be sold for a profit later. But at least these banks then, without forming new banks, would presumably supply a lot of credit to the system while you figure out what to do with the Bank of America and the Citigroups and the other banks that have these so-called toxic assets on the books.

And I think unless we do something along these lines, either change our policy along the lines of Krugman and Stiglitz, et al., or supplement the policy by forming new banks or funding existing smaller banks, you are not going to see credit, and we are going to have another Japanese lost decade, but it will be called the American lost decade.

Moving forward, we need to maintain real oversight as our plan unfolds and the economy recovers. We need comprehensive regulatory reform in order to stave off the next financial catastrophe. We need to take away from this experience a lesson I had thought the Nation learned in 1929, that sound regulation in markets is necessary to maintain stability. That markets are fine, but they cannot function on an even keel without proper regulation.

We do know that this crisis is real and immediate. Our recovery is directly dependent on the Federal Government's expert management and oversight of the TARP and on getting credit flowing again, which I do not believe the current plan is doing. And this can only be achieved with total transparency as we move forward.

Again, I thank the panel for its crucial work.

The CHAIR. Congressman, thank you very much. Lively, as always.

Thank you.

Representative NADLER. Thank you.

The CHAIR. Now I want to welcome Congresswoman Maloney, fresh off her victory last week of the passage of the credit card holders' bill of rights.

Congressman Maloney has proven both that she has foresight and that she is a fighter. She took on a fight that many believed

2 years ago, 3 years ago was completely unwinnable. And as I understand it, there was a ceremony in the Rose Garden on Friday, signing the bill that she has championed into law.

So, Congresswoman Maloney, thank you very much for being here. Welcome, and we welcome your remarks.

STATEMENT OF HON. CAROLYN MALONEY, U.S. REPRESENTATIVE FROM NEW YORK

Representative MALONEY. Well, thank you, Chairwoman Warren, for your leadership not only on this oversight panel, but you were a voice in the wilderness for many years on the need for credit card reform. I read your papers with great interest. They inspired me in my work, and you were talking about these abuses long before the Federal Reserve issued, in response to my legislation, a report calling them abusive, deceptive, anti-competitive, and totally unfair.

So it was a long battle, but Professor Warren, you were one of the first voices and a great leader in it. And if anyone should have been in the Rose Garden on Friday, it should have been you, Professor Warren. But I am sure you were probably working on this new need to move our economy forward.

I am very proud of the work of the Superintendent of the great State of New York Neiman for holding this hearing and inviting me to speak today on this topic of great importance. Your leadership in so many areas, not only on this board, but with our whole financial system, has been terrific.

And all of the members, I join my colleague Jerry Nadler in thanking NYU for what they do for our communities and our students. My daughter joins his son as a proud graduate of NYU Law School and is now practicing law.

And I just want to begin on how very important this is, and I agree with Mr. Sununu, you shouldn't have anecdotes. You should have the scientific data. But I must tell you that in the district that I represent, some of the most respected businessmen of great accomplishment, of great standing in the business community, they are all telling me that the access to commercial credit is absolutely frozen, that you cannot get it anywhere and that it is a crisis condition.

The amount of concern that I am feeling from the stakeholders in this area is equivalent to the anti-terrorism risk insurance proposal that we needed to get our economy moving in New York. Jerry and I fight every day in response to 9/11. But of all the programs that the Government provided, the most important in terms of getting our economy moving was the Government support, which gladly they have never had to tap into, of the anti-terrorism risk insurance program.

We could not even build a hot dog stand until that program was put in place. And what I am hearing from the industry is that if something is not done, that there will be a total collapse in this area with loss of jobs that Mr. Silvers so adequately expressed in his opening statement.

The problems that lenders and borrowers are facing in the commercial real estate market have been overshadowed by the persistent crisis we have been grappling with in residential mortgages.

But we are coming to an absolute critical juncture as many commercial real estate mortgage loans, issued at the height of the real estate bubble, are coming due for refinancing.

As we all know, a well-functioning commercial real estate market depends on the ability of mortgage holders to refinance because commercial real estate or CRE loans are often not self-amortizing, that is paying off the principal during their term. They are subject to large balloon payments at the close of the payment period. Refinancing is critical to meeting these obligations, as tenant rent payments are often not sufficient to cover the payment.

However, in this highly constrained credit market that we now live in, even borrowers with performing CRE loans who have equity in their properties report to me that they are having trouble getting refinancing. It is simply not there. Then there are the many borrowers whose commercial mortgages are underwater because the property simply isn't worth today what they paid for it a few years ago.

To be sure, data on the commercial real estate market offer a mixed picture. According to figures released by the Federal Reserve, 66 percent of domestic banks reported falling consumer demand for CRE loans, a trend that started in the third quarter of 2006.

But these statistics do not tell the whole story. At the same time that banks are reporting falling demand, more banks have reported tightening credit standards on commercial real estate loan applications. In the past three months alone, two-thirds of banks say their CRE loan standards have tightened.

Surely stringent credit requirements have had an effect on suppressing demand, most notably by dampening enthusiasm for investing in commercial property in the first place. The commercial real estate time bomb is ticking. An estimated $400 billion in commercial real estate debt is set to mature this year, with another $300 billion due in 2010.

If mortgagers are unable to refinance or otherwise pay these large balloon payments, we could expect to see the default rate climb much higher than the current 6.4 percent reported by commercial banks in the first quarter of this year. That, in turn, translates into potentially crippling bank losses that our recovering financial system is still too fragile to withstand, even with the news that banks have raised or announced some $50 billion in new private capital since the release of the stress test results.

Doing nothing is not an option because this looming crisis in commercial real estate lending could lead to an all-too-familiar predicament, where banks suffer significant losses, major owners of hotels and shopping centers are forced into bankruptcy, foreclosed properties push commercial real estate prices further downward, and a perfect storm of all these forces combine to inhibit prospects for a sustained economic recovery and result in greater job loss.

In response, the Federal Reserve last week announced that it would extend the TALF, the Term Asset-Backed Securities Loan Facility, to include both new and legacy commercial mortgage-backed securities. They are putting up, I understand, roughly $100 billion for these loans, and they urge—my constituents urge that it be for at least a 5-year period that you can get this because most of their commitments are 3, 5, 7, 10 years, and 3 years is simply not enough.

I think the timing is very interesting. You have organized this important hearing, and right before it, they have announced the access to the TALF program. So I congratulate you for being on top of a pressing issue in our country.

I do want to say that the regulations have not come out, which has many people mystified as how they apply, how they can move it into their business model. In other words, the Fed will issue loans secured by both existing loans as well as new ones. In expanding the eligible collateral for TALF loans, the Fed said this step was intended not only to restart the secondary market in commercial-backed securities, but indirectly to encourage CMBS originations, including refinancing.

The soon-to-be-launched public-private investment program will also provide an additional source of demand for legacy commercial mortgage-backed securities. I applaud these efforts by the Federal Reserve and the Treasury, but at the same time, we need to be very cautious of a potential problem first noted by the special inspector general for the TARP program.

He has pointed out that if private parties are allowed to buy legacy assets through the PPIP program and then sell them to TALF, taxpayer exposure to losses will be increased with no corresponding increase in taxpayers' share of profit. I believe that the Treasury and Federal Reserve should guard against this possibility in order to preserve the integrity of both the TALF program and the PPIP program and to safeguard taxpayer dollars.

With that in mind, I would say that the effects of TALF and PPIP on the commercial mortgage-backed securities market should be monitored very closely. We need to see if these programs help to restart this important market. If they do not, we may need to consider additional measures to aid the commercial real estate market.

I thank you for this opportunity. I would like to just respond to some issues raised. On the FDIC insured banks, the Financial Services Committee on which I serve is now reviewing legislation to expand that program to non-bank entities so that there is a reasonable way to confront these crises, as we have been able to do with FDIC-insured banks.

I would also urge you to have a similar hearing on housing and the housing market. That is likewise frozen. And as long as real estate is in a downward spiral, we will not recover. As almost every economist has said, if we do not get a hold on the downward fall of real estate values, we will not dig our way out of this recession. And we have come forward with various proposals, but we have not really taken the necessary steps to move forward.

I also know from all of the reports that credit is still not moving into the communities in a way that it should. I have even had leaders from the private sector come and say, similar to what my colleague said, why doesn't the Government just put a bank out there someplace with strong underwriting requirements where we can get access to capital? It is still not flowing.

And many ideas have come forward that any additional money be required to go into the communities and providing jobs and providing it, but a hearing I would request on real estate and also the access to capital, which my constituents in reports are showing is still not available.

I want to thank you very much for your efforts here today. I believe your body is Government at its best, looking at problems, trying to anticipate them and provide appropriate leadership to Congress, being a voice for change and what we should be—pointing out what needs to be done. And we thank you very much, and I am honored to have this opportunity to speak before you today.

Thank you.

The CHAIR. Thank you very much, Congresswoman. Thank you very much, Congressman. We appreciate your being here today.

Thank you.

Mr. Schuermann and Mr. Parkus, if you could take your seats, please?

Dr. Schuermann, Mr. Parkus, you have both been introduced earlier by Superintendent Neiman. We also have your written statements, which will become part of the official record. You are going to see a little timer. To the extent you can, we would like to hold the oral part to 5 minutes each so that we have more time for questions and more time for interaction.

I understand you are going to be presenting data, though, and we are not going to shortchange that. So thank you very much.

Dr. Schuermann, would you like to start.

STATEMENT OF TIL SCHUERMANN, VICE PRESIDENT, BANK SUPERVISION, FEDERAL RESERVE BANK OF NEW YORK

Dr. SCHUERMANN. Yes, thank you.

Members of the panel, thank you for giving me the opportunity to discuss with you some of the recent trends in commercial lending and especially the role banks have played and are playing in the provision of credit to this important sector.

My name is Til Schuermann. I am a vice president of the Federal Reserve Bank of New York. I wish to preface my remarks by noting that they do not reflect the official views of the Federal Reserve Bank of New York or any other component of the Federal Reserve System.

In early 2007, just before the crisis hit, U.S. commercial banks had $10 trillion of assets on their balance sheets. About 60 percent was composed of what we may think of as traditional banking assets in the form of loans and leases. And of that, about $1.2 trillion, or 20 percent, was in the form of commercial and industrial or C&I lending, and about $1.4 trillion, or 24 percent, in commercial real estate or CRE lending, the topic of today's hearing.

Meanwhile, the sum total of assets in other important non-bank intermediaries, such as finance companies, the Government-sponsored enterprises, investment banks, and importantly, issuers of securitized non-mortgage assets, such as auto loans, credit card receivables, student and small business loans, was over $16 trillion. So when one adds provision through corporate bonds and commercial paper, one realizes that—how is that?

The CHAIR. That is better.

Dr. SCHUERMANN. Good. So when one adds credit provision through corporate bonds and commercial paper, one realizes that commercial banks have provided only about 20 percent of total U.S. lending since the early '90s. In the four decades prior, banks' share was closer to 40 percent. So the rise of market-based instead of bank-based credit provision in the last 20 years has been substantial and important.

But banks play a critical role as shock absorbers to the financial system. So when times are good, borrowers and investors, so those that need and those that supply funds, seem content to move outside the safety net of the regulated banking system.

So when a shock hits, however, those investors return to the safety of banks. And firms, in turn, draw down their loan commitments they have in place for a rainy day. So credit assets, such as auto loans, small business loans, credit card receivables, and some commercial real estate, that once were easily securitized and moved off of bank balance sheets into the capital markets now remain on bank balance sheets and, therefore, use up scarce lending capacity.

So, in short, banks intermediate when the markets don't or can't. And what we see is a flight to banks. And at the same time, there is a limit to how much banks can reintermediate in place of markets, and that limit is typically dictated by capital.

Capital is a constraint on banks' balance sheets, meaning their lending capacity, even in good times. We impose minimum capital standards on banks as a buffer against unexpected losses. Where banks extend credit, regulators and market participants expect that they will have ample capital standing behind those commitments.

But during the crisis, banks have been confronted with a perfect storm as those very same assets moving onto bank balance sheets, as well as loans and securities already on banks' portfolios, face increased risk of credit deterioration and losses, especially if we experience a prolonged and a deep recession.

So banks have been playing this role of shock absorber in times of capital market disruption for decades. In this way, they helped the markets weather the storm in the fall of 1998, following Russia's sovereign bond default and the demise of the hedge fund LTCM. And during the darks days of September and October 2008, just 10 years later, banks faced an unprecedented demand on their balance sheet capacity. So that by the end of 2008, bank balance sheets had swelled to over $12 trillion from $10 trillion just at the dawn of the crisis.

There are, however, some important differences from 1998 and especially so for C&I and CRE lending. Aside from the obvious and the immediate, which is that the financial crisis is just far more severe than the turmoil experienced in the fall—in the few months in the early fall of 1998, we are now in the midst of what many consider to be the worst recession since World War II.

We want banks to expand credit, but not at the expense of credit quality. And indeed, lending patterns follow the trends of the overall economy so that during recessionary times when demand for credit naturally declines, so does bank lending.

It may take some time for bank lending to rebound to pre-recession levels. In the last two recessions, both of which were milder and shorter than the current one, it took at least 5 years to restore

C&I lending to pre-recession levels. And so, the charts that accompany my statement and that I have up here on the easel demonstrate this pattern quite vividly.

So the first chart, the top one, shows weekly C&I lending since 1985 and with the recession periods shaded in. You notice the current one isn't quite—we don't know when it is going to end. Lending peaks as one enters the recession and then declines, continuing to decline even after macroeconomic growth resumes.

The second chart below indexes the very same data to 100 at the beginning of the respective recessions and follows lending for 5 years, or about 250 weeks. So, in contrast to the previous two recessions, the current recession actually saw an increase in bank C&I balances during the fall of 2008. So just into the recession.

So this reflected the onboarding of off-balance sheet assets by banks, as well as the drawing down of loan commitments by firms with a latter effect being especially strong from mid-September to late October of 2008, where you see that spike just going up quite dramatically.

So this ballooning of bank balance sheets exactly reflects the reintermediation we expect during a time of financial turmoil. But it was not until early 2009, one year into the current recession, that we started to see the more typical recessionary pattern of balance sheet decline.

But if the two previous recessions are any guide, and to be sure, they were milder and shorter than the current one, we may well experience a period of more modest lending at banks before credit demand picks up. And this decline will likely be due to a combination of bank capital constraints and reduced market demand for banks loans.

Now capital injections from both private investors and the Government very likely helped significantly in enabling banks to play this important shock absorber role during the current crisis. So not only were banks faced with a sudden and unprecedented demand for balance sheet room, but they were beginning to experience heavy write-downs on loans already made with a prospect of still further write-downs to come.

The additional capital raised by the banking system in the course of 2008 and, more recently, in 2009 has given banks a buffer against future losses, as well as lending headroom that is badly needed in light of the drawdown of commitments that banks have experienced.

The result of the recently completed bank stress test has greatly reduced the uncertainty about just how much capital is needed for the largest banks to weather this storm and to continue to play their credit reintermediation role while capital markets slowly open up again.

Now the disruption of non-bank lending and investment within the last 18 months has hit commercial real estate especially hard. Commercial banks have typically provided less than half of the credit consumed by this market. Commercial mortgage-backed securities, or CMBS, make up about a quarter of CRE lending and with the rest coming from life insurers, thrifts, GSEs, and other financial institutions.

CMBS issuance has plummeted from over $300 billion in 2007 to well under $50 billion in 2008. Banks have picked up some of the slack. So here, too, just like in C&I lending, banks are reintermediating credit where the capital markets have shut.

Now banks cannot pick up all the slack. Reinvigorating the capital markets to intermediate between the supply and demand for credit is clearly very important. The Federal Reserve's Term Asset-Backed Securities Loan Facility, or TALF, is designed to help with this process by providing financing for the securitization of consumer assets. So, for example, auto loans, credit cards, student loans, and small business administration loans, as well as some CMBS. And as a result, spreads on consumer asset securitizations have already started to narrow.

Now, to be sure, this, like other Government programs, is not meant to replace private markets, but rather, TALF and similar programs are designed to help restart markets by providing some price transparency.

Bankers are starting to see some green shoots. The Federal Reserve's Senior Loan Officer Opinion Survey suggests that while the supply of credit remains tight, the extent of tightening has abated in recent quarters. One closely watched indicator of banks' appetite of extending credit is the net percent of loan officers reporting tightening standards for approving new loans.

After more than a year and a half of steady tightening, the net percent of loan officers reporting tightening standards for loans to large- and medium-sized firms reached an unprecedented peak of 84 percent in the fourth quarter of 2008. Since then, however, the tightening has fallen for two consecutive quarters down to 40 percent in April.

The tightening in standards for approving CRE loans has also abated, though not as dramatically. The net fraction of lenders reporting tightening standards for CRE dropped from a peak of 87 percent in the fourth quarter of 2008 to 66 percent in 2009.

The CHAIR. Dr. Schuermann, can we bring it to an end? I just want to make sure we have time for questions.

Dr. SCHUERMANN. Sorry, I shall. Yes.

The CHAIR. And we are at about double our time here.

Dr. SCHUERMANN. Twenty seconds, and I will be done.

The CHAIR. You bet.

Dr. SCHUERMANN. Thank you.

So the supply of commercial credit remains tight, but just as clearly, the extent of tightening is abating. But the same cannot be said for loan demand. The same survey reports that the net fraction of loan officers reporting weaker demand in April 2007 was 60 percent for C&I and 66 percent for CRE.

So, in sum, while green shoots may be sprouting in bank lending for commercial purposes, real estate or otherwise, it is really premature to start planning for the harvest. The combination of acute stresses in financial markets together with stresses on bank balance sheets in the middle of the worst recession in a generation should caution us from believing that recovery is just around the corner.

Thank you, and I apologize for going over my time.

[The prepared statement of Dr. Schuermann follows:]

For release on delivery
10:00 a.m. EDT
May 28, 2009

Statement by

Til Schuermann

Vice President, Risk Management

Federal Reserve Bank of New York

before the

Congressional Oversight Panel for the Troubled Asset Relief Program

Hearing on Commercial & Industrial and Commercial Real Estate Lending

New York, New York

May 28, 2009

Members of the Panel, thank you for giving me the opportunity to discuss with you some of the recent trends in commercial lending, and especially the role banks have played and are playing in the provision of credit to this important sector. My name is Til Schuermann, and I am a Vice President of the Federal Reserve Bank of New York. I wish to preface my remarks by noting that they do not reflect the official views of the Federal Reserve Bank of New York or any other component of the Federal Reserve System.

In early 2007, just before the crisis hit, U.S. commercial banks had $10 trillion of assets on their balance sheets. About 60% was composed of what we may think of as traditional banking assets in the form of loans and leases, and of that about $1.2 trillion or 20% was in the form of commercial & industrial (C&I) lending, and about $1.4 trillion or 24% in commercial real estate (CRE) lending, the topics of today's hearing.[1] Meanwhile, the sum total of assets at other important non-bank intermediaries such as finance companies, the government sponsored enterprises (GSEs), investment banks, and – importantly – issuers of securitized non-mortgage assets (such as auto loans, credit card receivables, student and small business loans) was over $16 trillion.

When one adds credit provision though corporate bonds and commercial paper, one realizes that commercial banks have provided only about 20% of total U.S. lending, since the early 90s. The four decades prior had banks' share closer to 40%. The rise of market-based instead of bank-based credit provision in the last twenty years has been substantial and important.

[1] Source: FDIC Statistics on Banking: http://www2.fdic.gov/SDI/SOB/.

But banks play a critical role as shock absorbers to the financial system. When times are good, borrowers and investors – i.e., those that need and those that supply funds – seem content to move outside the safety net of the regulated banking system. When a shock hits, however, those investors return to the safety of banks, and firms in turn draw down the loan commitments they have in place for a rainy day. Credit assets such as auto loans, small business loans, credit card receivables and some commercial real estate – once easily securitized and moved off of bank balance sheets into the capital markets – now remain on bank balance sheets and therefore use up scarce lending capacity. In short, banks intermediate when markets don't or can't, and what we see is a flight to banks.

At the same time, there is a limit to how much banks can re-intermediate in place of markets, and that limit is typically dictated by capital. Capital is a constraint on banks' balance sheets, meaning their lending capacity, even in good times. We impose minimum capital standards on banks as a buffer against unexpected losses. Where banks extend credit, regulators and market participants expect that they will have ample capital standing behind those commitments. But during the crisis banks have been confronted with a perfect storm as those very same assets moving onto bank balance sheets, as well as loans and securities already in the banks' portfolios, face increased risk of credit deterioration and losses, especially if we experience a prolonged and deep recession.

Banks have been playing this role of shock absorber in times of capital market disruption for decades. In this way they helped the markets weather the storm in the fall of 1998 following Russia's sovereign bond default and the demise of the hedge fund LTCM. And during the dark days of September and October 2008 – ten years later – banks faced an unprecedented demand on their balance sheet capacity. By the end of 2008, bank balance sheets had swelled to over $12 trillion (from $10 trillion at the dawn of the crisis).

There are, however, some important differences from 1998, and especially so for C&I and CRE lending. Aside from the obvious and immediate – this financial crisis is far more severe than the turmoil experienced for a few months in the early fall of 1998 – we are now in the midst of what many consider to be the worst recession since World War II. We want banks to expand credit, but not at the expense of credit quality. Indeed, lending patterns follow the trends of the overall economy, so that during recessionary times, when demand for credit naturally declines, so does bank lending. It may take some time for bank lending to rebound to pre-recession levels. In the last two recessions, both of which were milder and shorter than the current one, it took at least five years to restore C&I lending to pre-recession levels.

The charts that accompany my statement demonstrate this pattern vividly. The first chart shows weekly C&I lending since 1985, with the recession periods shaded in. Lending peaks as one enters the recession and then declines, continuing even after macroeconomic growth resumes. The second chart indexes the same data to 100 at the beginning of the respective recessions and follows lending for five years (or about 250 weeks). In contrast to the previous two recessions, the current recession saw an increase in banks' C&I balances during the fall of 2008. This reflected onboarding of off-balance sheet assets by banks as well as the drawing down of loan commitments by firms, with the latter effect being especially strong from mid-September to late October of 2008. This ballooning of bank balance sheets exactly reflects the re-intermediation we expect during a time of financial turmoil. It was not until early 2009, one year into the current recession, that we started to see the more typical recessionary pattern of balance sheet decline. But if the previous two recessions are any guide, and to be sure they were milder and shorter than the current one, we may well experience a period of more modest lending at banks before credit demand picks up. This decline will likely be due to a combination of bank capital constraints and reduced market demand for bank loans.

Capital injections, from both private investors and the government, very likely helped significantly in enabling banks to play this important shock absorber role during the current crisis. Not only were banks faced with a sudden and unprecedented demand for balance sheet room, but they were beginning to experience heavy write-downs on loans already made with the prospect of still further write-downs to come. The additional capital raised by the banking system in the course of 2008, and more recently in 2009, has given banks a buffer against future losses, as well as lending headroom that is badly needed in light of the draw-down of commitments that banks have experienced. The result of the recently completed bank stress test has greatly reduced the uncertainty about just how much capital is needed for the largest banks to weather this storm, and to continue to play their credit (re-)intermediation role while capital markets slowly open up again.

The disruption of non-bank lending and investment within the last 18 months has also hit commercial real estate lending hard. Commercial banks have typically provided less than half of the credit consumed by this market. Commercial mortgage backed securities (CMBS) make up about one-quarter of CRE lending, with the rest coming from life insurers, thrifts, GSEs, and other financial institutions.[2] CMBS issuance has plummeted from over $300 billion in 2007 to

[2] Source: Commercial Mortgage Securities Association *Compendium of Statistics*, May 15, 2009.

under $50 billion in 2008. Banks have picked up some of the slack. So here too, just like in C&I lending, banks are re-intermediating credit where the capital markets have shut.

CRE loans typically have longer maturities, at durations of five or more years, than C&I loans at durations of 1-2 years. As a result, the pick-up in CRE lending typically lags that of C&I lending as problems surface later and are therefore dealt with more gradually than in faster maturing C&I lending.

Banks cannot pick up all of the slack. Re-invigorating the capital markets to intermediate between the supply and demand for credit is clearly very important. The Federal Reserve's Term Asset-Backed Securities Loan Facility (TALF) is designed to help with this process by providing financing for the securitization of consumer assets (for example, auto loans, credit cards, student loans, and Small Business Administration loans) as well as some CMBS. As a result, spreads in consumer asset securitizations have started to narrow. To be sure, this, like other government programs, is not meant to replace the private markets. Rather, TALF and similar programs are designed to help restart markets by providing some price transparency.

And bankers are starting to see some "green shoots." The Federal Reserve's Senior Loan Officer Opinion Survey (SLOOS) suggests that, while the supply of bank credit remains tight, the extent of tightening has abated in recent quarters. One closely watched indicator of banks' appetite for extending credit is the net percent of loan officers reporting tightening standards for approving new loans. After more than 1½ years of steady tightening, the net percent of loan officers reporting tightening standards for loans to large- and medium-sized firms reached an unprecedented peak of 84% in the fourth quarter of 2008. Since then, however, the net percent tightening has fallen for two consecutive quarters, to 40% in April.[3] The tightening in standards for approving CRE loans has also abated, though not so dramatically: the net fraction of lenders reporting tightening standards for CRE dropped from its peak of 87% in the fourth quarter of 2008 to 66% in April 2009. Clearly, the supply of commercial credit remains tight, but just as clearly, the extent of tightening is abating.

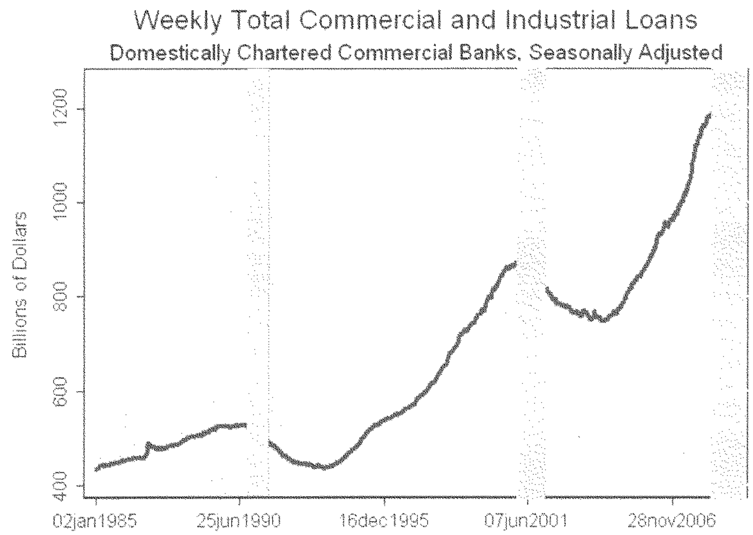
The same cannot be said for loan demand. The SLOOS reports that the net fraction of loan officers reporting weaker demand in April 2009 was 60% for C&I and 66% for CRE loans, a historical low for CRE demand. Weak demand bears emphasis, as it indicates that the observed slowdown in overall credit is partly due to firms' reluctance to borrow, and not entirely to banks reluctance to lend.

In sum, while green shoots may be sprouting in bank lending for commercial purposes – real estate or otherwise – it's premature to start planning for a harvest. The combination of acute stresses in the financial markets, together with stresses on bank balance sheets, in the middle of the worst recession in a generation, should caution us from believing that recovery is just around the corner.

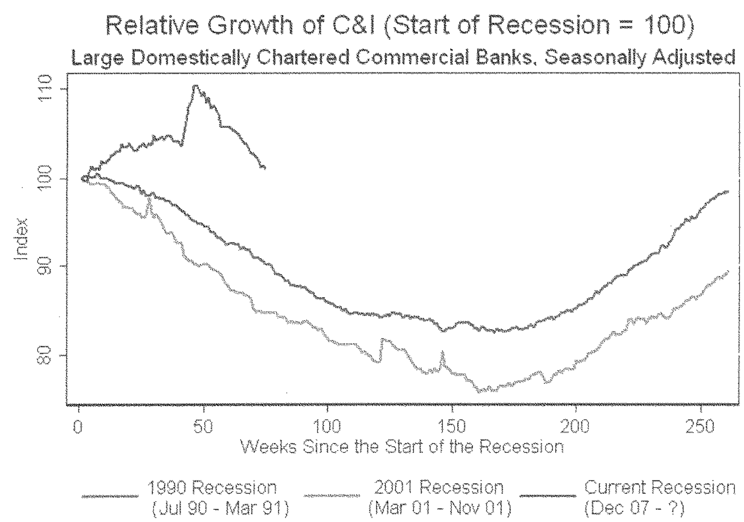
Thank you for the invitation to appear before you today. I look forward to your questions.

[3] Source: http://www.federalreserve.gov/boarddocs/snloansurvey/200905/chartdata.htm.

Appendix



Note: Shaded areas represent NBER recessions



Source: Federal Reserve H.8 data: http://www.federalreserve.gov/releases/h8/

The CHAIR. No, not at all. Thank you, Dr. Schuermann.

Mr. Parkus.

Pull the mike close. It is not as sensitive. There you go. It is on.

STATEMENT OF RICHARD PARKUS, HEAD OF CMBS AND ABS SYNTHETICS RESEARCH, DEUTSCHE BANK SECURITIES, INC.

Mr. PARKUS. Chairwoman Warren——

The CHAIR. Could you pull it a little closer?

Mr. PARKUS. Sure.

The CHAIR. I know it is a nuisance, but——

Mr. PARKUS. Oh, okay.

The CHAIR. Thank you.

Mr. PARKUS. Madam Chairwoman and distinguished members of the panel, my name is Richard Parkus. I am a research analyst working at Deutsche Bank Securities here in New York. I have been employed by Deutsche Bank since 1998, and my specialty is in providing coverage for the securitization markets, including the commercial mortgage-backed securities market.

It is a privilege for me to testify at this important hearing to explore the current state of commercial and industrial lending and to discuss the effectiveness of Government efforts to restart credit markets.

My testimony today will focus on three research reports that I recently published. The first report, published on April 23rd of this year, titled, "The Future Refinancing Crisis in Commercial Real Estate," addresses what we believe will be a widespread refinancing problem for commercial mortgages over the coming decade.

The other two reports, both published in May of this year, provide our views on the likely efficacy of the TALF programs, both for legacy CMBS and for new issue CMBS. All three of these reports have been provided to the panel as my written submission.

Before addressing my research, I must note that the views I express here today are my own and do not necessarily represent those of Deutsche Bank or any of its staff members.

It will be useful to begin with a few words about the size and structure of the commercial real estate debt market. The total market is approximately $3.4 trillion in size, with the CMBS market making up about 25 percent, banks and thrifts about 50 percent, and insurance companies 10 percent.

Commercial mortgages are non-recourse loans secured by income-producing properties—offices, shopping centers, hotels, et cetera. Most commercial mortgages have 3- to 10-year terms. At maturity, the loan balance is typically between 85 and 100 percent of the initial balance, depending on whether or not the loan amortizes.

Thus, at maturity, the borrowers must repay an amount which is not much below the initial loan amount. In the vast majority of cases, borrowers do this by refinancing. That is, by taking out a new loan that is large enough to allow them to pay off the old loan.

In cases where the value of the property has declined significantly since the loan was originated, the borrower may not be able to qualify for a new loan large enough to cover the maturing loan. In such circumstances, the end result is often maturity default, where the lender forecloses on the loan and liquidates the property.

Now to the future refinancing problems in commercial mortgages. As in most other credit markets, underwriting standards weakened significantly in commercial real estate debt markets from 2005 through 2007. Weakening underwriting standards, combined with widespread availability of cheap financing and high leverage, helped drive commercial real estate prices up nearly 60 percent between 2004 and the market's peak in mid 2007.

As the credit crisis took hold and intensified during 2008 and 2009, underwriting standards tightened dramatically. The allowable leverage plummeted, and the cost of credit, i.e., credit spreads, skyrocketed.

The combination of these three factors alone has, in our view, caused commercial real estate values to fall by at least 25 to 35 percent from their peak levels in 2007. In addition to this, declining rents and rising vacancy rates have pushed commercial real estate values down a further 10 to 15 percent. Thus, values have now fallen by 35 to 45 percent and may well fall further, particularly in certain markets.

As a result, many commercial mortgages, particularly those originated during the 2005–2007 timeframe, will simply not qualify at maturity to refinance into a mortgage sufficiently large to pay off the existing mortgage. The lender will then be faced either with foreclosing on the loan and liquidating the property or granting the borrower a maturity extension.

The question is what proportion of loans are likely to face this situation when they mature? Is this a small problem, or is this a large problem?

Our research studies this question purely within the CMBS market because that is the only segment of the commercial real estate debt market where there exists a wealth of data for virtually every loan. Our conclusion is that this is likely to be a big problem, a very big problem.

We believe that within CMBS, as many as two-thirds of the outstanding commercial mortgages may face problems refinancing at maturity over the coming decade. In dollar terms, as much as $400 billion of commercial mortgages in CMBS securitizations may have refinancing issues.

Recall now that CMBS is only 25 percent of the commercial real estate debt market. There is, in addition, more than $1 trillion of commercial mortgages in bank portfolios, and this excludes almost $600 billion of construction loans, by far the riskiest category of "commercial" mortgage debt, as well as $200 billion of multi-family loans, another risky category.

In our view, even the core commercial mortgages in bank portfolios are likely to be at least as risky as those in CMBS and possibly much riskier. If one simply extrapolates the scale of the potential problem in CMBS to commercial mortgages in bank portfolios, the conclusions are daunting.

Of the $1.3 trillion of commercial mortgages in CMBS and bank portfolios maturing over the next 5 years, more than $800 billion may well have trouble refinancing. Moreover, in our view, the granting of maturity extensions by lenders is unlikely to provide a solution to this problem.

We strongly support the efforts of the Fed and Treasury with respect to both TALF for legacy CMBS and TALF for new issue CMBS programs and believe that they are likely to help improve the liquidity in and functioning of commercial real estate finance markets. We stress, however, that neither program is likely to significantly impact the future refinancing problems outlined above.

These refinancing problems are the result of loans failing to qualify for refinancing due to massive price declines and a paradigm shift in the underwriting standards. They are not the result of illiquid and poorly functioning credit markets.

I thank you again for this opportunity to share my admittedly less than rosy assessment, and I am happy to take any questions.

[The prepared statement of Mr. Parkus follows:]

Written Statement of Richard Parkus

Congressional Oversight Panel Hearing: The Impact of Economic Recovery Efforts on Corporate and Commercial Real Estate Lending
Before the TARP Oversight Panel
May 28, 2009, New York

Chairman Warren and Distinguished Members of this Panel:

I am a research analyst at Deutsche Bank Securities Inc.,[1] located here in New York. My research focuses on the securitization markets, including the CMBS market. It is my understanding that the Panel is interested in hearing about three research reports that I published recently:

1. "The Future Refinancing Crisis in Commercial Real Estate" – published on April 23, 2009
2. "TALF for New Issue CMBS: Fed Releases Terms" – published on May 6, 2009.
3. "TALF for Legacy CMBS: Fed Releases Terms" – published on May 20, 2009

I am attaching these three research reports which shall serve as my written statement. I look forward to discussing these reports with the Panel and answering any questions the Panel may have.

[1] The views expressed during this testimony are mine and do not necessarily reflect the views of Deutsche Bank or anv of its other staff members.

23 April 2009

CMBS Research

The Future Refinancing Crisis in Commercial Real Estate*

Estimates of the Magnitude of Refinancing Risk, Equity Deficiency and Losses from Maturity Defaults

Special Report

Research Team

Richard Parkus
Research Analyst
(+1) 212 250-6724
richard.parkus@db.com

Jing An, CFA
Research Analyst
(+1) 212 250-5893
jing.an@db.com

**This is a revised version of a report originally published on 22 April 2009. It contains minor corrections to the text on page 21.*

Table of Contents

I. Introduction

The lesson that was learned (or re-learned) in the commercial real estate (CRE) crash of the early 1990s was that problems associated with massive over-supply can plague the industry for many years. The lesson that will be learned in the current crash (with CRE prices declining by 40-50%, or more, from their peaks, the term crash is, once again, appropriate) is that problems emanating from the financing side—in particular, a massive deterioration in underwriting standards and a concurrent rise of excessive leverage—can lead to problems of a similar (or greater) magnitude, even without supply problems.

While most attention in commercial real estate today is focused on the dramatic deterioration in term loan performance (i.e. the performance of loans prior to maturity), we believe that a potentially even more troublesome issue is the extent to which loans originated during the 2005-2007 period will encounter problems refinancing at maturity. To date, this issue has largely been dismissed with the vague and, in our view, naive observation that lenders will simply extend the maturity dates of loans that fail to qualify for refinancing. However, the scale of this problem is virtually unprecedented in commercial real estate, and its impact is likely to dominate the industry for the better part a decade.

At its core, the issue is fairly straightforward: The dramatic weakening in underwriting quality that began in 2005, along with compressing cap rates and ballooning leverage, led to rapidly rising commercial real estate prices. In 2007 the commercial real estate bubble burst, along with most other credit bubbles. Since that time underwriting standards have tightened back to their original levels, and perhaps further, as allowable leverage has plummeted and cap rates have skyrocketed. Purely as a result of the enormous changes in the available financing terms (e.g. lower leverage, higher cap rates and credit spreads), we estimate that commercial real estate prices have declined 25-30% from their 2007 peak. On top of this, the impact of the worst economic recession in decades on property cash flows will likely push them down additional 15-20% over and above the declines due to financing market changes. We argue in this report that, as a result, there are hundreds of billions of dollars, perhaps more than a trillion dollars, of commercial mortgages scheduled to mature over the next decade that are unlikely to qualify for refinancing without substantial equity infusions from the borrowers.

There are, in fact, two very different sources of refinancing problems, both of which are currently at play to varying degrees. The first source reflects the fact that most credit markets are currently either shut or operating at dramatically reduced levels. The problem here is not that maturing loans do not qualify for refinancing, but rather scarcity of credit makes it difficult for all loans to find refinancing, even those that would normally qualify under the new, tighter underwriting standards. Thus, in the current environment, the percentage of maturing loans that are able to refinance has been declining significantly since late 2008, despite the fact that the great majority of maturing loans is from the 1999 and 2000 vintages, have experienced enormous price appreciation and easily qualify for refinancing. As credit markets begin to heal, this source of refinancing problems will diminish.

The second source of refinancing problems, as previously noted, relates to the fact that a vast swath of the commercial mortgages originated during the bubble years (2005-2007) will not qualify for refinancing under the new standards. It is this source of refinancing problems that we focus in this report, and this problem will not go away as credit market rebound.

The focus of this report is on the refinancing problem for commercial mortgages in CMBS transactions. But CMBS is only 25% of the entire commercial real estate debt market, and the same processes that created a vast refinancing problem here were at work, to varying degrees, in other segments of the commercial real estate financing market as well. In particular, we expect that the same type of refinancing problems will be present in both bank and insurance company loan portfolios, and that they will likely be of a similar magnitude, at least in the case of banks.

The goal of this analysis is to quantify the scale of the refinancing problem in commercial real estate. In particular, by making conservative assumptions, we attempt to determine the minimum size of the problem. The quantitative analysis is carried out only on commercial mortgages in CMBS because only here do we have extremely detailed and complete data about every individual loan, including exact cash flow models. It is then possible, however, to extrapolate the findings on CMBS to the broader commercial real estate debt market.

Our findings with respect to CMBS are as follows:

1. At least two thirds of the loans maturing between 2009 and 2018 ($410 billion) are unlikely to qualify for refinancing at maturity without significant equity infusions from borrowers. For the 2007 vintage, well in excess of 80% of the loans are unlikely to qualify.

2. The aggregate equity deficiency (i.e. the additional amount of equity that borrowers would have to put up in order to qualify to refinance) is at least on the order of $100 billion.

3. Our (conservative) estimate of maturity default-related losses for fixed rate CMBS is $50 billion, 6.5% of the aggregate outstanding balance.

4. We estimate that maturity default-related losses will be at least 4.6% for the 2005 vintage, 5.8% for the 2006 vintage and 12.5% for the 2007 vintage.

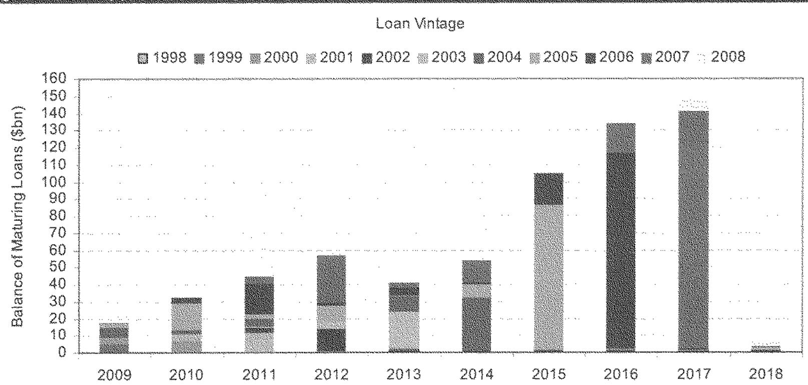
It must be emphasized that this report considers the likely percentage of CMBS loans that would not qualify for refinancing and the associated maturity default-related losses assuming that loans do not default prior to maturity. In reality, a large percentage of these loans are likely to default prior to maturity. Thus, a significant part of what we calculate as maturity default-related losses will actually end up as term default losses. Total losses—the sum of term and maturity-related losses, are likely to be well in excess of the losses shown in this report. We will, in the near future, publish additional results using a combination of our term and maturity default analyses. The purpose of this report, however, was to focus on refinancing and maturity default related issues.

The report is structured as follows: Section II explores the scale of the refinancing problem, including the bank and insurance company components of the commercial real estate financing market. Section III discusses the quantitative analysis upon which our results are based, and presents the underlying assumptions. Section IV examines in some detail the amount of debt that is unlikely to qualify for refinancing without equity infusions from the borrower. In Section VI we provide estimates of the magnitude of the equity deficiency and maturity default-related losses. Average loss estimates are provided for each vintage, and for the 2005, 2006, 2007 and 2008 vintages losses are provided for each CMBS deal. The report concludes with Section VII, which discusses why we do not think that maturity extensions provide a solution to the refinancing problem outlined here.

II. The Magnitude of the Problem

In order to convey the scale of the future refinancing problem, we start by noting that there are approximately $685 billion of non-defeased commercial mortgages in CMBS maturing between now and 2018, of which $640 billion is fixed rate conduit and about $45 billion is floating rate.[1] Of this, approximately $236 billion matures by the end of 2013. Figure 1 provides a breakdown of the maturity profile of fixed rate loans by origination vintage. We include the origination vintage because maturing loans from older vintages clearly pose less of a refinancing problem.

Figure 1: Maturity profile of fixed rate commercial mortgages in CMBS transactions

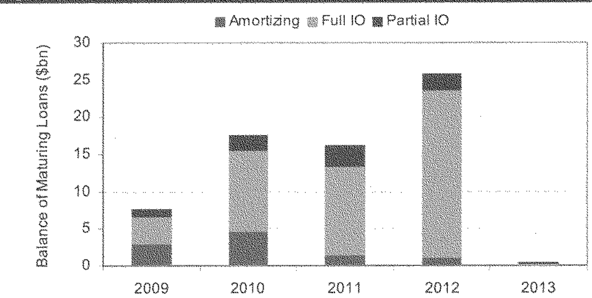


Source: Deutsche Bank, Intex, Trepp

By far the most problematic of the fixed rate CMBS loans are the $67 billion of short-term loans that were originated during the 2005-2007 period and mature in 2010-2013. See Figure 2. These loans were originated at the top of the market, and the subsequent 35-50% price declines will leave a large percentage of them with negative equity just as they approach maturity, making refinancing all but impossible without very significant equity infusions by borrowers, as we will show in the analysis that follows. On top of the shortage of equity issue, these loans also exhibited the worst deterioration in underwriting standards. We argue in a later section that only a small percentage of these loans are likely to be able to qualify for refinancing when they mature.

[1] This excludes whole loans in CRE CDOs, as well as small sectors such as seasoned loan deals.

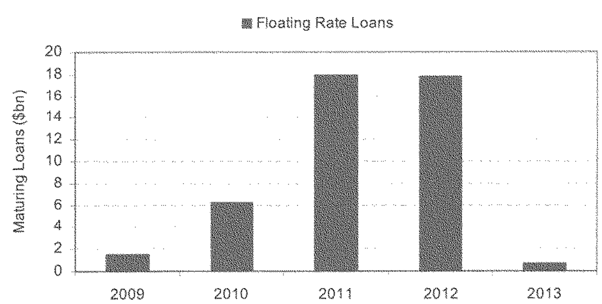
Figure 2: Short term fixed rate CMBS loans maturing through 2013



Source: Deutsche Bank, Intex, Trepp

The $45 billion of floating rate loans (see Figure 3) mentioned above, plus the billions of dollars worth of floating rate whole loans in CRE CDOs that we have not accounted for, are even more problematic than the short-term fixed rate loans. The reason is that these are nearly all short-term loans (five to six year terms) on transitional properties. The properties being transitional, this is where pro forma underwriting was most widespread. In addition, these loans were usually the most highly levered with various types of subordinate debt—B-notes and mezzanine loans. We expect that the vast majority of these loans will not qualify for refinancing without extremely large infusions of borrower equity—imagine the required equity infusion to refinance a loan with an original LTV of 90, where the new minimum LTV is 65 and the value of the securing property has declined by 50%. Needless to say, not many borrowers will be willing to make put this amount of additional equity into an underwater loan.

Figure 3: Maturity profile of floating rate CMBS loans



Source: Deutsche Bank, Intex, Trepp

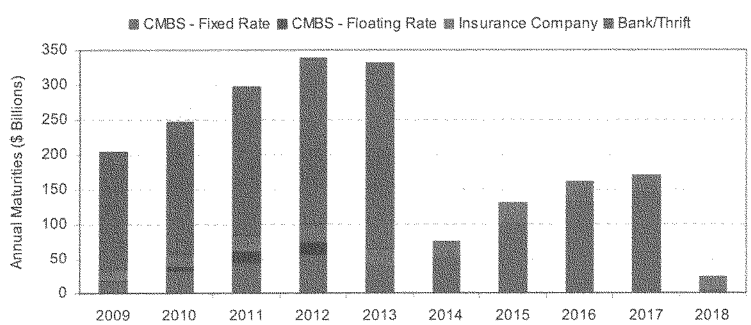
The quantitative analysis in this report focuses only on commercial mortgages in CMBS transactions because only here do we have sufficient data available. However, CMBS represents only about 25% of the $3.4 trillion commercial real estate market. Banks and life companies, which make up approximately 50% and 10% of the market, respectively, must also be considered in the mix. After all, the same combination of deteriorating underwriting standards and excessive price inflation were operating in bank and life company lending (although we do not expect life company direct loans to suffer to same degree as either CMBS or bank loans.)

Banks have $1.068 trillion of core commercial real estate loans on their books, according to the FDIC. This amount does not include $590 billion of (highly combustible) construction loans, $205 billion of multifamily loans or $63 billion of farm loans. We do not know the precise time profile for maturing commercial mortgage loans in bank portfolios. However, bank loans tend to of relatively short term duration to better fit bank liability structures. In order to get a reasonable estimate for the time profile of maturities we assume that all loans have five-year terms and thus mature by 2013. Moreover, this category of bank commercial mortgages has experienced an average annual grown rate of approximately 12% over the past five years. Thus, as a simple approximation, we assume that the amount of bank commercial mortgage maturities each year grow at 12% from 2009 through 2013.

According to the Mortgage Bankers Association, life companies have approximately $222 billion of direct loans maturing through 2018, with annual maturities in the $15-$25 billion range.

The total from these three sources is $1.973 trillion maturing over through 2018, and $1.415 trillion maturing through 2013. See Figures 4 and 5.

Figure 4: Estimated maturity profile of commercial mortgages in CMBS, bank and life company portfolios



Source: Deutsche Bank, Intex, Trepp, Mortgage Bankers Association, Federal Reserve

Figure 5: Annual maturities ($ billion) in CMBS, banks and life companies

Year	CMBS - Fixed Rate	CMBS - Floating Rate	Insurance Company	Bank/Thrift*
2009	17.6	1.5	16.8	168.1
2010	32.2	6.2	19.8	188.3
2011	44.1	17.8	23.1	210.9
2012	57.6	17.7	26.1	236.2
2013	40.9	0.7	24.8	264.6
2014	54.2		20.6	
2015	104.5		25.7	
2016	133.9		27.3	
2017	148.2		21.4	
2018	6.1		16.3	
Total ($bn)	**639.3**	**43.9**	**221.9**	**1,068.2**

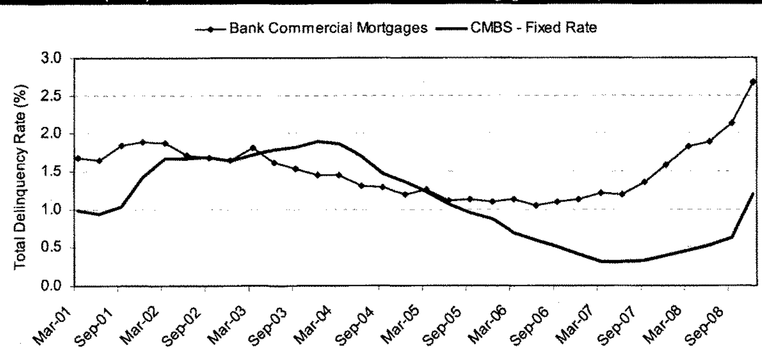
* Maturity timing is estimated

Source: Deutsche Bank, Intex, Trepp, Mortgage Bankers Association, Federal Reserve

When commercial mortgage maturities from bank and life company portfolios are added to the picture, the enormous scale of the problem becomes clear. Without a doubt, the period 2010-2013 will be one of very significant stress in the commercial real estate market. During this period, banks will likely also be taking very large losses not only on residential mortgage portfolios, but also on their construction loan portfolios. According to Foresight Analytics, delinquency rates for construction and land loans stood at 11.4% in 4Q 2008.

In our view, there is also a distinct risk that bank commercial mortgages will under-perform CMBS loans. Figure 6 compares the total delinquency rates for the two universes of loans. On a historical basis, bank commercial mortgages (excluding construction and land loans and multifamily loans) have significantly under-performed CMBS loans. As of Q4 22008, the total delinquency rate for commercial mortgages in bank portfolios bank was more than twice that of fixed rate CMBS. The same is true for multifamily loans as well. As of Q4 2008, multifamily loans in bank portfolios exhibited a total default rate of 4.6%, versus 2.6% for those in CMBS.

Figure 6: Total delinquency rates: fixed rate CMBS versus commercial mortgages in bank portfolios



Source: Deutsche Bank, Intex, Trepp, Foresight Analytics

Our main point is that the amount of commercial mortgages maturing over the next five to seven years that will face formidable refinancing problems could be well in excess of $1 trillion dollars.

Of course, all of this begs the question of precisely where the future financing for commercial real estate will come from. At the moment, the CMBS market is moribund. We speculate

III. Description of the Analysis and Assumptions

The quantitative analysis presented in this report is based entirely on 54,079 currently outstanding and non-defeased fixed rate commercial mortgages in CMBS transactions with an aggregate balance of $601.9 billion.

The analysis begins with the Intex cash flow model for each of the 54,079 loans. Portfolio and Property Research (PPR), an independent commercial real estate research firm, produces 5-year rent, vacancy and NOI projections for each major property segment in the 54 largest commercial real estate markets in the US. For each loan in our sample, we project the NOI of the underlying property five years forward (thorough 2013) using the PPR projections for the appropriate property type and market. After 2013, we assume that NOI returns (linearly) to its peak level at the end of 2007 by 2018. This NOI projection is then run through the Intex cash flow model for the loan until its maturity date. At this point, the property's approximate value is calculated by applying the appropriate cap rate to the property's projected NOI. By making specific assumptions about maximum LTV, minimum DSCR and the future cost of financing (i.e. mortgage rates), we are able to estimate whether the loan would qualify for refinancing at the new tighter underwriting standards, the amount, if any, of the equity deficiency (i.e. the amount of new equity the borrower would need to put into the loan in order to refinance) and an estimate of the maturity default-related loss.

At each stage of the analysis, we have attempted to make assumptions that are reasonable, but conservative in the sense of giving rise to the least stress or the lowest losses. The exception is the NOI scenarios, which we simply take from PPR.

The PPR NOI scenarios are summarized at an aggregated level in Figure 7 by taking, for each property segment, the weighted average of NOI projections across markets, where the weights represent the size of the property sector in that market.

Scenario 1 is the current PPR severe recession scenario. Scenario 2 is the previous PPR severe recession scenario, which now looks relatively mild. Scenario 1 clearly entails extreme cash flow stress for properties. In our view, the magnitudes of these projections are reasonable.

Figure 7: Summary of aggregated NOI growth scenarios

NOI Growth Assumptions

	PPR Peak-Trough NOI % Change	
Property Type	**NOI Scenario 1**	**NOI Scenario 2**
Industrial	-16.3	-8.5
Multifamily	-15.0	-5.4
Office	-32.6	-13.4
Retail	-26.6	-19.7
Hotel *	-20.0	-20.0

* Hotel projection is not based on PPR

Source: Deutsche Bank, PPR

Cap rates are an important component of the analysis and the results are sensitive to the assumed levels. In order to produce conservative estimates, we have chosen to use what are in our view conservative cap rate assumptions. These are shown in Figure 8.

Figure 8: Cap rate assumptions

Cap Rate Assumptions

Property Type	Current	24 Mnths	60 Months	120 Mnths	240 Mnths
Industrial	8.5	8.5	8.5	8.0	8.0
Multifamily	8.0	8.0	8.0	8.0	8.0
Office	8.5	8.5	8.5	8.0	8.0
Retail	8.5	8.5	8.5	8.0	8.0
Hotel	9.5	9.5	9.5	9.0	9.0

Source: Deutsche Bank

We believe that in many cases actual cap rates are currently 100-200bp, or more, higher

The results of or analysis are contained in the next two sections. We believe that these results are conservative (in the sense that the proportion of loans that will not qualify for refinancing without additional borrower equity infusions, as well as maturity default-related losses, will both be higher than our estimates) for the following reasons:

1. Our analysis does not take account of subordinate debt. However, large conduit loans originated from 2005 through 2007 often had large amounts of subordinate debt either in the form of B-notes, mezzanine loans or both. While we do have fairly complete data on B-notes, we have very sketchy information on mezzanine debt, at least in Intex. The inclusion of subordinate debt would likely significantly increase the equity deficiency in the 2005-2007 vintage loans. On the other hand, the impact the mezzanine loan component may not be as relevant as the B-note component since they are not secured by the property directly and only really determines, ultimately, who the borrower is. Apart from more recently originated loans on larger assets, a significant percentage of smaller seasoned conduit loans also have some amount of subordinate debt, often 2nd lien mortgages. This clearly increases the equity deficiency beyond our estimates. On the other had, subordinate debt is not as relevant for loss estimates since, by definition, it is subordinate to the first mortgage.

2. As already discussed, our cap rates assumptions are conservative.

3. As will be discussed in the next two sections, our underwriting assumptions–maximum LTVs (70%), minimum DSCRs (1.3x) and future mortgage rates (8%)–are conservative.

IV. Estimating the Amount of Non-Refinanceable Loans

To be clear, by not qualifying for refinancing, we mean that when the existing loan matures the borrower will not be able to qualify for a new loan with sufficient proceeds to payoff the existing loan. In particular, the borrower will need to put additional equity to payoff the existing loan.

The amount of refinanceable loans is particularly important because, in our view, commercial real estate borrowers will, for the most part, either be unable or unwilling (or both) to put additional equity into these properties. Instead, borrowers will be faced either with negotiating for maturity extensions from their lenders or walking away from the property. As we argue in the final section, we do not believe that loan extensions offer a way out of this problem and expect that both routes will ultimately lead to losses.

This section provides a variety of results meant to shed light on the nature and scope of the refinancing problem. In order to qualify to refinance an existing loan, the property must satisfy three criteria:

1. The new loan balance must be at least as large as the existing loan balance.

2. The LTV of the loan must be no greater than 70 (current maximum LTVs are between 60 and 65).

3. The DSCR, based on a 10-year fixed rate loan with a 25-year amortization schedule and an 8% mortgage rate, must be no less than 1.3x.

We provide results over two different horizons, the shorter-term horizon consisting of loans maturing between 2009 and 2012 and the full term horizon consisting of all loans. The reason we look at the shorter-term results separately is that our projections have more accuracy over this shorter period. The further out in time we go, the less sure we are that the actual future environment will match up to our projections.

We begin with the shorter-term results. Unless otherwise noted, all results correspond to the more severe NOI Scenario 1.

Figure 9 indicates that of all fixed rate CMBS loans maturing during the 2009-2012 period, approximately 67% (on a balance basis) would not qualify for refinancing.

Figure 9: Estimated percentage of loans that do not qualify for refinancing: NOI Scenario 1

	Loans Maturing 2009 - 2012					
	Refinancing Requirement: LTV < 70 & DCSR > 1.3					
Property Type	# Loans	Balance ($BB)	Loans Not Qualifying (#)	Loans Not Qualifying ($BB)	% Not Qualifying (Loan Count)	% Not Qualifying (Balance)
Hotel	475	7.3	182	4.1	38.3	55.5
Industrial	1,189	5.8	330	2.2	27.8	37.9
Multifamily	3,793	24.4	2,220	18.9	58.5	77.3
Office	2,629	40.9	1,433	30.8	54.5	75.3
Retail	4,156	44.6	1,727	24.6	41.6	55.1
Multi Property	672	29.6	339	21.1	50.4	71.3
Other	1,545	12.0	639	8.7	41.4	71.9
Aggregate	**14,459**	**164.7**	**6,870**	**110.3**	**47.5**	**66.9**

Source: Deutsche Bank

Figure 10 provides the results from the same analysis as the previous case, except that only the LTV constraint is applied for qualifying. Here the percentage that does not qualify drops to 56%.

Figure 10: Estimated percentage of loans that do not qualify for refinancing: NOI Scenario 1

	Loans Maturing 2009 - 2012					
	Refinancing Requirement: LTV < 70					
Property Type	# Loans	Balance ($BB)	Loans Not Qualifying (#)	Loans Not Qualifying ($BB)	% Not Qualifying (Loan Count)	% Not Qualifying (Balance)
Hotel	475	7.3	168	3.9	35.4	52.7
Industrial	1,189	5.8	286	2.0	24.1	34.4
Multifamily	3,793	24.4	1,958	17.3	51.6	70.8
Office	2,629	40.9	1,357	27.1	51.6	66.3
Retail	4,156	44.6	1,655	22.4	39.8	50.3
Multi Property	672	29.6	306	15.0	45.5	50.5
Other	1,545	12.0	573	4.0	37.1	33.0
Aggregate	**14,459**	**164.7**	**6,303**	**91.6**	**43.6**	**55.6**

Source: Deutsche Bank

Figure 11 again applies the same analysis, except that here we only apply the DSCR constraint for qualifying. The result is that 66% do not qualify for refinancing.

Figure 11: Estimated percentage of loans that do not qualify for refinancing: NOI Scenario 1

	Loans Maturing 2009 - 2012					
	Refinancing Requirement: DSCR > 1.3					
Property Type	**# Loans**	**Balance ($BB)**	**# Loans Not Qualifying**	**Balance Not Qualifying ($BB)**	**% Not Qualifying (Loan Count)**	**% Not Qualifying (Balance)**
Hotel	475	7.3	155	3.7	32.6	50.3
Industrial	1,189	5.8	323	2.1	27.2	36.9
Multifamily	3,793	24.4	2,220	18.9	58.5	77.3
Office	2,629	40.9	1,407	30.6	53.5	74.8
Retail	4,156	44.6	1,680	24.2	40.4	54.3
Multi Property	672	29.6	336	21.1	50.0	71.1
Other	1,545	12.0	548	8.2	35.5	68.6
Aggregate	**14,459**	**164.7**	**6,669**	**108.9**	**46.1**	**66.1**

Source: Deutsche Bank

From the preceding three sets of results, we conclude that in general both valuation (via the LTV constraint) and cash flow (via the DSCR constraint) are binding constraints, although cash flow appears to be slightly more significant of a constraint.

Next, Figure 12 indicates that, as would be expected, the situation is much worse for the 2007 vintage loans maturing between 2009 and 2012. Here nearly 80% do not qualify.

Figure 12: Estimated percentage of loans that do not qualify for refinancing: NOI Scenario 1

	2007 Vintage Loans Maturing 2009 - 2012					
	Refinancing Requirement: LTV < 70 & DSCR > 1.3					
Property Type	**# Loans**	**Balance ($BB)**	**# Loans Not Qualifying**	**Balance Not Qualifying ($BB)**	**% Not Qualifying (Loan Count)**	**% Not Qualifying (Balance)**
Hotel	79	2.7	51	2.1	64.6	77.7
Industrial	53	0.6	39	0.4	73.6	73.0
Multifamily	197	3.6	179	3.4	90.9	94.5
Office	197	7.6	172	6.7	87.3	88.0
Retail	118	2.0	96	1.9	81.4	94.6
Multi Property	81	7.9	66	6.9	81.5	87.4
Other	135	3.9	91	1.1	67.4	28.3
Aggregate	**860**	**28.2**	**694**	**22.5**	**80.7**	**79.6**

Source: Deutsche Bank

Figure 13 indicates that for all loans maturing in during 2009 and thereafter, effectively all outstanding loans, more than 68% ($411 billion out of $602 billion) do not qualify for refinancing.

Figure 13: Estimated percentage of loans that do not qualify for refinancing: NOI Scenario 1

	All Loans Maturing 2009 and Thereafter					
	Refinancing Requirement: LTV < 70 & DCSR>1.3					
Property Type	# Loans	Balance ($BB)	Loans Not Qualifying (#)	Loans Not Qualifying ($BB)	% Not Qualifying (Loan Count)	% Not Qualifying (Balance)
Hotel	2,756	34.1	594	12.7	21.6	37.1
Industrial	3,666	20.2	1,292	9.7	35.2	48.2
Multifamily	11,880	81.3	7,118	62.1	59.9	76.4
Office	9,192	162.1	5,515	122.7	60.0	75.7
Retail	18,121	168.6	10,805	118.8	59.6	70.5
Multi Property	2,541	94.6	1,236	58.1	48.6	61.4
Other	5,923	41.0	2,651	26.7	44.8	65.2
Aggregate	**54,079**	**601.9**	**29,211**	**410.9**	**54.0**	**68.3**

Source: Deutsche Bank

For the 2007 vintage loans as a whole, approximately 72% do not qualify under our scenario analysis. See Figure 14.

Figure 14: Estimated percentage of loans that do not qualify for refinancing: NOI Scenario 1

	2007 Vintage Loans Maturing 2009 and Thereafter					
	Refinancing Requirement: LTV < 70					
Property Type	# Loans	Balance ($BB)	Loans Not Qualifying (#)	Loans Not Qualifying ($BB)	% Not Qualifying (Loan Count)	% Not Qualifying (Balance)
Hotel	814	13.1	202	5.8	24.8	44.7
Industrial	732	5.5	358	3.3	48.9	59.3
Multifamily	1,674	19.6	1,158	16.1	69.2	82.4
Office	1,965	47.7	1,256	37.7	63.9	79.0
Retail	3,567	38.2	2,268	30.2	63.6	79.2
Multi Property	629	31.4	324	20.6	51.5	65.6
Other	1,231	12.5	722	7.2	58.7	57.6
Aggregate	**10,612**	**168.0**	**6,288**	**121.0**	**59.3**	**72.0**

Source: Deutsche Bank

Finally, Figures 15 and 16 report the results under the less stressful NOI Scenario 2. As expected, the percentage of loans failing to qualify declines. However, it remains in excess of 50%, enough to have extraordinarily stressful consequences.

Figure 15: Estimated percentage of loans that do not qualify for refinancing: NOI Scenario 2

	Loans Maturing 2009 - 2012					
	Refinancing Requirement: LTV < 70 & DCSR>1.3					
Property Type	# Loans	Balance ($BB)	Loans Not Qualifying (#)	Loans Not Qualifying ($BB)	% Not Qualifying (Loan Count)	% Not Qualifying (Balance)
Hotel	475	7.3	142	3.5	29.9	47.4
Industrial	1189	5.8	266	1.9	22.4	31.9
Multifamily	3793	24.4	1791	16.3	47.2	66.8
Office	2629	40.9	1086	23.5	41.3	57.5
Retail	4156	44.6	1439	20.5	34.6	46.0
Multi Property	672	29.6	300	14.9	44.6	50.1
Other	1545	12.0	482	3.6	31.2	29.6
Aggregate	**14,459**	**164.7**	**5,506**	**84.1**	**38.1**	**51.0**

Source: Deutsche Bank

Figure 16: Estimated percentage of loans that do not qualify for refinancing: NOI Scenario 2

	Loans Maturing 2009 - 2018					
	Refinancing Requirement: LTV < 70					
Property Type	# Loans	Balance ($BB)	Loans Not Qualifying (#)	Loans Not Qualifying ($BB)	% Not Qualifying (Loan Count)	% Not Qualifying (Balance)
Hotel	2,756	34.1	410	9.6	14.9	28.2
Industrial	3,666	20.2	995	7.9	27.1	39.2
Multifamily	11,880	81.3	5571	52.4	46.9	64.4
Office	9,192	162.1	4015	97.7	43.7	60.2
Retail	18,121	168.6	9100	104.5	50.2	62.0
Multi Property	2,541	94.6	1017	43.8	40.0	46.3
Other	5,923	41.0	2259	17.9	38.1	43.7
Aggregate	**54,079**	**601.9**	**23,367**	**333.7**	**43.2**	**55.4**

Source: Deutsche Bank

V. Equity Deficiency and Losses from Maturity Defaults

This section presents our estimates on both equity deficiency and maturity default-related losses. The equity deficiency in a given loan represents the amount of additional equity the borrower would have to inject in order for the loan to meet the 70 LTV hurdle. Losses estimates are calculated in two alternative ways. In the first method—Scenario 1—we assume that for any loan with less than a 100 LTV, the borrower puts in the additional equity, and there is no maturity default. For loans with greater than 100 LTV, the loss is calculated by subtracting 90% of the property value from the maturing loan balance. In the second method—Scenario 2—we assume that the borrower does not put up additional equity for loans having less than 100 LTV. The difference between these two approaches is that loans with less than 100 LTV cannot have losses under Scenario 1, while they can under Scenario 2. Thus, Scenario 1 is more conservative in the sense of producing lower losses.

In both calculations we use 90% of the estimated property value in order to account for:

1. The (quite significant) transactions costs associated with foreclosing upon and liquidating property, and
2. The fact that the liquidations will be taking place in an extremely stressed commercial real estate environment.

We believe that taking 90% of the property value is extremely conservative in this situation.

Figure 17 presents our basic results under NOI Scenario 1. The results are given by CMBS deal vintage. We present, first, maturity default-related loss estimates for loans maturing between 2009 and 2012 and second from all loans.

Figure 17: Estimated equity deficiency and maturity default-related loss rates: NOI Scenario 1

				Scenario 1: Equity Infusions for LTV < 100		Scenario 2: Zero Equity Infusions	
Vintage	# of Deals	Aggregate Balance ($BB)	Avg Equity Deficiency Rate	Avg Loss Rate Through 2012	Avg Loss Rate Lifetime	Avg Loss Rate Through 2012	Avg Loss Rate Lifetime
2000	32	19.4	4.0	1.5	1.5	2.3	2.3
2001	38	27.1	5.6	1.8	1.8	2.8	2.8
2002	38	27.5	6.4	2.1	2.1	2.7	2.7
2003	47	42.2	7.4	2.2	2.3	2.8	2.9
2004	60	64.8	9.0	1.1	2.8	1.3	3.3
2005	63	130.8	13.5	1.8	4.6	2.0	5.2
2006	64	159.6	15.5	1.9	5.8	2.2	6.5
2007	61	190.0	23.7	4.0	12.5	4.1	13.2
2008	8	10.7	12.5	3.0	5.8	3.0	6.1
Aggregate	**411**	**672.0**	**15.1**	**2.4**	**6.5**	**2.7**	**7.2**

Source: Deutsche Bank

Under the more conservative approach, estimated losses are nearly $44 billion, or 6.5% of the total outstanding balance. Under the alternative method, estimated losses are almost $49 billion, or 7.2%. By far the worst vintage is 2007, not surprising. What is surprising is how much worse the 2007 vintage is than either the 2005 or 2006 vintages.

Also interesting is the magnitude of the average equity deficiency. For the 2005-2008 vintages, the average equity deficiency ranges from 12% to nearly 24%. And this excludes subordinates debt!

The results are presented again in Figure 18 under the milder NOI Scenario 2.

Figure 18: Estimated equity deficiency and maturity default-related loss rates: NOI Scenario 1

				Scenario 1: Equity Infusions for LTV < 100		Scenario 2: Zero Equity Infusions	
Vintage	# of Deals	Aggregate Balance ($BB)	Avg Equity Deficiency Rate	Avg Loss Rate Through 2012	Avg Loss Rate Lifetime	Avg Loss Rate Through 2012	Avg Loss Rate Lifetime
2000	32	19.4	3.8	1.4	1.4	2.2	2.2
2001	38	27.1	4.7	1.5	1.5	2.5	2.5
2002	38	27.5	4.5	1.6	1.6	2.1	2.1
2003	47	42.2	5.1	1.5	1.6	2.1	2.1
2004	60	64.8	7.0	0.9	2.0	1.1	2.5
2005	63	130.8	11.2	1.3	3.4	1.5	3.9
2006	64	159.6	13.4	1.4	4.5	1.6	5.2
2007	61	190.0	22.2	3.4	11.2	3.5	11.8
2008	8	10.7	11.3	2.1	4.6	2.2	5.1
Aggregate	**411**	**672.0**	**13.3**	**1.9**	**5.4**	**2.2**	**6.1**

Source: Deutsche Bank

Finally, for each 2005-2008 vintage fixed rate conduit deal, we present both estimated average equity deficiency and losses. See Figures 19-22.

Figure 19. Estimated equity deficiency and losses for 2005 Vintage: NOI Scenario 1

		Scenario 1: Equity Infusions for LTV < 100		Scenario 2: Zero Equity Infusions	
Deal Name	Equity Deficiency	Loss % (Through 2012)	Loss % (Lifetime)	Loss % (Through 2012)	Loss % (Lifetime)
BACM0501	14.98	3.20	5.04	3.30	5.24
BACM0502	21.50	5.29	10.07	5.29	10.45
BACM0503	14.76	3.33	4.61	4.18	5.52
BACM0504	13.29	0.86	3.89	0.96	4.22
BACM0505	15.57	5.18	7.71	5.18	7.81
BACM0506	7.50	0.30	2.19	0.30	2.33
BSC05P10	13.79	0.85	6.44	0.94	6.56
BSC05PW7	11.79	1.58	3.81	1.66	4.22
BSC05PW8	7.62	0.30	2.56	0.30	2.76
BSC05PW9	14.83	3.72	5.50	4.17	6.19
BSC05T18	3.87	0.00	0.47	0.01	0.52
BSC05T20	6.52	0.10	0.65	0.32	1.41
CD05CDC1	14.39	1.02	3.56	1.18	4.06
COM05C06	14.03	0.96	4.44	1.19	4.76
COM05LP5	10.53	1.70	3.09	2.04	3.77
CSF05C01	11.14	0.70	2.55	0.85	3.38
CSF05C02	17.14	3.43	5.77	3.52	7.74
CSF05C03	16.47	1.36	6.08	2.26	7.60
CSF05C04	9.00	0.02	1.54	0.03	2.26
CSF05C05	10.83	0.76	2.52	0.78	3.00
CSF05C06	15.22	0.81	6.05	1.33	6.93
CTG05C03	14.45	0.85	5.12	1.08	5.94
CTG05EMG	2.84	1.04	1.04	1.51	1.51
GCC05GG3	14.39	2.57	4.07	2.77	4.89
GCC05GG5	18.57	3.60	5.25	4.15	6.91
GECC05C1	11.99	1.96	3.11	2.06	3.40
GECC05C2	16.84	6.78	8.44	6.86	8.79
GECC05C3	13.99	2.05	4.73	2.16	5.11
GECC05C4	12.83	0.08	3.38	0.42	4.04
GMAC05C1	13.28	1.14	2.98	1.89	3.97
GSM205G4	16.13	1.98	5.75	2.11	6.66
JPC05C11	12.18	2.31	3.62	2.56	4.33
JPC05C12	12.12	2.39	4.19	2.52	4.45
JPC05C13	17.54	3.39	7.41	3.48	7.68
JPC05LD1	12.04	2.32	4.03	2.56	4.36
JPC05LD2	15.56	3.05	5.85	3.19	6.34
JPC05LD3	15.54	2.49	5.47	2.81	6.26
JPC05LD4	14.65	2.37	4.89	2.42	5.19
JPC05LD5	10.73	0.84	2.76	1.36	3.45
LBUB05C1	11.87	0.89	2.58	1.21	3.36
LBUB05C2	15.43	0.59	3.59	1.27	4.74
LBUB05C3	11.82	1.91	4.09	1.95	4.37
LBUB05C5	21.58	0.77	12.51	0.87	12.63
LBUB05C7	13.70	2.09	7.48	2.24	7.84
MLT05CK1	10.38	0.33	1.69	0.41	2.20
MLT05CP1	12.86	2.45	5.13	2.46	5.25
MLT05LC1	10.45	0.56	1.75	0.57	1.97
MLT05MC1	14.70	1.71	5.42	2.05	6.46
MLT05MK2	7.62	0.35	2.01	0.35	2.16
MSC05HQ5	12.48	0.48	3.24	1.45	4.93
MSC05HQ6	21.78	0.91	9.30	1.57	10.57
MSC05HQ7	12.65	0.17	4.43	0.24	4.87
MSC05I10	18.05	7.73	11.32	7.73	11.71
MSC05IQ9	14.30	1.79	4.34	2.16	5.67
MSC05T17	5.31	0.07	0.18	0.07	0.21
MSC05T19	8.34	0.41	1.45	0.47	2.30
WBC05C16	8.92	0.29	2.78	0.38	3.12
WBC05C17	12.04	0.39	3.50	0.69	4.04
WBC05C18	14.81	2.29	4.56	2.51	5.12
WBC05C19	18.10	4.52	7.70	4.70	8.00
WBC05C20	12.51	2.45	3.66	2.57	4.00
WBC05C21	12.06	0.26	2.96	0.31	3.30
WBC05C22	11.85	0.21	2.69	0.22	3.27

Source: Deutsche Bank

Figure 20: Estimated equity deficiency and losses for 2006 Vintage: NOI Scenario 1

		Scenario 1: Equity Infusions for LTV < 100		Scenario 2: Zero Equity Infusions	
Deal Name	Equity Deficiency	Loss % (Through 2012)	Loss % (Lifetime)	Loss % (Through 2012)	Loss % (Lifetime)
BACM0601	9.72	0.99	1.84	2.48	3.40
BACM0602	14.17	0.96	3.49	1.12	4.44
BACM0603	16.63	0.97	5.12	0.97	5.84
BACM0604	13.57	2.88	4.54	3.04	5.20
BACM0605	11.37	0.41	2.70	0.65	3.17
BACM0606	25.45	13.11	13.64	13.11	14.23
BSC06P11	9.64	0.00	0.74	0.00	1.61
BSC06P12	8.61	0.28	2.27	0.28	2.49
BSC06P13	11.10	1.11	3.49	1.12	3.79
BSC06P14	13.01	2.71	5.58	2.73	5.76
BSC06T22	4.97	0.13	1.60	0.20	1.80
BSC06T24	11.32	1.36	2.38	1.49	2.96
CD06CD2	15.29	2.92	5.40	2.94	5.67
CD06CD3	11.71	0.24	3.84	0.26	4.34
COB06C01	16.45	3.77	7.41	3.78	8.14
COM06C07	9.80	0.21	2.53	0.22	2.89
COM06C08	23.46	3.07	8.82	9.59	15.43
CSM06C01	11.97	2.41	3.99	2.41	4.89
CSM06C02	14.92	0.29	3.09	0.29	4.12
CSM06C03	20.80	0.05	8.79	0.07	9.91
CSM06C04	21.24	0.63	9.46	0.63	10.10
CSM06C05	16.61	1.34	8.29	1.39	8.86
CSM06K01	7.43	3.13	3.31	3.16	3.34
CTG06C04	10.78	1.65	3.14	1.67	3.46
CTG06C05	13.47	1.09	5.13	1.18	5.44
GCC06GG7	20.21	2.67	7.30	2.69	8.24
GECC06C1	10.74	0.00	2.84	0.02	2.96
GMAC06C1	12.47	0.69	3.83	0.69	4.11
GSM206G6	17.86	4.00	7.41	4.32	7.88
GSM206G8	23.31	2.56	8.75	2.75	9.44
JPC06C14	12.13	0.49	2.95	0.76	3.43
JPC06C15	17.17	0.57	5.81	0.57	6.01
JPC06C16	9.01	0.00	2.85	0.00	3.00
JPC06C17	17.32	0.81	5.49	0.87	6.26
JPC06LD6	10.27	0.71	2.26	0.84	3.68
JPC06LD7	13.30	0.52	3.49	0.68	4.26
JPC06LD8	19.00	0.42	7.25	0.44	9.41
JPC06LD9	22.97	3.91	12.35	4.18	12.86
LBUB06C1	10.28	1.37	3.61	1.75	4.00
LBUB06C3	13.34	5.02	6.82	5.02	6.91
LBUB06C4	19.87	1.33	10.02	1.33	10.10
LBUB06C6	16.46	2.28	5.63	2.42	6.09
LBUB06C7	18.73	3.21	5.37	3.48	6.33
MA111PA2	0.00	0.00	0.00	0.00	0.00
MLCF0601	9.23	0.26	2.20	0.29	2.37
MLCF0602	6.82	0.22	1.61	0.23	1.91
MLCF0603	9.67	0.16	1.96	0.65	2.80
MLCF0604	23.44	4.12	9.34	4.23	9.89
MLT06C01	14.61	0.32	5.52	0.55	6.26
MLT06C02	9.55	0.04	1.64	0.04	2.27
MSC06H10	13.18	0.11	5.07	0.11	5.16
MSC06HQ8	15.96	0.12	6.25	0.32	7.14
MSC06HQ9	16.85	2.87	6.79	2.87	6.85
MSC06I11	4.00	0.00	0.50	0.00	0.63
MSC06I12	18.52	7.15	10.33	7.42	11.36
MSC06T21	8.02	0.35	1.76	0.44	1.96
MSC06T23	8.72	0.16	0.98	0.33	1.69
WBC06C23	14.86	0.16	5.64	0.18	6.42
WBC06C24	13.60	0.00	4.73	0.00	4.91
WBC06C25	9.01	0.42	1.20	0.43	1.62
WBC06C26	20.18	7.88	11.85	7.88	12.16
WBC06C27	18.21	2.58	7.35	2.70	8.07
WBC06C28	23.70	3.69	10.24	3.73	11.55
WBC06C29	21.16	1.59	7.45	2.08	9.01

Source: Deutsche Bank

Figure 21: Estimated equity deficiency and losses for 2007 Vintage: NOI Scenario 1

		Scenario 1: Equity Infusions for LTV < 100		Scenario 2: Zero Equity Infusions	
Deal Name	Equity Deficiency	Loss % (Through 2012)	Loss % (Lifetime)	Loss % (Through 2012)	Loss % (Lifetime)
BACM0701	22.59	9.00	12.08	9.00	12.81
BACM0702	31.20	13.87	17.69	13.88	18.13
BACM0703	32.92	7.31	18.45	7.49	19.30
BACM0704	20.49	0.72	8.56	0.76	8.91
BACM0705	20.33	1.37	9.12	1.44	9.98
BSC07P15	18.00	0.87	7.15	0.87	7.68
BSC07P16	15.24	3.91	6.93	4.16	7.24
BSC07P17	17.14	1.23	5.44	1.36	6.15
BSC07P18	10.98	0.38	1.88	0.40	2.46
BSC07T26	9.70	0.88	3.28	1.00	3.70
BSC07T28	11.15	0.26	2.19	0.36	2.76
CD07CD4	22.35	4.96	11.94	4.96	12.49
CD07CD5	14.05	2.75	5.25	2.78	5.84
COB07C02	16.59	0.81	6.03	0.81	6.23
COB07C03	28.41	1.60	16.27	1.66	16.74
COM07C09	12.77	0.87	3.62	1.01	4.30
CSM07C01	23.51	0.93	13.73	1.01	14.23
CSM07C02	32.30	1.46	19.36	1.54	19.69
CSM07C03	24.93	3.69	13.04	3.79	13.76
CSM07C04	31.61	6.63	21.02	6.65	21.38
CSM07C05	26.26	5.16	15.12	5.19	15.64
CTG07C06	21.46	0.89	6.56	0.90	9.95
GCC07G11	26.92	7.38	15.31	7.38	15.78
GCC07GG9	26.51	4.87	11.64	4.94	12.98
GECC07C1	30.27	8.08	18.15	8.14	18.78
GS207G10	37.58	2.90	23.72	3.02	24.44
JPC07C01	9.42	0.15	2.80	0.28	2.96
JPC07C18	14.55	0.24	4.81	0.25	5.93
JPC07C19	19.83	0.68	8.41	1.35	9.74
JPC07C20	12.63	0.77	4.36	0.77	4.64
JPC07L10	27.78	5.77	15.85	5.87	16.25
JPC07L11	26.58	6.33	13.80	6.39	14.11
JPC07L12	24.79	4.85	11.78	5.13	12.50
LBC07C03	27.14	8.52	17.42	8.60	17.67
LBUB07C1	30.63	3.80	16.31	3.82	17.48
LBUB07C2	20.59	1.56	9.84	1.60	10.40
LBUB07C6	19.70	5.97	10.05	5.97	10.50
LBUB07C7	17.34	2.29	8.12	2.29	8.36
MLCF0705	25.11	0.92	13.73	1.02	14.36
MLCF0706	21.50	3.52	8.18	3.81	9.06
MLCF0707	21.27	3.74	10.33	3.81	10.80
MLCF0708	11.43	0.36	3.87	0.36	4.27
MLCF0709	16.30	0.74	6.78	0.78	7.28
MLT07C01	20.45	4.70	8.71	4.71	9.35
MSC07H11	26.19	6.19	14.64	6.20	14.79
MSC07H12	38.35	17.46	25.48	17.47	25.86
MSC07H13	22.08	4.93	10.32	4.93	11.10
MSC07I13	20.75	4.01	12.49	4.01	12.74
MSC07I14	23.79	7.10	12.29	7.10	12.64
MSC07I15	17.59	1.61	4.35	2.19	5.33
MSC07I16	12.71	1.96	4.04	1.96	4.25
MSC07T25	13.47	0.09	5.16	0.09	5.70
MSC07T27	12.74	0.75	2.85	0.85	3.44
PFCR07PL	0.00	0.00	0.00	0.00	0.00
SVG07C01	20.25	5.91	7.82	7.03	9.07
UCB07001	1.93	0.56	0.68	0.60	0.74
WBC07C30	36.21	6.44	25.76	6.49	25.98
WBC07C31	30.64	3.41	19.21	3.48	19.43
WBC07C32	33.21	7.80	20.03	7.80	20.41
WBC07C33	31.82	5.23	23.46	5.24	23.72
WBC07C34	16.12	2.95	9.64	2.95	10.10

Source: Deutsche Bank

Figure 22: Estimated equity deficiency and losses for 2008 Vintage: NOI Scenario 1

		Scenario 1: Equity Infusions for LTV < 100		Scenario 2: Zero Equity Infusions	
Deal Name	Equity Deficiency	Loss % (Through 2012)	Loss % (Lifetime)	Loss % (Through 2012)	Loss % (Lifetime)
BACM0801	12.40	0.00	7.11	0.04	7.37
CLT08LS1	14.57	0.54	5.28	0.58	6.24
CSM08C01	26.62	13.11	16.97	13.11	17.68
CTG08C07	15.57	5.58	7.44	5.58	7.74
JPC08C02	7.08	2.55	2.73	2.55	2.74
LBUB08C1	4.86	0.00	1.61	0.00	1.62
MLT08C01	10.23	2.92	4.12	2.96	4.22
MSC08T29	7.16	0.29	2.28	0.29	2.32

Source: Deutsche Bank

VI. Concluding Remarks

In this report we have argued that a very large proportion of outstanding commercial mortgages are likely to be unable to refinance at maturity over the coming five to ten years. We have provided what we believe are conservative estimates of the magnitude of the equity deficiency as well as maturity default-related losses.

To date, many market participants have dismissed the seriousness of the future refinancing issue, believing that lenders will simply agree to maturity extensions for loans that fail to qualify. Such an approach might prove fruitful were the percentage of loans failing to qualify relatively small, say five percent of the total. However, our analysis suggests that that percentage is likely to be 60-70% or more.

The underlying premise of a maturity extension as a solution to a loan's qualifying problem is that during the extension period the lender is either able to increase the amortization on the loan by some means (e.g. increasing the interest rate and using the extra cash flow to accelerate the pay down of the loan) or able to achieve value growth sufficient to allow the loan to qualify by the end of the extension period. With respect to the first possibility, we have seen that the equity deficiency for many loans is enormous, far too large, in fact, to be tackled by accelerating the amortization over a moderate period of time. With respect to value growth, we think that with hundreds of billions of dollars of distressed mortgages building up over time via maturity extensions, the likelihood of significant property price appreciation is remote. After all, hundreds of billions of dollars of extended mortgages represent potentially hundreds of billions of dollars of distressed real estate ready to flood the market.

In our view, the belief that maturity extensions present any sort of real solution is naïve. In fact, maturity extensions do little more than push the problem down the road. Moreover, those counting on maturity extensions to save the day may be in for a rude awakening, at least in CMBS. Here, not only are special servicers typically limited to granting at most two to four year maturity extensions, but AAA investors are already mobilizing to stanch any move to widespread extensions as a means of dealing with the refinancing problem.

Finally, there is also the view that the refinancing problem could fix itself. The argument appears to be that commercial real estate cash flows are likely to rebound quickly as the economy begins to improve due to pent-up demand. We do not find this argument particularly compelling. As we noted earlier in the report, even if cash flows were to recover to their peak 2007 levels, values would still be down 25-35% as a result of the paradigm shift in financing terms. It would require cash flows rebounding far beyond their peak levels to push values up sufficiently to overcome the steep declines. In our view, this is tantamount to predicting that the market will be saved by the next rent bubble.

Appendix 1

Important Disclosures

Additional information available upon request

For disclosures pertaining to recommendations or estimates made on a security mentioned in this report, please see the most recently published company report or visit our global disclosure look-up page on our website at http://gm.db.com/ger/disclosure/DisclosureDirectory.eqsr.

Analyst Certification

The views expressed in this report accurately reflect the personal views of the undersigned lead analyst(s). In addition, the undersigned lead analyst(s) has not and will not receive any compensation for providing a specific recommendation or view in this report. Richard Parkus

[illegible]

Buy: These bonds are expected to outperform other issues in the sector/industry group over the next three to six-month period.
Hold: These bonds are fairly valued currently. If owned, no need to sell, but we await events/ releases/ conditions that would make the bond attractive enough for us to upgrade. In the interim, the bond will likely perform as well as the average issue in the sector/industry group.
Sell: There exists a significant likelihood that these bonds will underperform relative to other issues in their sector/industry group, at least over the next three months.

Regulatory Disclosures

1. Important Additional Conflict Disclosures

Aside from within this report, important conflict disclosures can also be found at https://gm.db.com/equities under the "Disclosures Lookup" and "Legal" tabs. Investors are strongly encouraged to review this information before investing.

2. Short-Term Trade Ideas

Deutsche Bank equity research analysts sometimes have shorter-term trade ideas (known as SOLAR ideas) that are consistent or inconsistent with Deutsche Bank's existing longer term ratings. These trade ideas can be found at the SOLAR link at http://gm.db.com.

3. Country-Specific Disclosures

Australia: This research, and any access to it, is intended only for "wholesale clients" within the meaning of the Australian Corporations Act.

EU countries: Disclosures relating to our obligations under MiFiD can be found at http://globalmarkets.db.com/riskdisclosures.

Japan: Disclosures under the Financial Instruments and Exchange Law: Company name - Deutsche Securities Inc. Registration number - Registered as a financial instruments dealer by the Head of the Kanto Local Finance Bureau (Kinsho) No. 117. Member of associations: JSDA, The Financial Futures Association of Japan. This report is not meant to solicit the purchase of specific financial instruments or related services. We may charge commissions and fees for certain categories of investment advice, products and services. Recommended investment strategies, products and services carry the risk of losses to principal and other losses as a result of changes in market and/or economic trends, and/or fluctuations in market value. Before deciding on the purchase of financial products and/or services, customers should carefully read the relevant disclosures, prospectuses and other documentation.

Malaysia: Deutsche Bank AG and/or its affiliate(s) may maintain positions in the securities referred to herein and may from time to time offer those securities for purchase or may have an interest to purchase such securities. Deutsche Bank may engage in transactions in a manner inconsistent with the views discussed herein.

New Zealand: This research is not intended for, and should not be given to, "members of the public" within the meaning of the New Zealand Securities Market Act 1988.

Russia: This information, interpretation and opinions submitted herein are not in the context of, and do not constitute, any appraisal or evaluation activity requiring a license in the Russian Federation.

David Folkerts-Landau
Managing Director
Global Head of Research

Stuart Parkinson Chief Operating Officer	Guy Ashton Global Head Company Research	Marcel Cassard Global Head Fixed Income Strategies and Economics

Germany	Asia-Pacific	Americas
Andreas Neubauer Regional Head	Michael Spencer Regional Head	Steve Pollard Regional Head

Principal Locations

Deutsche Bank AG
London
1 Great Winchester Street
London EC2N 2EQ
Tel: (44) 20 7545 8000

Deutsche Bank AG
New York
60 Wall Street
New York, NY 10005
United States of America
Tel: (1) 212 250-2500

Deutsche Bank AG
Hong Kong
Cheung Kong Center,
2 Queen's Road Central
Hong Kong
Tel: (52) 2203 8888

Deutsche Bank AG
Japan
2-11-1 Nagatacho
Sanno Park Tower
Chiyoda-ku, Tokyo 100-6171
Tel: (81) 3 5156 6701

Deutsche Bank AG
Frankfurt
Große Gallusstraße 10-14
60272 Frankfurt am Main
Germany
Tel: (49) 69 910 00

Deutsche Bank AG
Aurora business park
82 bld 2 Sadovnicheskaya street
Moscow, 115035
Russia
Tel: (7) 495 797-5000

Deutsche Bank AG
Singapore
One Raffles Quay
South Tower
Singapore 048583
Tel: (65) 6423 8001

Deutsche Bank AG
Australia
Deutsche Bank Place, Level 16
Corner of Hunter & Phillip Streets
Sydney NSW 2000
Tel: (61) 2 8258 1234

Deutsche Bank Dubai
Dubai International Financial Centre
The Gate, West Wing, Level 3
P.O. Box 504 902
Dubai City
Tel: (971) 4 3611 700

Subscribers to research via email receive their electronic publication on average 1-2 working days earlier than the printed version.

If you would like to receive this or any other product via email please contact your usual Deutsche Bank representative.

Publication Address:
Deutsche Bank Securities Inc.
60 Wall Street
New York, NY 10005
United States of America
(1) 212 250 2500

Internet:
http://gmr.db.com
Ask your usual contact for a username and password.

Global Disclaimer

Deutsche Bank

6 May 2009

CMBS Research

Special Report

TALF for New Issue CMBS: Fed Releases Terms

Research Team

Richard Parkus
Research Analyst
(+1) 212 250-6724
richard.parkus@db.com

Jing An, CFA
Research Analyst
(+1) 212 250-5893
jing.an@db.com

On Friday, May 1st, the Fed finally announced the long-awaited details for the expansion of TALF to commercial mortgage-backed securities. To the surprise of the market, however, details were released for TALF for new issue CMBS, not legacy securities, as had been expected. The market immediately sold off in dramatic fashion, with CMBX AAA indices widening 60-65bp. Much of this move was undone Monday as the indices tightened back 40bp.

This report summarizes the terms and conditions of TALF for new issue CMBS and examines whether they are likely to be sufficient to encourage new lending to emerge. Our conclusions are as follows:

1. The TALF terms for new issue CMBS appear to be less compelling than for the existing new issue consumer ABS program. In the worst case scenario where the investor exercises the put option at the maturity of the TALF loan term, investment ROEs are likely to be significantly negative.

2. Assuming that TALF investors will require at least a mid teens ROE on their investments, the minimum coupon at which commercial mortgage loans would have to be originated is sufficiently high that, in our view, there would be limited appetite on the part of borrowers.

3. Thus, the initial terms for TALF for new issue CMBS appear unlikely to be sufficient to bring many participants, either borrowers or investors, to the table.

4. On the other hand, the basic structure is promising. It is our hope that the terms can be modified to the extent necessary to make this program successful in helping to re-start lending to the commercial real estate sector.

5. We view the resuscitation of the commercial real estate finance market as a critical step not only for the commercial real estate sector, but for banks, which have $2 trillion of commercial real estate loans on their balance sheets.

We begin with a summary of the terms and conditions of the TALF for new issue CMBS program.

Qualifying securities and assets

- Qualifying securities

Qualifying securities include only cash bonds issued after January 1, 2009. The securities must carry a 'AAA' rating without the benefit of a third-party guarantee or on credit watch for downgrade. There must be no other AAA class senior to this class. The securities must receive both interest and principal payments, in other words, neither IO nor PO securities are eligible. Agency issued securities are not eligible for TALF either.

- Qualifying assets

Qualifying assets include amortizing, fixed-rate first mortgages originated on or after July 1, 2008. The FRBNY particularly requires that loans be underwritten based on in-place revenue and expenses only.

- Pooling and Servicing Agreements

Appraisal reduction amounts ("ARA") have been introduced as new triggers in the Pooling and Servicing Agreements ("PSA"). In particular, time-tranched AAA bonds will receive pro rata principal allocations once the credit support is reduced to zero as a result of actual realized losses and ARA. ARA is also introduced in the determination of "directing certificateholder". The shift of control over the servicing of the assets will be triggered once the principal balance of the junior class is reduced to less than 25% of its initial principal balance as a result of both actual realized losses and ARA.

When it comes to post-securitization property appraisals, the FRBNY requires that the appraisals will only be recognized if they are ordered by the servicer. But the FRBNY doesn't specify whether the servicer is master serivicer or special servicer.

Loan term highlights

The FRBNY retains the right to reject any CMBS as TALF loan collateral based on its risk assessment. Each CMBS TALF loan will have either a three-year or five-year term. The financing rate on three-year loans will be 100bp over three-year swap rate, while that on five-year loans will be 100bp over five-year swap rate.

The collateral haircut for CMBS bonds with average lives of five years or less will be 15%. For CMBS bonds with average lives in excess of five years, the haircut will increase by one percent for each additional year of average life beyond five years. No CMBS security may have an average life beyond ten years.

Loan paydown/ amortization features

There are two features of TALF loans that are likely to give rise to paydowns over time. The first is related to principal paydowns on the underlying CMBS security, while the second is related to a turbo paydown feature tied to interest payments from the security.

- Paydowns from principal payments

The New York Fed states that "*Any remittance of principal on the CMBS must be used immediately to reduce the principal amount of the TALF loan in proportion to the TALF advance rate.*" For example, if the initial haircut is, say, 15%, then 85% of any principal payment on the security will be used to pay down the loan and 15% will go to the investor (i.e. TALF borrower).

- Paydowns from interest payments (Turbo paydown feature)

The most unusual and unexpected feature of the TALF terms and conditions is that net interest payments in excess of a specified amount will be used to accelerate the paydown of the loan relative to the paydown of the CMBS security. Specifically, the net interest payments (i.e. the interest received from the CMBS security minus the interest due on the TALF loan) to the investor are capped at 25% of the haircut amount (i.e. equity contribution) during the first three years of the loan term, 10% in the fourth year and 5% in the fifth year. This effectively capped the cumulative net interest payout during the five years at 90% of the equity contribution, and any interest payments in excess of the caps will be used to pay down the TALF loan. This "turbo" feature ensures that the investors will have "skin in the game" through the TALF loan term.

The turbo feature also has implications on the coupon rates and ultimately the loan rates on the pooled mortgages. Given the five year swap rate of 2.6% on May 5th, we calculate that any coupon higher than 6.8% will trigger the turbo feature during the first three years of the TALF loan.

In general, the turbo feature reduces the ROE for investors. In order to gauge the magnitude of the impact, consider a simplified example with a non-amortizing 'AAA' security that is purchased at par with the maximum leverage under the TALF program. Assume the bond is either sold at par or the principal is fully paid back exactly on the maturity date of the TALF loan. In order to achieve a 20% ROE, the required coupon rate for the AAA security would be 5.84% in the absence of the turbo feature. With this coupon and the turbo feature, the ROE declines to 19.4%. The difference is small in this example because the coupon rates are both below 6.8%, and thus the turbo feature is only triggered in the last two years. Using an 8% coupon, the ROE would be 38.1% without the turbo and 31.7% with the turbo.

An alternative way of looking at this issue is that for a given required investment ROE, the addition of the turbo feature raises the required AAA coupon rate, which in turn increases the required rate on the underlying commercial mortgages.

Worst case scenario: ROEs under exercise of put at TALF loan maturity[1]

In terms of TALF investment performance, the worst case ROE corresponds to the situation where the terminal market value of the CMBS security is below the TALF loan balance at maturity. In this case, we assume that an investor will exercise the put option. The ending balance of the TALF loan is, in effect, the strike of the put option–if the CMBS security value is below this level, the put is exercised. Figure 1 presents, for a given bond coupon rate, the maximum market value of the CMBS security under which the put is exercised (i.e. the put strike) and the ROE on the TALF investment under this scenario. For example, with a 6% AAA coupon, the investor exercises the put at maturity if the value of the CMBS security is below 81, in which case the investment ROE is -13.6%.

Figure 1: Worst case ROEs and put option strike prices

Bond Coupon	5.0%	6.0%	7.0%	8.0%	9.0%	10.0%
Put Option Strike Price	83	81	79	73	68	62
ROE Under Put Exercise	-22.8%	-13.6%	-5.3%	-5.3%	-5.3%	-5.3%

Source: Deutsche Bank

[1] We assume throughout this report that neither losses nor appraisal reductions in the CMBS collateral pool are high enough to affect the AAA class during the five-year TALF loan. Clearly, absent this, the worst case scenario is for all underlying loans to default immediately with 100% loss severity.

Figure 1 indicates that, due to the turbo feature, the worst case ROE never becomes positive as the bond coupon increases, but rather reaches a ceiling of -5.3%. The reason is that once the coupon rate passes the 6.8% hurdle, the "turbo" feature will be triggered through the entire TALF loan term. In this case, when an investor decides to walk away, the cash flow will be capped at 90% of the equity investment so the ROE will be a constant -5.3% no matter how high the coupon is. In other words, an investor will prefer a coupon rate at or above 6.8% which will provide a floor of -5.3% on its ROE.

Figure 2 presents the CMBS security price at TALF loan maturity that produces a 0% ROE for a given AAA bond coupon. For example, when the bond coupon is 8%, the investor can realize above 0% ROE if the value of the CMBS security is higher than 75 cents on the dollar. Notice that the 0% ROE value is higher than the strike price given a coupon rate.

Figure 2: CMBS market values producing 0% ROEs for given AAA coupon rates

Bond Coupon	5.0%	6.0%	7.0%	8.0%	9.0%	10.0%
Terminal Security Value Producing 0% ROE	90	85	80	75	69	64

Source: Deutsche Bank

Base case scenario

Moving away from worst case scenarios, Figure 3 presents ROEs for more realistic levels of AAA coupons and security market values at the TALF loan maturity. ROEs in the mid teens are clearly achievable.

Note that for AAA coupons above, say, 7%, the interest rates on the underlying mortgages would have to be so high (due to the cost of financing the below-AAA classes) that few borrowers would be interested. This issue is discussed in greater detail in the following section.

Figure 3: Base case ROEs for given CMBS market values and AAA coupon rates

AAA Coupon\Terminal Security Value	90	100
5%	-0.9%	13.3%
6%	8.6%	20.5%
7%	17.4%	27.5%

Source: Deutsche Bank

Expected impact on new issuance

For a particular combination of ROE and terminal CMBS security value, Figure 4 presents the implied AAA coupon. Commercial real estate borrowers have typically shown little interest in borrowing at rates in excess of 8-9%, so a necessary condition for the viability of TALF is a AAA coupon consistent with mortgage rates of no more than 8-9%. Even if we make very conservative assumptions on the deal structure with 20% subordination, 20% yield on the below-AAA component of the deal and zero issuer profit, the AAA coupon rate needs to be lower than approximately 6.5% to originate loans with a mortgage rate lower than 9%. The shaded portion of Figure 4 shows those combinations of ROEs and terminal security values consistent with mortgage rates of 9% and below. The question is whether a sufficient number of TALF investors will be willing to participate in these ranges.

Figure 4: Implied AAA bond coupon rates given ROEs and terminal security values

ROE\Terminal Security Value	70	75	80	85	90	95	100
0%	8.9%	8.0%	7.1%	6.1%	5.1%	4.1%	3.1%
2%	9.1%	8.1%	7.2%	6.3%	5.3%	4.3%	3.4%
5%	9.3%	8.4%	7.4%	6.5%	5.6%	4.7%	3.8%
10%	9.8%	8.8%	7.9%	7.0%	6.2%	5.3%	4.5%
15%	10.4%	9.4%	8.5%	7.6%	6.7%	6.0%	5.2%
20%	11.1%	10.2%	9.3%	8.3%	7.4%	6.6%	5.9%
25%	12.0%	11.1%	10.2%	9.3%	8.3%	7.4%	6.6%
30%	13.2%	12.2%	11.3%	10.4%	9.4%	8.5%	7.6%

Source: Deutsche Bank

Conclusion

While the TALF for new issue CMBS program is clearly a promising start, we believe that the terms and conditions are not yet such that wide scale participation by either investors or borrowers is likely. That said, we remain optimistic that a workable solution exists and will be the end result of the enormous effort that has already gone into this work.

Appendix 1

Important Disclosures

Additional information available upon request

For disclosures pertaining to recommendations or estimates made on a security mentioned in this report, please see the most recently published company report or visit our global disclosure look-up page on our website at http://gm.db.com/ger/disclosure/DisclosureDirectory.eqsr.

Analyst Certification

The views expressed in this report accurately reflect the personal views of the undersigned lead analyst(s). In addition, the undersigned lead analyst(s) has not and will not receive any compensation for providing a specific recommendation or view in this report. Richard Parkus

Deutsche Bank debt rating key

Buy: These bonds are expected to outperform other issues in the sector/industry group over the next three to six-month period.
Hold: These bonds are fairly valued currently. If owned, no need to sell, but we await events/ releases/ conditions that would make the bond attractive enough for us to upgrade. In the interim, the bond will likely perform as well as the average issue in the sector/industry group.
Sell: There exists a significant likelihood that these bonds will underperform relative to other issues in their sector/industry group, at least over the next three months.

Regulatory Disclosures

1. Important Additional Conflict Disclosures

Aside from within this report, important conflict disclosures can also be found at https://gm.db.com/equities under the "Disclosures Lookup" and "Legal" tabs. Investors are strongly encouraged to review this information before investing.

2. Short-Term Trade Ideas

Deutsche Bank equity research analysts sometimes have shorter-term trade ideas (known as SOLAR ideas) that are consistent or inconsistent with Deutsche Bank's existing longer term ratings. These trade ideas can be found at the SOLAR link at http://gm.db.com.

3. Country-Specific Disclosures

Australia: This research, and any access to it, is intended only for "wholesale clients" within the meaning of the Australian Corporations Act.

EU countries: Disclosures relating to our obligations under MiFiD can be found at http://globalmarkets.db.com/riskdisclosures.

Japan: Disclosures under the Financial Instruments and Exchange Law: Company name – Deutsche Securities Inc. Registration number – Registered as a financial instruments dealer by the Head of the Kanto Local Finance Bureau (Kinsho) No. 117. Member of associations: JSDA, The Financial Futures Association of Japan. This report is not meant to solicit the purchase of specific financial instruments or related services. We may charge commissions and fees for certain categories of investment advice, products and services. Recommended investment strategies, products and services carry the risk of losses to principal and other losses as a result of changes in market and/or economic trends, and/or fluctuations in market value. Before deciding on the purchase of financial products and/or services, customers should carefully read the relevant disclosures, prospectuses and other documentation.

Malaysia: Deutsche Bank AG and/or its affiliate(s) may maintain positions in the securities referred to herein and may from time to time offer those securities for purchase or may have an interest to purchase such securities. Deutsche Bank may engage in transactions in a manner inconsistent with the views discussed herein.

New Zealand: This research is not intended for, and should not be given to, "members of the public" within the meaning of the New Zealand Securities Market Act 1988.

Russia: This information, interpretation and opinions submitted herein are not in the context of, and do not constitute, any appraisal or evaluation activity requiring a license in the Russian Federation.

David Folkerts-Landau
Managing Director
Global Head of Research

Stuart Parkinson Chief Operating Officer	Guy Ashton Global Head Company Research	Marcel Cassard Global Head Fixed Income Strategies and Economics

Germany	Asia-Pacific	Americas
Andreas Neubauer Regional Head	Michael Spencer Regional Head	Steve Pollard Regional Head

Principal Locations

Deutsche Bank AG
London
1 Great Winchester Street
London EC2N 2EQ
Tel: (44) 20 7545 8000

Deutsche Bank AG
New York
60 Wall Street
New York, NY 10005
United States of America
Tel: (1) 212 250-2500

Deutsche Bank AG
Hong Kong
Cheung Kong Center,
2 Queen's Road Central
Hong Kong
Tel: (52) 2203 8888

Deutsche Bank AG
Japan
2-11-1 Nagatacho
Sanno Park Tower
Chiyoda-ku, Tokyo 100-6171
Tel: (81) 3 5156 6701

Deutsche Bank AG
Frankfurt
Große Gallusstraße 10-14
60272 Frankfurt am Main
Germany
Tel: (49) 69 910 00

Deutsche Bank AG
Aurora business park
82 bld.2 Sadovnicheskaya street
Moscow, 115035
Russia
Tel: (7) 495 797-5000

Deutsche Bank AG
Singapore
One Raffles Quay
South Tower
Singapore 048583
Tel: (65) 6423 8001

Deutsche Bank AG
Australia
Deutsche Bank Place, Level 16
Corner of Hunter & Phillip Streets
Sydney NSW 2000
Tel: (61) 2 8258 1234

Deutsche Bank Dubai
Dubai International Financial Centre
The Gate, West Wing, Level 3
P.O. Box 504 902
Dubai City
Tel: (971) 4 3611 700

Subscribers to research via email receive their electronic publication on average 1-2 working days earlier than the printed version.

If you would like to receive this or any other product via email please contact your usual Deutsche Bank representative.

Publication Address:
Deutsche Bank Securities Inc.
60 Wall Street
New York, NY 10005
United States of America
(1) 212 250 2500

Internet:
http://gmr.db.com
Ask your usual contact for a username and password.

Global Disclaimer

The information and opinions in this report were prepared by Deutsche Bank AG or one of its affiliates (collectively "Deutsche Bank"). The information herein is believed to be reliable and has been obtained from public sources believed to be reliable. Deutsche Bank makes no representation as to the accuracy or completeness of such information.

Deutsche Bank may (1) engage in securities transactions in a manner inconsistent with this research report, (2) with respect to securities covered by this report, sell to or buy from customers on a principal basis, and (3) consider this report in deciding to trade on a proprietary basis.

Opinions, estimates and projections in this report constitute the current judgment of the author as of the date of this report. They do not necessarily reflect the opinions of Deutsche Bank and are subject to change without notice. Deutsche Bank has no obligation to update, modify or amend this report or to otherwise notify a recipient thereof in the event that any opinion, forecast or estimate set forth herein, changes or subsequently becomes inaccurate. Prices and availability of financial instruments are subject to change without notice. This report is provided for informational purposes only. It is not an offer or a solicitation of an offer to buy or sell any financial instruments or to participate in any particular trading strategy.

The financial instruments discussed in this report may not be suitable for all investors and investors must make their own informed investment decisions. Stock transactions can lead to losses as a result of price fluctuations and other factors. If a financial instrument is denominated in a currency other than an investor's currency, a change in exchange rates may adversely affect the investment. Past performance is not necessarily indicative of future results.

Unless governing law provides otherwise, all transactions should be executed through the Deutsche Bank entity in the investor's home jurisdiction. In the U.S. this report is approved and/or distributed by Deutsche Bank Securities Inc., a member of the NYSE, the NASD, NFA and SIPC. In Germany this report is approved and/or communicated by Deutsche Bank AG Frankfurt authorized by the BaFin. In the United Kingdom this report is approved and/or communicated by Deutsche Bank AG London, a member of the London Stock Exchange and regulated by the Financial Services Authority for the conduct of investment business in the UK and authorized by the BaFin. This report is distributed in Hong Kong by Deutsche Bank AG, Hong Kong Branch, in Korea by Deutsche Securities Korea Co. and in Singapore by Deutsche Bank AG, Singapore Branch. In Japan this report is approved and/or distributed by Deutsche Securities Inc. The information contained in this report does not constitute the provision of investment advice. In Australia, retail clients should obtain a copy of a Product Disclosure Statement (PDS) relating to any financial product referred to in this report and consider the PDS before making any decision about whether to acquire the product. Deutsche Bank AG Johannesburg is incorporated in the Federal Republic of Germany (Branch Register Number in South Africa: 1998/003298/10). Additional information relative to securities, other financial products or issuers discussed in this report is available upon request. This report may not be reproduced, distributed or published by any person for any purpose without Deutsche Bank's prior written consent. Please cite source when quoting.

Deutsche Bank

20 May 2009

CMBS Research

Special Report

TALF for Legacy CMBS: Fed Releases Terms

Research Team

Richard Parkus
Research Analyst
(+1) 212 250-6724
richard.parkus@db.com

Jing An, CFA
Research Analyst
(+1) 212 250-5893
jing.an@db.com

The Federal Reserve released the terms and conditions for the TALF for Legacy CMBS program on May 19th. While many terms of the TALF for New Issue CMBS program were carried over to the Legacy program, there were also some important new features. Excluded from TALF-eligibility are the following:

- Both mezzanine and junior AAA classes (AMs and AJs)
- Floating rate CMBS
- Agency CMBS
- Interest-only securities

However, the most interesting term, in or view, is the following:

- The Fed retains the right to reject any CMBS bond for TALF-eligibility

Moreover the Fed intends to engage a collateral monitor to evaluate credit risk in securities and verify pricing. In our view, the Fed approach to TALF-eligibility is likely to push the CMBS market towards more efficient pricing with respect to credit risk, as well as prevent the TALF for Legacy CMBS program from racking up large losses for tax payers.

Under the terms of the program, investors might reasonably achieve ROEs in the 20-30% range assuming that market prices at the maturity of the TALF loan do not erode severely. The opportunities, in our view, look very attractive. We also believe that there is room for further tightening in decent quality super duper AAAs, though we are wary of AAAs from poorer quality deals as they may prove ineligible for TALF.

In reaction to the announcement, cash super duper AAAs tightened approximately 75bp, while the impact on AJs and AMs was more muted. We expect both of these excluded classes to underperform good quality super duper AAAs in the near-term, particularly as both experienced 10+ point rallies over the past month.

Review of Terms and Conditions

The Federal Reserve Bank of New York released the very long-awaited terms for TALF for Legacy CMBS on May 19th. Overall, we view the sophistication of the Legacy CMBS program to be a big step forward relative to the existing TALF for ABS program. The Fed clearly understands the differences between credit risk in AAA CMBS securities and AAA credit card/ student loan securities, and has designed a program that will potentially avoid saddling tax payers with heavy losses. The program is also likely to push the CMBS market towards more efficient pricing of credit risk.

This report is organized as follows. We begin by reviewing the main terms and conditions that were announced for TALF for Legacy CMBS. Next, we present the results of a simple scenario analysis, exploring the achievable ROEs for investors participating in the program. Finally, we discuss our views of the program. We speculate about why the Fed included specific features, and what it is trying to achieve.

Eligible CMBS Securities

TALF for Legacy CMBS imposes the following eligibility constraints on CMBS securities:

- Must be U.S. dollar-denominated, cash securities issued prior to January 1, 2009
  - No synthetic CMBS
  - No commercial real estate CDOs
  - No balance-guaranteed CMBS securities
- Must have a credit rating in the highest rating category (AAA) from at least two TALF for Legacy CMBS-eligible rating agencies (i.e. Moody's, S&P, Fitch, DBRS and Realpoint)
- Upon issuance, must not have been junior to any other securities with claims on the same pool of loans
  - No Mezzanine or junior AAA classes (i.e. AMs or AJs)
- No interest-only or principal-only securities
- No floating rate CMBS
- No agency CMBS (e.g. Fannie Mae Dus bonds)
- Security's rating must not rely on a third-party guarantee

FRBNY Discretionary Eligibility Criterion

The Fed reserves the right to reject any CMBS security for TALF. They indicate that a rejection may be based upon various measures of "unacceptable" collateral performance, including high cumulative loss, high percentage of specially serviced loans, high percentage of watch-listed loans, high percentage of loans with B-notes and/or mezzanine loans and forecasts of high future defaults and losses (presumably from some parametric model). Figures 3-6 present the current percentages of delinquent loans, specially serviced loans and watch-listed loans for each fixed rate CMBS deal, for each vintage from 2005 through 2008. We regard the Fed's ability to reject CMBS securities unilaterally as one of the most important aspects of the program. We explore this feature and its potential impact in the last section of the report.

Timing

First subscription date is expected to be in late July (the exact date to be announced shortly)

Financing Terms

- 3-year or 5-year loans
- Financing rates:
    - o 3-year loan: fixed rate at 3yr swaps + 100bp
    - o 5-year loan: fixed rate at 5yr swaps + 100bp
- Haircuts
    - o To be calculated as percentage of par, not market price
    - o 15% of par plus 1% for each year that WAL exceeds 5 years (e.g. 17% for a bond with WAL of 7 years)
    - o Proceeds are equal to the market price of security minus the haircut (e.g. for a security with a market price of 85 and a WAL of 7 years, the proceeds are equal to 85-17=68)
    - o It is stated that the Fed may make adjustments to the WAL calculation to reflect "default-related circumstances". This seems odd to us. Term default-related losses generally tend to shorten the WAL of AAA classes, so the Fed must have maturity defaults and extensions in mind here. But the TALF program is itself aimed at minimizing extensions by revitalizing the market. Adding features to reduce the impact of extension risk into a program intended to reduce extension risk appears to be self-defeating
- Turbo Amortization Feature
    - o 3-year loan: In each of the three years, net interest distributions (i.e. CMBS interest distribution minus interest due on TALF loan) in excess of 30% per annum of the initial haircut (i.e. initial investor equity) will be applied to pay down the TALF loan
    - o 5-year loan: In each of the *first* three years, net interest distributions (i.e. CMBS interest distribution minus interest due on TALF loan) in excess of 25% per annum of the initial haircut (i.e. initial investor equity) will be applied to pay down the TALF loan; this cap declines to 10% in year 4 and 5% in year 5

Other

- The TALF borrower must agree not to exercise (or refrain from exercising) any voting, consent or waiver rights without the consent of the Fed
- All settlements must be made through DTC
- The Fed may limit the volume of TALF loans secured by CMBS, and may allocate loans via an auction. How such a process might work is unclear
- The Fed wants TALF to be used for financing "recent secondary market transactions between unaffiliated parties that are executed on an arm's length basis". We interpret this as meaning that the Fed intends TALF to revitalize secondary trading and wants to preclude situations where, for example, a bank with an SIV holding large quantities of eligible AAA CMBS uses TALF for cheap financing.

Potential Investment ROEs

Figures 1 and 2 present the ROEs under the 5-year and 3-year TALF programs. Results are given for various combinations of entry and exit prices, and are based on the COMM 2007-C9 A4 bond.[1]

ROEs assuming a $80-$85 initial (entry) price and $80-$100 exit price are in the 20-30% range and look quite attractive. The "walk-away" ROEs, however, are in the negative 10-15% range. Depending on the market's view on the likely range of prices at the end of the TALF loan term (i.e. exit price), high quality AAA securities may well have room to rally further. For lower quality AAAs, this is less clear.

Figure 1: ROE given entry/exit price under five-year TALF – COMM 2007-C9 A4

Entry Price\Exit Price	75	80	85	90	95	100	Walk-away*
75	23%	27%	30%	33%	35%	37%	-10%
80	18%	22%	26%	29%	32%	34%	-12%
85	12%	17%	21%	25%	28%	31%	-13%
90	3%	10%	15%	20%	24%	27%	-15%
95	-9%	2%	9%	14%	19%	22%	-16%
100	n/a	-12%	0%	8%	13%	18%	-18%

Source: Deutsche Bank

**ROE numbers are calculated based on compounded monthly IRR*
In the walk-away scenario, we assume that an investor exercises the implied put option at the end of the TALF loan term

Figure 2: IRR given entry/exit price under three-year TALF – COMM 2007-C9 A4

Entry Price\Exit Price	75	80	85	90	95	100	Walk-away*
75	27%	34%	41%	47%	52%	57%	-19%
80	17%	26%	33%	40%	46%	51%	-20%
85	5%	16%	25%	32%	39%	45%	-22%
90	-10%	4%	15%	24%	31%	38%	-23%
95	-40%	-12%	3%	14%	23%	30%	-25%
100	n/a	-43%	-13%	2%	13%	22%	-27%

Source: Deutsche Bank

**ROE numbers are calculated based on compounded monthly IRR*
In the walk-away scenario, we assume that an investor exercises the implied put option at the end of the TALF loan term

Discussion of the Basic Program

The Fed clearly recognizes that credit risk in CMBS securities is quite different than credit risk in credit card and auto loan securities, even at the AAA level. CMBS deals have consistently exhibited extremely wide variation in losses due to the small number of loans and the significant heterogeneity of loans across deals. This, combined with the fact that CMBS market pricing has historically failed to adequately differentiate between bonds of the similar rating but different credit risk, suggests that the Fed could potentially be cherry-picked by investors. This is much less of an issue in consumer ABS where performance tends to be much more homogenous across deals.

TALF for Legacy CMBS appears to be designed to protect against this type of potential problem by allowing the Fed to reject TALF-eligibility for a given bond. The Fed notes that it will engage a "collateral monitor" to assess credit risk and valuations. We believe that the Fed is likely to make use of relatively sophisticated model-based analytics to help in determining TALF-eligibility. In fact, we think the Fed may go one step further and use valuation analytics to determine TALF-eligibility as a function of the combination of credit risk

[1] In calculating the ROEs, we assume 0 CDR and 0 CPR.

and market price. This is entirely reasonable since the Fed's risk of loss from financing even a highly risky bond can be made arbitrarily low simply by agreeing to finance it at a sufficiently low market price. This is just the concept of *effective* subordination. The other great advantage of such a scheme—making TALF eligibility a function of both credit risk and market price—is that it focuses the market on pricing credit risk efficiently. After all, getting the market up and running again and getting it to efficiently price credit risk, are the main objectives of TALF.

We do not expect that the Fed will publish a list of TALF eligible bonds, nor bonds that are TALF eligible at a given price. Nevertheless, to the extent that the Fed uses estimates of credit risk in determining TALF-eligibility, we expect that bonds from middle to high quality deals will outperform relative to bonds from lower quality deals.

When describing the its right to reject TALF-eligibility, the Fed specifically mentioned deals with high exposure to loans with subordinate financing (e.g. B-notes, mezzanine loans) in place. We believe this signals that the Fed is concerned about the heightened credit risk of highly levered loans due to the events surrounding the GGP bankruptcy filing. The more highly levered loan, the greater the risk of the loan sponsor filing for bankruptcy. We also wonder if this played any role in precluding floating rate CMBS, where many loans are highly levered with B-notes and mezzanine debt, from being TALF-eligible.

We were not surprised that mezzanine and junior AAA classes (AMs and AJs) were excluded from the program given the significant credit risk inherent in many of these bonds, particularly the AJs. It seems unlikely to us that the Fed will make them eligible at some future date. Given this, and the fact that both AM and AJ prices have rallied ten points or more over the past month, we would expect them to underperform relative to good quality super duper AAAs.

Overall, the TALF for Legacy CMBS program appears to us to be a well thought out and sophisticated program. Not only is it unlikely to saddle tax payers with heavy losses, but it may well push the CMBS market towards more efficient pricing of credit risk. On the other hand, the price of such sophistication is that it will likely take time to get the program up and running. We think that it is overly optimistic to expect the program to be going by late July. Many of the operational details have yet to be released. Simply selecting the collateral monitor(s) and getting them up and running could take a significant amount of time.

Figure 3: Ranking performance data for the 2005 vintage

Deal Name	Total Delinquency %	Rank	Deal Name	Perf Spec Serv. %	Rank	Deal Name	Watchlist. %	Rank
BACM 2005-1	0.23	11	BACM 2005-1	-	1	BACM 2005-1	14.58	43
BACM 2005-2	-	1	BACM 2005-2	2.17	40	BACM 2005-2	6.58	8
BACM 2005-3	1.91	42	BACM 2005-3	8.60	57	BACM 2005-3	10.30	22
BACM 2005-4	1.22	29	BACM 2005-4	8.11	56	BACM 2005-4	20.02	53
BACM 2005-5	2.50	49	BACM 2005-5	1.94	37	BACM 2005-5	7.74	9
BACM 2005-6	2.45	47	BACM 2005-6	4.79	49	BACM 2005-6	11.68	30
BSCMS 2005-PW10	0.62	19	BSCMS 2005-PW10	-	1	BSCMS 2005-PW10	26.84	63
BSCMS 2005-PWR7	2.63	50	BSCMS 2005-PWR7	-	1	BSCMS 2005-PWR7	13.64	42
BSCMS 2005-PWR8	1.38	30	BSCMS 2005-PWR8	0.30	24	BSCMS 2005-PWR8	13.21	41
BSCMS 2005-PWR9	0.26	12	BSCMS 2005-PWR9	7.89	54	BSCMS 2005-PWR9	15.07	46
BSCMS 2005-T18	0.46	14	BSCMS 2005-T18	0.39	26	BSCMS 2005-T18	5.40	4
BSCMS 2005-T20	0.06	7	BSCMS 2005-T20	-	1	BSCMS 2005-T20	16.02	48
CD 2005-CD1	2.46	48	CD 2005-CD1	3.74	46	CD 2005-CD1	14.98	45
CGCMT 2005-C3	6.11	61	CGCMT 2005-C3	2.05	39	CGCMT 2005-C3	8.37	13
CGCMT 2005-EMG	-	1	CGCMT 2005-EMG	-	1	CGCMT 2005-EMG	8.18	11
COMM 2005-C6	8.11	64	COMM 2005-C6	0.30	24	COMM 2005-C6	6.24	7
COMM 2005-LP5	0.20	10	COMM 2005-LP5	1.53	32	COMM 2005-LP5	16.68	51
CSFB 2005-C1	2.07	43	CSFB 2005-C1	0.89	30	CSFB 2005-C1	24.46	61
CSFB 2005-C2	5.27	60	CSFB 2005-C2	-	1	CSFB 2005-C2	15.73	47
CSFB 2005-C3	2.34	46	CSFB 2005-C3	6.90	52	CSFB 2005-C3	12.15	34
CSFB 2005-C4	3.45	54	CSFB 2005-C4	-	1	CSFB 2005-C4	5.87	6
CSFB 2005-C5	0.78	24	CSFB 2005-C5	0.09	20	CSFB 2005-C5	11.55	27
CSFB 2005-C6	2.21	44	CSFB 2005-C6	5.96	51	CSFB 2005-C6	16.30	50
GCCFC 2005-GG3	0.69	22	GCCFC 2005-GG3	11.16	62	GCCFC 2005-GG3	11.85	31
GCCFC 2005-GG5	0.98	28	GCCFC 2005-GG5	8.96	59	GCCFC 2005-GG5	13.08	38
GECMC 2005-C1	3.77	55	GECMC 2005-C1	10.33	61	GECMC 2005-C1	16.23	49
GECMC 2005-C2	0.49	15	GECMC 2005-C2	1.98	38	GECMC 2005-C2	23.07	58
GECMC 2005-C3	-	1	GECMC 2005-C3	3.95	47	GECMC 2005-C3	11.65	28
GECMC 2005-C4	0.74	23	GECMC 2005-C4	11.91	64	GECMC 2005-C4	9.70	19
GMACC 2005-C1	4.23	56	GMACC 2005-C1	4.44	48	GMACC 2005-C1	12.58	35
GSMS 2005-GG4	0.14	8	GSMS 2005-GG4	1.86	36	GSMS 2005-GG4	20.99	55
JPMCC 2005-CB11	1.65	36	JPMCC 2005-CB11	1.78	35	JPMCC 2005-CB11	8.19	12
JPMCC 2005-CB12	4.57	58	JPMCC 2005-CB12	0.62	28	JPMCC 2005-CB12	8.91	18
JPMCC 2005-CB13	3.10	53	JPMCC 2005-CB13	0.51	27	JPMCC 2005-CB13	23.61	59
JPMCC 2005-LDP1	0.62	19	JPMCC 2005-LDP1	8.85	58	JPMCC 2005-LDP1	9.99	20
JPMCC 2005-LDP2	1.81	40	JPMCC 2005-LDP2	0.25	23	JPMCC 2005-LDP2	14.95	44
JPMCC 2005-LDP3	5.26	59	JPMCC 2005-LDP3	3.12	44	JPMCC 2005-LDP3	20.06	54
JPMCC 2005-LDP4	2.64	51	JPMCC 2005-LDP4	-	1	JPMCC 2005-LDP4	22.64	57
JPMCC 2005-LDP5	4.54	57	JPMCC 2005-LDP5	-	1	JPMCC 2005-LDP5	12.04	33
LBUBS 2005-C1	0.59	18	LBUBS 2005-C1	0.19	22	LBUBS 2005-C1	1.97	1
LBUBS 2005-C2	2.32	45	LBUBS 2005-C2	1.27	31	LBUBS 2005-C2	8.60	14
LBUBS 2005-C3	1.77	39	LBUBS 2005-C3	0.16	21	LBUBS 2005-C3	11.66	29
LBUBS 2005-C5	0.55	16	LBUBS 2005-C5	11.52	63	LBUBS 2005-C5	2.46	2
LBUBS 2005-C7	0.67	21	LBUBS 2005-C7	1.64	33	LBUBS 2005-C7	8.87	16
MLMT 2005-CIP1	1.76	37	MLMT 2005-CIP1	10.14	60	MLMT 2005-CIP1	10.40	23
MLMT 2005-CKI1	1.57	35	MLMT 2005-CKI1	1.68	34	MLMT 2005-CKI1	12.69	36
MLMT 2005-LC1	1.76	37	MLMT 2005-LC1	-	1	MLMT 2005-LC1	22.56	56
MLMT 2005-MCP1	6.30	62	MLMT 2005-MCP1	2.43	41	MLMT 2005-MCP1	10.21	21
MLMT 2005-MKB2	1.40	31	MLMT 2005-MKB2	-	1	MLMT 2005-MKB2	13.18	39
MSC 2005-HQ5	0.92	27	MSC 2005-HQ5	0.73	29	MSC 2005-HQ5	17.23	52
MSC 2005-HQ6	0.55	16	MSC 2005-HQ6	8.05	55	MSC 2005-HQ6	26.82	62
MSC 2005-HQ7	1.89	41	MSC 2005-HQ7	-	1	MSC 2005-HQ7	10.98	25
MSC 2005-IQ10	1.56	34	MSC 2005-IQ10	-	1	MSC 2005-IQ10	31.01	64
MSC 2005-IQ9	1.54	33	MSC 2005-IQ9	7.85	53	MSC 2005-IQ9	12.87	37
MSC 2005-T17	0.83	26	MSC 2005-T17	-	1	MSC 2005-T17	8.82	15
MSC 2005-T19	-	1	MSC 2005-T19	-	1	MSC 2005-T19	8.90	17
WBCMT 2005-C16	-	1	WBCMT 2005-C16	2.89	43	WBCMT 2005-C16	7.83	10
WBCMT 2005-C17	-	1	WBCMT 2005-C17	2.62	42	WBCMT 2005-C17	11.92	32
WBCMT 2005-C18	0.78	24	WBCMT 2005-C18	-	1	WBCMT 2005-C18	11.39	26
WBCMT 2005-C19	0.39	13	WBCMT 2005-C19	-	1	WBCMT 2005-C19	5.82	5
WBCMT 2005-C20	7.06	63	WBCMT 2005-C20	-	1	WBCMT 2005-C20	10.81	24
WBCMT 2005-C21	1.46	32	WBCMT 2005-C21	-	1	WBCMT 2005-C21	5.13	3
WBCMT 2005-C22	2.79	52	WBCMT 2005-C22	3.50	45	WBCMT 2005-C22	13.18	39
WMCMS 2005-C1A	0.17	9	WMCMS 2005-C1A	5.22	50	WMCMS 2005-C1A	23.62	60

Source: Deutsche Bank and Trepp

Figure 4: Ranking performance data for the 2006 vintage

Deal Name	Total Delinquency %	Rank	Deal Name	Perf Spec Serv. %	Rank	Deal Name	Watchlist. %	Rank
BACM 2006-1	3.44	39	BACM 2006-1	2.68	40	BACM 2006-1	7.34	5
BACM 2006-2	1.49	19	BACM 2006-2	6.95	54	BACM 2006-2	11.73	18
BACM 2006-3	7.62	62	BACM 2006-3	1.06	31	BACM 2006-3	19.65	52
BACM 2006-4	1.82	23	BACM 2006-4	0.81	29	BACM 2006-4	16.68	45
BACM 2006-5	3.67	42	BACM 2006-5	7.58	56	BACM 2006-5	11.00	17
BACM 2006-6	0.27	6	BACM 2006-6	0.44	26	BACM 2006-6	42.33	64
BSCMS 2006-PW11	1.05	13	BSCMS 2006-PW11	-	1	BSCMS 2006-PW11	7.68	6
BSCMS 2006-PW12	2.87	32	BSCMS 2006-PW12	0.27	25	BSCMS 2006-PW12	15.81	41
BSCMS 2006-PW13	0.54	7	BSCMS 2006-PW13	1.47	35	BSCMS 2006-PW13	14.96	34
BSCMS 2006-PW14	1.33	17	BSCMS 2006-PW14	4.06	45	BSCMS 2006-PW14	27.97	59
BSCMS 2006-T22	0.20	5	BSCMS 2006-T22	0.21	24	BSCMS 2006-T22	13.94	30
BSCMS 2006-T24	1.75	22	BSCMS 2006-T24	4.28	46	BSCMS 2006-T24	7.01	4
CD 2006-CD2	5.02	51	CD 2006-CD2	-	1	CD 2006-CD2	27.99	60
CD 2006-CD3	3.40	38	CD 2006-CD3	8.74	57	CD 2006-CD3	10.77	15
CGCMT 2006-C4	2.50	28	CGCMT 2006-C4	1.46	34	CGCMT 2006-C4	12.15	22
CGCMT 2006-C5	1.51	20	CGCMT 2006-C5	10.18	60	CGCMT 2006-C5	14.58	33
COMM 2006-C7	0.17	4	COMM 2006-C7	2.78	41	COMM 2006-C7	19.06	51
COMM 2006-C8	6.40	57	COMM 2006-C8	4.99	48	COMM 2006-C8	36.65	63
CSMC 2006-C1	1.24	15	CSMC 2006-C1	6.63	53	CSMC 2006-C1	13.58	28
CSMC 2006-C2	6.54	58	CSMC 2006-C2	11.16	62	CSMC 2006-C2	8.04	8
CSMC 2006-C3	2.31	26	CSMC 2006-C3	10.47	61	CSMC 2006-C3	5.15	1
CSMC 2006-C4	5.59	55	CSMC 2006-C4	7.08	55	CSMC 2006-C4	16.24	42
CSMC 2006-C5	3.61	41	CSMC 2006-C5	5.85	50	CSMC 2006-C5	23.76	57
CSMC 2006-K1A	-	1	CSMC 2006-K1A	-	1	CSMC 2006-K1A	15.42	39
CWCI 2006-C1	3.94	46	CWCI 2006-C1	13.38	65	CWCI 2006-C1	17.18	46
FHMS K001	-	1	FHMS K001	-	1	FHMS K001	15.42	39
GCCFC 2006-GG7	5.40	53	GCCFC 2006-GG7	2.63	39	GCCFC 2006-GG7	11.77	19
GECMC 2006-C1	0.73	9	GECMC 2006-C1	0.85	30	GECMC 2006-C1	6.59	3
GMACC 2006-C1	1.16	14	GMACC 2006-C1	8.91	58	GMACC 2006-C1	18.42	50
GSMS 2006-GG6	6.70	60	GSMS 2006-GG6	-	1	GSMS 2006-GG6	17.58	47
GSMS 2006-GG8	8.64	64	GSMS 2006-GG8	-	1	GSMS 2006-GG8	15.31	37
HCC 2006-1	24.81	65	HCC 2006-1	3.99	44	HCC 2006-1	47.86	65
JPMCC 2006-CB14	6.66	59	JPMCC 2006-CB14	-	1	JPMCC 2006-CB14	12.87	26
JPMCC 2006-CB15	7.23	61	JPMCC 2006-CB15	-	1	JPMCC 2006-CB15	15.34	38
JPMCC 2006-CB16	3.83	44	JPMCC 2006-CB16	-	1	JPMCC 2006-CB16	14.23	32
JPMCC 2006-CIBC17	1.56	21	JPMCC 2006-CIBC17	-	1	JPMCC 2006-CIBC17	23.00	55
JPMCC 2006-LDP6	4.78	50	JPMCC 2006-LDP6	1.96	36	JPMCC 2006-LDP6	11.94	20
JPMCC 2006-LDP7	4.15	47	JPMCC 2006-LDP7	-	1	JPMCC 2006-LDP7	12.63	24
JPMCC 2006-LDP8	1.82	23	JPMCC 2006-LDP8	5.86	51	JPMCC 2006-LDP8	8.41	9
JPMCC 2006-LDP9	2.45	27	JPMCC 2006-LDP9	1.11	32	JPMCC 2006-LDP9	28.91	61
LBUBS 2006-C1	1.36	18	LBUBS 2006-C1	0.17	21	LBUBS 2006-C1	12.90	27
LBUBS 2006-C3	1.26	16	LBUBS 2006-C3	0.50	27	LBUBS 2006-C3	21.16	54
LBUBS 2006-C4	1.97	25	LBUBS 2006-C4	-	1	LBUBS 2006-C4	25.42	58
LBUBS 2006-C6	0.85	11	LBUBS 2006-C6	-	1	LBUBS 2006-C6	14.05	31
LBUBS 2006-C7	5.57	54	LBUBS 2006-C7	0.18	23	LBUBS 2006-C7	8.76	11
MLCFC 2006-1	3.33	37	MLCFC 2006-1	0.50	27	MLCFC 2006-1	13.62	29
MLCFC 2006-2	2.78	30	MLCFC 2006-2	-	1	MLCFC 2006-2	8.46	10
MLCFC 2006-3	3.88	45	MLCFC 2006-3	6.58	52	MLCFC 2006-3	16.37	43
MLCFC 2006-4	4.19	48	MLCFC 2006-4	4.83	47	MLCFC 2006-4	19.86	53
MLMT 2006-C1	3.23	35	MLMT 2006-C1	11.62	63	MLMT 2006-C1	30.99	62
MLMT 2006-C2	4.66	49	MLMT 2006-C2	5.54	49	MLMT 2006-C2	10.90	16
MSC 2006-HQ10	1.01	12	MSC 2006-HQ10	-	1	MSC 2006-HQ10	10.54	14
MSC 2006-HQ8	3.58	40	MSC 2006-HQ8	-	1	MSC 2006-HQ8	12.56	23
MSC 2006-HQ9	3.05	34	MSC 2006-HQ9	-	1	MSC 2006-HQ9	9.32	13
MSC 2006-IQ11	3.32	36	MSC 2006-IQ11	3.80	43	MSC 2006-IQ11	7.74	7
MSC 2006-IQ12	5.03	52	MSC 2006-IQ12	2.04	37	MSC 2006-IQ12	23.44	56
MSC 2006-T21	0.78	10	MSC 2006-T21	-	1	MSC 2006-T21	11.97	21
MSC 2006-T23	-	1	MSC 2006-T23	9.13	59	MSC 2006-T23	5.36	2
WBCMT 2006-C23	2.83	31	WBCMT 2006-C23	3.05	42	WBCMT 2006-C23	18.35	49
WBCMT 2006-C24	7.97	63	WBCMT 2006-C24	2.20	38	WBCMT 2006-C24	16.39	44
WBCMT 2006-C25	0.65	8	WBCMT 2006-C25	-	1	WBCMT 2006-C25	8.79	12
WBCMT 2006-C26	6.17	56	WBCMT 2006-C26	11.73	64	WBCMT 2006-C26	12.66	25
WBCMT 2006-C27	2.92	33	WBCMT 2006-C27	-	1	WBCMT 2006-C27	17.67	48
WBCMT 2006-C28	3.69	43	WBCMT 2006-C28	1.42	33	WBCMT 2006-C28	15.12	35
WBCMT 2006-C29	2.58	29	WBCMT 2006-C29	0.17	21	WBCMT 2006-C29	15.24	36

Source: Deutsche Bank and Trepp

Figure 5: Ranking performance data for the 2007 vintage

Deal Name	Total Delinquency %	Rank	Deal Name	Perf Spec Serv. %	Rank	Deal Name	Watchlist. %	Rank
BACM 2007-1	1.98	33	BACM 2007-1	7.30	66	BACM 2007-1	17.00	23
BACM 2007-2	3.50	50	BACM 2007-2	1.04	46	BACM 2007-2	33.11	60
BACM 2007-3	3.85	53	BACM 2007-3	5.56	62	BACM 2007-3	27.64	52
BACM 2007-4	1.59	27	BACM 2007-4	2.14	53	BACM 2007-4	16.90	22
BACM 2007-5	3.49	49	BACM 2007-5	3.99	57	BACM 2007-5	19.86	32
BSCMS 2007-PW15	0.15	10	BSCMS 2007-PW15	0.04	24	BSCMS 2007-PW15	8.81	9
BSCMS 2007-PW16	1.81	31	BSCMS 2007-PW16	0.49	36	BSCMS 2007-PW16	13.13	16
BSCMS 2007-PW17	0.98	20	BSCMS 2007-PW17	-	1	BSCMS 2007-PW17	19.34	30
BSCMS 2007-PW18	2.57	40	BSCMS 2007-PW18	9.08	67	BSCMS 2007-PW18	19.57	31
BSCMS 2007-T26	3.33	45	BSCMS 2007-T26	0.35	32	BSCMS 2007-T26	6.90	6
BSCMS 2007-T28	-	1	BSCMS 2007-T28	-	1	BSCMS 2007-T28	8.88	10
CCRF 2007-MF1	5.32	60	CCRF 2007-MF1	0.49	36	CCRF 2007-MF1	17.26	24
CD 2007-CD4	0.88	19	CD 2007-CD4	11.40	68	CD 2007-CD4	26.17	48
CD 2007-CD5	2.20	36	CD 2007-CD5	1.69	52	CD 2007-CD5	18.94	28
CGCMT 2007-C6	1.69	29	CGCMT 2007-C6	4.10	58	CGCMT 2007-C6	15.71	19
COMM 2007-C9	1.24	22	COMM 2007-C9	-	1	COMM 2007-C9	15.54	18
CSMC 2007-C1	9.46	65	CSMC 2007-C1	5.59	63	CSMC 2007-C1	34.11	61
CSMC 2007-C2	3.24	44	CSMC 2007-C2	-	1	CSMC 2007-C2	26.47	50
CSMC 2007-C3	5.13	56	CSMC 2007-C3	1.03	43	CSMC 2007-C3	22.71	43
CSMC 2007-C3A	5.13	56	CSMC 2007-C3A	1.03	43	CSMC 2007-C3A	22.71	43
CSMC 2007-C4	2.50	39	CSMC 2007-C4	0.74	41	CSMC 2007-C4	49.88	68
CSMC 2007-C5	7.47	63	CSMC 2007-C5	-	1	CSMC 2007-C5	22.65	42
CWCI 2007-C2	1.59	27	CWCI 2007-C2	5.10	59	CWCI 2007-C2	17.88	26
CWCI 2007-C3	-	1	CWCI 2007-C3	0.27	29	CWCI 2007-C3	20.60	35
FHMS K002	5.13	56	FHMS K002	1.03	43	FHMS K002	22.71	43
GCCFC 2007-GG11	0.67	17	GCCFC 2007-GG11	-	1	GCCFC 2007-GG11	26.27	49
GCCFC 2007-GG9	0.23	11	GCCFC 2007-GG9	1.24	49	GCCFC 2007-GG9	20.78	36
GECMC 2007-C1	2.04	34	GECMC 2007-C1	5.37	61	GECMC 2007-C1	20.16	33
GSMS 2007-GG10	4.33	55	GSMS 2007-GG10	0.70	40	GSMS 2007-GG10	43.42	66
HCC 2007-1A	38.38	68	HCC 2007-1A	-	1	HCC 2007-1A	17.50	25
JPMCC 2007-C1	9.38	64	JPMCC 2007-C1	-	1	JPMCC 2007-C1	25.55	47
JPMCC 2007-CB18	2.79	41	JPMCC 2007-CB18	0.20	27	JPMCC 2007-CB18	25.12	46
JPMCC 2007-CB19	3.54	51	JPMCC 2007-CB19	1.13	48	JPMCC 2007-CB19	20.30	34
JPMCC 2007-CB20	3.45	47	JPMCC 2007-CB20	-	1	JPMCC 2007-CB20	21.97	40
JPMCC 2007-LD11	5.57	61	JPMCC 2007-LD11	-	1	JPMCC 2007-LD11	22.07	41
JPMCC 2007-LD12	1.49	25	JPMCC 2007-LD12	0.97	42	JPMCC 2007-LD12	31.03	58
JPMCC 2007-LDPX	3.77	52	JPMCC 2007-LDPX	7.13	65	JPMCC 2007-LDPX	21.44	38
LBCMT 2007-C3	10.68	66	LBCMT 2007-C3	1.45	50	LBCMT 2007-C3	14.02	17
LBSBC 2007-1A	-	1	LBSBC 2007-1A	-	1	LBSBC 2007-1A	-	1
LBSBC 2007-2A	-	1	LBSBC 2007-2A	-	1	LBSBC 2007-2A	-	1
LBSBC 2007-3A	-	1	LBSBC 2007-3A	-	1	LBSBC 2007-3A	-	1
LBUBS 2007-C1	13.21	67	LBUBS 2007-C1	2.15	55	LBUBS 2007-C1	2.88	5
LBUBS 2007-C2	5.20	59	LBUBS 2007-C2	5.92	64	LBUBS 2007-C2	9.64	11
LBUBS 2007-C6	1.41	24	LBUBS 2007-C6	0.09	25	LBUBS 2007-C6	27.49	51
LBUBS 2007-C7	0.65	15	LBUBS 2007-C7	-	1	LBUBS 2007-C7	16.38	21
MLCFC 2007-5	1.40	23	MLCFC 2007-5	0.20	27	MLCFC 2007-5	28.43	55
MLCFC 2007-6	0.56	13	MLCFC 2007-6	-	1	MLCFC 2007-6	30.88	57
MLCFC 2007-7	6.51	62	MLCFC 2007-7	1.08	47	MLCFC 2007-7	21.61	39
MLCFC 2007-8	2.43	38	MLCFC 2007-8	-	1	MLCFC 2007-8	16.21	20
MLCFC 2007-9	1.12	21	MLCFC 2007-9	2.14	53	MLCFC 2007-9	30.33	56
MLMT 2007-C1	3.46	48	MLMT 2007-C1	-	1	MLMT 2007-C1	10.81	14
MSC 2007-HQ11	1.53	26	MSC 2007-HQ11	0.62	39	MSC 2007-HQ11	35.69	63
MSC 2007-HQ12	-	1	MSC 2007-HQ12	0.46	35	MSC 2007-HQ12	44.79	67
MSC 2007-HQ13	-	1	MSC 2007-HQ13	1.64	51	MSC 2007-HQ13	27.88	54
MSC 2007-IQ13	2.04	34	MSC 2007-IQ13	0.40	33	MSC 2007-IQ13	31.86	59
MSC 2007-IQ14	-	1	MSC 2007-IQ14	-	1	MSC 2007-IQ14	18.10	27
MSC 2007-IQ15	3.18	43	MSC 2007-IQ15	-	1	MSC 2007-IQ15	9.95	12
MSC 2007-IQ16	0.65	15	MSC 2007-IQ16	5.13	60	MSC 2007-IQ16	12.38	15
MSC 2007-T25	3.99	54	MSC 2007-T25	-	1	MSC 2007-T25	10.72	13
MSC 2007-T27	1.90	32	MSC 2007-T27	-	1	MSC 2007-T27	7.46	7
PRFIC 2007-PLA	0.49	12	PRFIC 2007-PLA	-	1	PRFIC 2007-PLA	-	1
SOVC 2007-C1	3.34	46	SOVC 2007-C1	0.14	26	SOVC 2007-C1	20.85	37
TIAAS 2007-C4	-	1	TIAAS 2007-C4	0.41	34	TIAAS 2007-C4	8.39	8
WBCMT 2007-C30	0.76	18	WBCMT 2007-C30	0.30	31	WBCMT 2007-C30	41.43	64
WBCMT 2007-C31	2.33	37	WBCMT 2007-C31	2.80	56	WBCMT 2007-C31	34.81	62
WBCMT 2007-C32	1.74	30	WBCMT 2007-C32	0.28	30	WBCMT 2007-C32	42.32	65
WBCMT 2007-C33	3.10	42	WBCMT 2007-C33	0.56	38	WBCMT 2007-C33	27.65	53

Source: Deutsche Bank and Trepp

Figure 6: Ranking performance data for the 2008 vintage

Deal Name	Total Delinquency %	Rank	Deal Name	Perf Spec Serv. %	Rank	Deal Name	Watchlist. %	Rank
BACM 2008-1	1.24	3	BACM 2008-1	0.8	5	BACM 2008-1	4.33	2
CGCMT 2008-C7	0.96	2	CGCMT 2008-C7	3.61	7	CGCMT 2008-C7	10.76	4
CMLT 2008-LS1	1.51	4	CMLT 2008-LS1	0	1	CMLT 2008-LS1	19.94	7
CSMC 2008-C1	1.58	5	CSMC 2008-C1	0.5	4	CSMC 2008-C1	13.36	5
JPMCC 2008-C2	20.12	8	JPMCC 2008-C2	2.15	6	JPMCC 2008-C2	16.99	6
LBUBS 2008-C1	4.71	7	LBUBS 2008-C1	0	1	LBUBS 2008-C1	2.07	1
MLMT 2008-C1	2.43	6	MLMT 2008-C1	8.35	8	MLMT 2008-C1	6.8	3
MSC 2008-T29	0	1	MSC 2008-T29	0	1	MSC 2008-T29	24.58	8

Source: Deutsche Bank and Trepp

Appendix 1

Important Disclosures

Additional information available upon request

For disclosures pertaining to recommendations or estimates made on a security mentioned in this report, please see the most recently published company report or visit our global disclosure look-up page on our website at http://gm.db.com/ger/disclosure/DisclosureDirectory.eqsr.

Analyst Certification

The views expressed in this report accurately reflect the personal views of the undersigned lead analyst(s). In addition, the undersigned lead analyst(s) has not and will not receive any compensation for providing a specific recommendation or view in this report. Richard Parkus

Deutsche Bank Debt Rating Key

Buy: These bonds are expected to outperform other issues in the sector/industry group over the next three to six-month period

Hold: These bonds are fairly valued currently. If owned, no need to sell, but we await events/ releases/ conditions that would make the bond attractive enough for us to upgrade. In the interim, the bond will likely perform as well as the average issue in the sector/industry group

Sell: There exists a significant likelihood that these bonds will underperform relative to other issues in their sector/industry group, at least over the next three months.

Regulatory Disclosures

1. Important Additional Conflict Disclosures

Aside from within this report, important conflict disclosures can also be found at https://gm.db.com/equities under the "Disclosures Lookup" and "Legal" tabs. Investors are strongly encouraged to review this information before investing.

2. Short-Term Trade Ideas

Deutsche Bank equity research analysts sometimes have shorter-term trade ideas (known as SOLAR ideas) that are consistent or inconsistent with Deutsche Bank's existing longer term ratings. These trade ideas can be found at the SOLAR link at http://gm.db.com.

3. Country-Specific Disclosures

Australia: This research, and any access to it, is intended only for "wholesale clients" within the meaning of the Australian Corporations Act.
EU countries: Disclosures relating to our obligations under MiFiD can be found at http://globalmarkets.db.com/riskdisclosures.
Japan: Disclosures under the Financial Instruments and Exchange Law: Company name – Deutsche Securities Inc. Registration number – Registered as a financial instruments dealer by the Head of the Kanto Local Finance Bureau (Kinsho) No. 117. Member of associations: JSDA, The Financial Futures Association of Japan. This report is not meant to solicit the purchase of specific financial instruments or related services. We may charge commissions and fees for certain categories of investment advice, products and services. Recommended investment strategies, products and services carry the risk of losses to principal and other losses as a result of changes in market and/or economic trends, and/or fluctuations in market value. Before deciding on the purchase of financial products and/or services, customers should carefully read the relevant disclosures, prospectuses and other documentation.
Malaysia: Deutsche Bank AG and/or its affiliate(s) may maintain positions in the securities referred to herein and may from time to time offer those securities for purchase or may have an interest to purchase such securities. Deutsche Bank may engage in transactions in a manner inconsistent with the views discussed herein.
New Zealand: This research is not intended for, and should not be given to, "members of the public" within the meaning of the New Zealand Securities Market Act 1988.
Russia: This information, interpretation and opinions submitted herein are not in the context of, and do not constitute, any appraisal or evaluation activity requiring a license in the Russian Federation.

David Folkerts-Landau
Managing Director
Global Head of Research

Stuart Parkinson Chief Operating Officer	Guy Ashton Global Head Company Research	Marcel Cassard Global Head Fixed Income Strategies and Economics

Germany	Asia-Pacific	Americas
Andreas Neubauer Regional Head	Michael Spencer Regional Head	Steve Pollard Regional Head

Principal Locations

Deutsche Bank AG
London
1 Great Winchester Street
London EC2N 2EQ
Tel: (44) 20 7545 8000

Deutsche Bank AG
New York
60 Wall Street
New York, NY 10005
United States of America
Tel: (1) 212 250-2500

Deutsche Bank AG
Hong Kong
Cheung Kong Center,
2 Queen's Road Central
Hong Kong
Tel: (52) 2203 8888

Deutsche Bank AG
Japan
2-11-1 Nagatacho
Sanno Park Tower
Chiyoda-ku, Tokyo 100-6171
Tel: (81) 3 5156 6701

Deutsche Bank AG
Frankfurt
Große Gallusstraße 10-14
60272 Frankfurt am Main
Germany
Tel: (49) 69 910 00

Deutsche Bank AG
Aurora business park
82 bld.2 Sadovnicheskaya street
Moscow, 115035
Russia
Tel: (7) 495 797-5000

Deutsche Bank AG
Singapore
One Raffles Quay
South Tower
Singapore 048583
Tel: (65) 6423 8001

Deutsche Bank AG
Australia
Deutsche Bank Place, Level 16
Corner of Hunter & Phillip Streets
Sydney NSW 2000
Tel: (61) 2 8258 1234

Deutsche Bank Dubai
Dubai International Financial Centre
The Gate, West Wing, Level 3
P.O. Box 504 902
Dubai City
Tel: (971) 4 3611 700

Subscribers to research via email receive their electronic publication on average 1-2 working days earlier than the printed version.

If you would like to receive this or any other product via email please contact your usual Deutsche Bank representative.

Publication Address:
Deutsche Bank Securities Inc.
60 Wall Street
New York, NY 10005
United States of America
(1) 212 250 2500

Internet:
http://gmr.db.com
Ask your usual contact for a username and password.

Global Disclaimer

The CHAIR. Good. Thank you very much, Mr. Parkus. I appreciate it.

If we can, I am just going to move to the questions quickly. And as much as you can keep your questions short—this is always hard—we appreciate it, just so everyone gets a chance to ask as much as we can.

I would like to start with a question about the stress test. We are working on this now for our report. It has certainly been in the news.

One of the issues that I am concerned about and hope you might speak to, given the kind of data you are talking about in particular, Mr. Parkus, but also you, Dr. Schuermann, is the question of the length of time that should be in the stress test projections. We are trying to understand the riskiness and effect in the banking system right now, and that is not only for the purposes of understanding our own exposure, but also for purposes of trying to attract new capital.

But no one thinks that at the end of 2010, the game stops. The notion is it is going to go forward. So in light of the data you are talking about, do you have concerns about whether the stress test has appropriately captured the period of greatest risk?

Mr. Parkus.

Mr. PARKUS. Chairwoman Warren, I have to admit I am not—I do not have expertise in the details of the stress test. I do, however, understand the timeframe for the stress test was, I believe, 3 years. And that, if that is the case, that would, in my view, be fairly short, as many of the mortgages that we are looking at do not mature for quite a while, and losses in commercial real estate and defaults often tend to be very what we refer to as "back-ended." They tend to occur well into the life of the mortgage.

The CHAIR. Right. Actually, let me just ask you this on a data question as we do this. I was reading—your reports are very good, but often the data are cumulative. I take it, though, that you have them on year-by-year maturity dates?

Mr. PARKUS. I do.

The CHAIR. So that it is possible, in effect, to model out what the wave looks like.

Mr. PARKUS. Exactly. We do that in a very precise way.

The CHAIR. And might we be able to have access to some of those data if we have further conversations about it?

Mr. PARKUS. Absolutely.

The CHAIR. That could be very helpful, I think, on this very question.

Dr. Schuermann, would you like to add anything?

Dr. SCHUERMANN. Sure. The stress test scenario was a 2-year scenario through the end of 2010. But my colleague is correct in saying that there is an implicit third year because we thought about—part of the stress test looked at provisions for loan losses or expected loan losses for the following year. So, in that sense, it is taking into account sort of a longer horizon than just 2 years.

The CHAIR. Do you have concerns, in light of Mr. Parkus' data, that we may be stress testing the wrong end of the curve or at least not the most worrisome end of the curve?

Dr. SCHUERMANN. While I am not an expert in commercial real estate, some of the poor underwriting occurred late—much like in other parts of the real estate business, occurred late in the recent cycle. So that would be in ’04, ’05, ’06.

So typical maturities for these loans are 5 years. So that still takes us into, a bulk into the tail end of the period that the stress test took into account. For sure, there are going to be some of the losses that will occur after this horizon, but I think I feel comfortable that a sizable portion of the commercial real estate exposure was, in fact, taken into account in the stress test.

The CHAIR. Well, Mr. Parkus’s data may help us with that.

Dr. SCHUERMANN. Indeed.

The CHAIR. Yes.

Could I ask a question about your testimony? Another data based question, if you will indulge me. You write in your testimony that one closely watched indicator of banks’ appetite for extending credit is the net percent of loan officers reporting tightening standards for approving new loans.

After more than a year and a half of steady tightening, the net percent of loan officers reporting tightening standards for loans reached an unprecedented peak of 84 percent in the fourth quarter of 2008. You noted since then, however, the net percent for tightening has fallen for two consecutive quarters to 40 percent.

What I don’t understand is exactly how this is calculated. So each time, you ask a loan officer are you loosening, staying the same, or tightening? If everyone has tightened, 84 percent have tightened, and then let us just say most of them stay the same and 40 percent, whether it is 40 percent of the 84 or some overlapping or the ones who didn’t tighten last time tightened, that doesn’t seem to me that things are getting better.

It only seems to me that things are getting better when we have reports of loosening standards. And I am not seeing that. I am seeing your—you seem to be celebrating the fact that there are fewer who are tightening, but if they have left it just as tight as it was in the preceding quarter, I am not quite understanding how that improved things. Perhaps you could enlighten me?

Dr. SCHUERMANN. So I actually am not, by any means, an expert on this survey. I don’t know exactly how those nuances are calculated.

The pattern, though, that we are seeing is, in essence, fairly typical of recessions is that there is the sort of peak tightening and then slow loosening well into the recession. It takes a while before reduced tightening. It takes a while before actual loosening happens. But the trend is certainly there that loosening, I don’t know if it is just around the corner, but——

The CHAIR. Well, I am not seeing anything in your testimony about loosening yet. So if you have more data on that——

Dr. SCHUERMANN. There is no loosening yet.

The CHAIR [continuing]. That could be valuable. Good.

Senator Sununu. Thank you.

Senator SUNUNU. Thank you.

If there is a silver lining, maybe it isn’t that things are getting worse, but that they are worsening at a slower rate.

The CHAIR. Because they are already so bad?

Senator SUNUNU. When we look at the relative growth of C&I, you have got two previous recessions, 2001 and the '90–'91 recession. In those past recessions, how much of that decline was driven by the constriction of supply, the tightening standards, and how much of it was demand driven?

Dr. SCHUERMANN. You know, this is one of the most difficult questions any economist faces in doing empirical work is trying to tease apart because what you see is prices moving and quantities moving. What you don't see is, is that due to supply shifts or demand shift?

So I don't know the answer to that question, but what is clear is that both play a very important role.

Senator SUNUNU. I think it is fair to say that the initial objectives of the TARP, and the CPP in particular, was to establish some basic level of stability in the financial markets as a precursor for more normal operation. And I think that some credit has to be given to the CPP for, again, stabilizing the situation, especially in November and December of last year.

But now we are trying to understand whether and when the markets begin to operate more normally, and I appreciate that you can't tell how much of that is supply driven and how much of it is demand driven. But what metrics would you look at as good criteria for determining whether our credit markets, and C&I in particular, are operating more normally?

Dr. SCHUERMANN. So there are several metrics that are at our disposal. Pricing is a very important one. Pricing for commercial lending in the form of corporate bonds, commercial paper—corporate bonds simply being long-term, commercial paper being short-term borrowing—and also securitizations, securitization of a variety of assets.

I am looking at the pricing that that commands in the market. The latter, we are certainly seeing already a decline in the pricing, a tightening of those spreads. Even after just the announcement of TALF, there was a tightening of spreads, which continued after the first couple of deals were completed. So I would look to the market's data for pricing and spreads, as well as quantity data in terms of issuance and C&I lending in banks.

Senator SUNUNU. Mr. Parkus, I guess this is in your first report, and I don't know if it is an appendix, page 20, some of the latter parts of the report, you list out all of these deals, deal by deal, and you show an equity deficiency loss through 2012 and then the lifetime loss.

Now some of the deals—I think this is a vintage 2007, I am not going to be too specific here. But there are deals that show an equity deficiency of 32 percent, 31 percent, 37 percent. Pretty significant numbers. And lifetime losses for those specific deals of 21 percent, 18 percent, 23 percent. Those are huge numbers, from my perspective, looking at potential loss of a vintage 2007 deal.

When you put this out, when you released this report, was this perceived to be new information, relatively new information or a new analysis? And I am curious to know how the particular holders of this paper reacted and how markets, more broadly, reacted?

Mr. PARKUS. Senator Sununu, yes. The analysis was considered to be a new look at a problem that everybody sort of had in the back of their mind. However, there are so many problems to confront today in commercial real estate, the problems of refinancing are easy to brush to the side.

Senator SUNUNU. Did many people try to argue that, well, you didn't understand this deal?

Mr. PARKUS. No.

Senator SUNUNU. You didn't really look carefully enough?

Mr. PARKUS. No, no.

Senator SUNUNU. This is actually a good deal. It is not going to be 28 percent, but it is really 2 percent?

Mr. PARKUS. No. The interesting thing about the feedback was that, and I have heard from several hundred people in every—mortgage brokers, every type of individual investor, people involved in commercial real estate markets. I have not heard one comment of disagreement with the basic findings.

I should mention that all this report does is in a very quantitative and highly parameterized way simply look at how many loans may not—under a very reasonable set of assumptions look like they will not qualify for refinancing.

Senator SUNUNU. I have one last question.

The CHAIR. Senator, can we be really short?

Senator SUNUNU. Yes. You talk a lot about the fixed-rate CMBS and the floating-rate CMBS, but you also show debt held by insurance companies and banks and thrifts. I know you didn't do a detailed analysis, but the comparative underwriting standards for those deals as well do you think are similar to the ones that you did look at in detail?

Mr. PARKUS. Yes and no. Insurance company portfolios are comprised of much higher quality on average loans. They tend to be long-term fixed-rate loans, and for the most part, we believe that the problems will be much—at a much lower scale for loans originated by insurance companies.

Bank portfolios are a different story. In our view, for a variety of reasons that I could get into, we view core commercial real estate—and this is quite apart from the construction loans and the multi-family loans that are broken out—core commercial real estate, in our view, is at least as risky and, in our view, probably significantly riskier.

Senator SUNUNU. Thank you.

The CHAIR. Thank you.

Superintendent Neiman.

Mr. NEIMAN. Thank you.

Mr. Parkus, I would like to follow up on that because I am fascinated by your testimony and your reports, where you indicate that commercial mortgages held in bank portfolios may be riskier and more likely to underperform than commercial real estate mortgages held by CMBS. Because, to me, that is counterintuitive to the extent that you would expect that origination and hold would have a tighter underwriting standard than an originate-to-distribute model. Could you expand on that?

Mr. PARKUS. Sure. Mr. Neiman, let me just explain that this is highly conjecture. We don't know exactly what is in bank portfolios, and this is one of the problems. In CMBS, we know exactly what is there. We know every loan characteristic. It is perfectly transparent.

In bank portfolios, we are going on, unfortunately, anecdotal evidence. But some of the principal characteristics that we are basing our views on are the following. First of all, loans in bank portfolios, and there is significant difference, differentiation across banks in this. But loans tend to be much shorter maturities than in CMBS.

CMBS loans tend to be 10-year, fixed-rate loans for the bulk of the industry. What that means is that most of these loans don't mature until '15, '16, '17. You can see that in the graph in the report. There is some maturity, there are some 5-year loans, and those are maturing over the next few years.

The point about this is that the loans—the shorter the maturity of the loan, the greater the risk of the loan because the loan was originated, most of these loans were originated at the peak of the market, and the shorter the maturity, the more they will be coming up for refinancing at the trough of the market.

If you had a 30-year loan, we probably would have no problems here, even if they were IO loans. The horizon is so long. So the maturity term profile is very important.

The second is that bank lending tends to be much more skewed towards transitional types of properties, properties where in-place cash flows are currently low relative to projected future cash flows. A property, which is—say, a property, a new office building, which is purchased and being renovated, currently, the rent levels are low. The expectation is within a year or two after the renovation is complete, you re-lease at higher rent levels.

In many cases, the size of the loan is based on the projected future—the projected higher future cash flows. That is a major problem. If we looked at sort of transitional loans in CMBS, that is the floating-rate sector, relatively small sector, but a major sector nonetheless. Almost everything we are seeing now come up for refinancing is defaulting, almost everything at this point.

Mr. NEIMAN. That was very helpful.

You mentioned the expansion of the TALF to impact the maturity default issue in terms of addressing liquidity, but not credit. I would like you both to kind of comment on how expansion of the TALF to include CMBS particularly, legacy CMBS, will have on the impact of credit availability in these markets and particularly on the CRE likely default and refinancing issues.

Mr. PARKUS. Well, TALF for legacy securities will and has already driven credit spreads in dramatically. With existing what we view as relatively risk-free AAAs or very low risk AAA securities out there, if you can imagine AAA securities with very low risk offering 18 percent yields, it is hard to get an investor interested in buying new loans when he can just buy an existing risk-free AAA bond at two or three times the yields.

So getting those yields down sort of takes away the alternative very juicy opportunities. That is the importance of legacy TALF, at least in my view. Of course, it has the advantage of helping out, of getting pricing to more rational levels. Right now, there is a tremendous liquidity premium in the market.

TALF for new issue is important for getting new credit. We believe that these are very important and likely to be successful programs in helping to get mortgage credit flowing, flowing to loans that qualify. This is the key issue.

This is why the amount of origination may not be a great metric for is the market working? The market works. I would say the market is not working when mortgage credit is going to loans that don't qualify. That was what got us into this problem in the first place.

And that is why, in my view, we don't want to see underwriting standards easing. We want to see them extremely tight for the foreseeable future. And I believe that that is where they will remain.

Mr. NEIMAN. Thank you.

I also hope that you will both stay for the next panel to hear the dialogue, and we may want to follow up with you on issues with this panel and on the next panel.

Thank you.

The CHAIR. Good. Thank you.

Thank you.

Mr. Silvers.

Mr. SILVERS. I would like to turn to commercial and industrial lending for a moment. Dr. Schuermann, your testimony focused on the shift from institutional forms of credit to market-based forms of credit. Could you please explain how that—to what extent that has occurred in the commercial and industrial market?

And obviously, there has always been a public bond market for large issuers, but for those issuers that are not able to access that market, to what extent has that shift occurred in that type of commercial and industrial lending?

Dr. SCHUERMANN. All right. Now that is a very good question. The shifting from bank-based lending to market-based lending for C&I has been much longer in forming and much more extensive through the growth of the capital markets, commercial paper issuance and corporate bond issuance.

But another form of this intermediation actually is the selling of loans that the banks do into the capital markets. So bundling up of loans and selling them. That actually increased more than fourfold from the mid '90s until about 2007 and, for the first time, declined last year. So that is important in part because even the degree to which banks' regular intermediation activity is part of the credit provision process for C&I lending, they also counted on being able to offload some of these risks from their balance sheet to create additional room by putting them into the capital markets in the form of direct loan sales.

Mr. SILVERS. What percentage of bank C&I lending was then subsequently resold during the run-up to the crisis? Do you know?

Dr. SCHUERMANN. Oh, gosh. That is a good question. I don't have that, but I can get that for you.

Mr. SILVERS. All right, and then—but my further question is if you are a business in the market for a commercial and industrial credit and you are not of the scale to access the bond markets or the commercial paper markets, which is even a larger-scale enterprise, has there really been, even in the most recent years, an alternative to bank financing and to what degree?

Dr. SCHUERMANN. Well, there has been finance companies that have been there, and that market actually has grown.

Mr. SILVERS. So what portion would you say they would be of that market?

Dr. SCHUERMANN. I don't have that. But again, that I can get for you.

Mr. SILVERS. What I am trying to get at is would you agree that really commercial banks have remained the primary source of credit for that portion of the C&I market that can't access the public capital markets.

Dr. SCHUERMANN. They are certainly a very important source of credit for that small business and middle market, the privately held firms that don't have sort of a natural other access to either market, aside from the finance companies.

Mr. SILVERS. And in a way that is, say, quite different from what has happened in mortgages and credit cards and so forth, where there has been a move, a very heavy move away from bank financing into credit cards?

Dr. SCHUERMANN. Yes, I think that is definitely fair to say. Yes.

Mr. SILVERS. Okay. That is very helpful. Thank you.

Mr. Parkus, I was very struck by the conclusion of your testimony, where you said that really this is not a liquidity problem, that the problems in commercial real estate finance are not a liquidity problem fundamentally, but fundamentally, essentially a question of value.

Am I paraphrasing you——

Mr. PARKUS. That is right, Mr. Silvers.

Mr. SILVERS. A, it struck me they are parallel to the problems we face in the residential mortgage market, where there is definitely a value issue embedded in everything. But what I wanted to put to sort of get your thoughts on is what—is there a solution to the problem that a lot of people lent a lot of money on essentially unrealistic assumptions? Is there a solution here other than the fact that those people are going to take a haircut?

Mr. PARKUS. Not in my view. There are no easy solutions to this. There is no way to—there are very large losses embedded in the system, and those losses can either be—we can either confront those quickly, which I think would be by far the best approach. Or we can let them remain and stagnate in portfolios.

Mr. SILVERS. The stagnation option would, in your view, would come from a kind of an extending and figuring out ways to extend the time horizons here?

Mr. PARKUS. Yes, precisely.

Mr. SILVERS. You would view that as a stagnations choice?

Mr. PARKUS. That is right.

Mr. SILVERS. What is the—I think our charge, as I think we were reminded by our congressional witnesses earlier, our charge is heavily oriented toward the interaction of the financial crisis with the real economy, with jobs, with incomes, and so forth. It strikes me in listening to your testimony that there are kind of several different interwoven problems in your data—that your data highlights.

And I don't mean problems with your data. I mean the problems that your data highlight. One problem is the lack of financing—one problem is this haircut problem, that there are a lot of loans out there that can't be refinanced for good reason, right?

Mr. PARKUS. Right.

Mr. SILVERS. Another problem is that there appears to be, as a result of all these things, no financing available for existing projects, in part because of the crowding out problem you alluded to.

What should we be focused on here? Meaning, should we be expending public resources to try to rescue the existing sort of investors and so forth? Should we be expending public resources to try to get new projects started, assuming proper underwriting terms? Do you follow my——

Mr. PARKUS. Yes, I do. I would say that certainly the TALF programs are perfectly suited to getting credit up and running.

I should be clear that there really are two sources of problems here. There are currently poorly functioning credit markets, particularly in commercial real estate, that is operating now and preventing many loans that do qualify, that do qualify for a mortgage under the tighter underwriting standards from getting credit. Those problems will and should be addressed by the existing TALF programs.

Quite apart from this and what I am addressing in my research is sort of a problem which is already in the system. It is not—these results do not rely on poorly functioning credit markets. These are problems that we have inherited that are in the system already.

Did I address your question?

Mr. SILVERS. Yes, I am well over, and I thank you both.

The CHAIR. Thank you very much.

Thank you, Dr. Schuermann. Thank you, Mr. Parkus.

Both witnesses are excused. We hope we will be able to talk with you later and have some more questions about data. If you are able to stay for another half hour, it would give us the option if we have more questions as we go with the next panel.

Thank you very much. We appreciate your time.

If I could have Mr. DeBoer, Mr. Pearson, and Mr. Rogus, please?

Thank you, gentlemen.

As with the earlier panel, your written statement will become part of the official record. So I will ask you to hold your remarks, if you could, to 5 minutes. And I am going to be a bit more aggressive about time just so that we will all have time to ask questions.

Is it "Mr. De-Bore" or "Mr. De-Beer"?

Mr. DEBOER. "De-Bore."

The CHAIR. DeBoer. Okay. Mr. DeBoer, could you begin, please?

Mr. DEBOER. Sure.

The CHAIR. Thank you.

STATEMENT OF JEFFREY DEBOER, CHIEF EXECUTIVE OFFICER, THE REAL ESTATE ROUNDTABLE

Mr. DEBOER. Thank you, and good morning.

My name is Jeff DeBoer, and I am president and CEO of the Real Estate Roundtable. We are headquartered in Washington, D.C.

I am here today to continue to sound the alarm bell. In our view, the current financial system, the banking system, simply doesn't have enough capacity to meet the growing demand for commercial real estate debt, and that is why there needs to be this reconnection between the loan originating market and the secondary market.

Albeit this reconnection needs to be under new terms, where there is stronger underwriting, where real values are recognized, and where there is additional equity. But the process needs to be moving forward.

The commercial real estate industry today is in deep stress for two reasons. First of all, from a macroeconomic point of view, unemployment is obviously high and going higher. Consumers aren't spending, and people aren't traveling either for business reasons or personal reasons. That causes net operating income on properties to drop substantially, and it is causing property values to drop substantially.

But secondly, and perhaps more importantly, as we have heard and it is no secret now, that the credit markets are essentially closed for refinancing existing real estate debt or securing new debt on properties. This lack of a functioning credit market is putting further downward pressure on property values and is causing many commercial property owners to face what we call maturity default on their loans.

This has and will continue to create great problems for the banking industry, for the system as a whole, and for the economy as a whole. And that is why this hearing today is very well conceived, and I congratulate you for doing that.

The size of the problem today is large, and it is getting larger, and it needs to be addressed. The commercial real estate market is valued at approximately $6.5 trillion. It is supported by about $3.4 trillion of debt. As we have heard from the previous panel, this debt is typically 10 years or less in maturity. Therefore, it is constantly maturing every year. Just like the flowers hopefully bloom in the spring, debt matures and hopefully gets refinanced.

We have heard already from Congresswoman Maloney that the size, we estimate somewhere between $300 billion and $500 billion of loans, both CMBS and non-CMBS loans that mature this year, the amount of maturities will explode in the next few years, reaching about $2.6 trillion, we believe, between 2010 and 2012.

We know that the sources of—the primary sources of this credit are banks and CMBS. About 83 percent of all financing comes from that, and we know that both of those sources are essentially shut down. The bottom line is we have a liquidity crisis here that affects even well-positioned, strong assets, which have good debt coverage are in a very difficult, if not impossible, situation to get refinanced.

Some people say why should we care? We care because that in addition to dropping values, the lack of available financing causes values to drop even further artificially. This, in turn, reduces revenues for local governments that depend on healthy real estate markets to provide the funds for education, road construction, law enforcement, energy planning, and other things that we all like to have in our communities.

It sometimes surprises people when I report that local governments, on average, require about 50 to 70 percent or get about 50 to 70 percent of their local budget money from commercial real estate property values and transaction taxes.

Artificially low values also mean fewer transactions. Commercial property transactions on a year-over-year basis are down about 80 percent. That means fewer jobs at the local level. It means fewer construction jobs. It means fewer retrofitting jobs. And it means fewer opportunities for building owners to become more energy efficient and have green jobs.

Importantly, a growing number of Americans have a stake in commercial real property because of their investments in pension plans, 401(k) plans, and direct investments in R-E-I-Ts, REITs in the public marketplace. So, as goes commercial real estate, so goes jobs, so goes retirement, and so forth.

We like the TALF. We think it will help reconnect the originating market, as has been described. I won't go into many details there, maybe in questions. We also like the PPIP. We think that it will be particularly helpful for legacy assets.

But I do want to underscore one thing that was touched on by Mr. Parkus.

The CHAIR. If we can wrap up?

Mr. DEBOER. Very quickly, equity is going to be important. In addition to these programs that you have, we need to find a new equity source. It is not within your purview to look at it, but there are restrictions that currently apply only to foreign investment in U.S. equity, real estate. These need to be reviewed by Congress. That is where the equity could come from. That is how we can possibly get out of this program.

Thank you very much.

[The prepared statement of Mr. DeBoer follows:]

The Real Estate Roundtable

UNITED STATES CONGRESSIONAL OVERSIGHT PANEL
FIELD HEARING

"THE IMPACT OF ECONOMIC RECOVERY EFFORTS ON CORPORATE AND COMMERCIAL REAL ESTATE LENDING"

THE STATE OF THE COMMERCIAL REAL ESTATE CREDIT MARKETS

ROSENTHAL PAVILION
NEW YORK UNIVERSITY
NEW YORK, NY

Thursday, May 28, 2009

STATEMENT OF

JEFFREY D. DEBOER

ON BEHALF OF

THE REAL ESTATE ROUNDTABLE

Thank you, Congressman Hensarling, Superintendent Neiman, Mr. Silvers, Senator Sununu and Professor Warren, for conducting today's hearing on the state of the economy with respect to the housing and the commercial real estate markets.

My name is Jeffrey DeBoer, and I am the President and Chief Executive Officer of The Real Estate Roundtable, an organization that represents the leadership of the nation's top privately owned and publicly-held real estate ownerships, development, lending and management firms, as well as the elected leaders of the major national real estate industry trade associations. Collectively, Roundtable members hold portfolios containing over 5 billion square feet of developed property valued at over $1 trillion; over 1.5 million apartment units, and in excess of 1.3 million hotel rooms. Participating Roundtable trade associations represent more than 1.5 million people involved in virtually every aspect of the real estate business.

Thank you for the opportunity to testify today about the impact the economic downturn and credit market dislocation is having on commercial real estate.

By way of background, when I speak of the commercial real estate sector I am speaking of five principal property types – apartment, office, retail, industrial and hotels. It is also important to realize that commercial real estate markets includes many diverse regional and local markets, as well as submarkets within markets, each with their own dynamics. A common attribute through all, however, is that they each depend on a healthy economy for occupancy and operating income, and on a liquid financing market to facilitate investment, development and transfer.

My message today is simple and straightforward.

The commercial real estate industry is in deep stress for two reasons. First, the macro economy is not doing well: unemployment is high and likely going higher; consumer spending is down substantially; and business and personal travel is down. All of which results in reduced operating income for property owners and lower property values. Second, and perhaps more importantly, the credit markets are essentially closed to refinancing existing real estate debt or securing new debt to facilitate transactions. The lack of a functioning credit market is putting further downward pressure on property values and is causing many commercial property owners to face "maturity defaults" on their loans. This will create a great deal of added stress on the banking system and the overall economy.

The size of the problem is large today and if not addressed could become large enough to undermine the positive economic growth signs that are starting to appear. Commercial real estate in America is valued at approximately $6.5 trillion. It is supported by about $3.4 trillion of debt. Most commercial real estate debt has loan terms of 10 years or less, and therefore a large amount of debt matures each year and needs to be refinanced. The three largest providers of credit to the sector are: 1) commercial banks, with $1.5 trillion, or 43%; 2) commercial mortgage backed securities (CMBS) accounts for approximately $750 billion, or 22%; and 3) life insurance companies, with $315 billion or 9%. Additionally, some $330 billion is held by the government sponsored enterprises (GSEs), agencies or GSE-backed mortgage pools.

In 2009 the amount of maturing commercial real estate loans in 2009 is estimated to be between $300 and $500 billion. Between 2010 and 2012, maturing debt in this sector will explode to more than $2.6 trillion. During the last several years, banks and the commercial mortgage backed securities market provided about 83% of all commercial real estate debt and today both of these large sources of commercial real estate credit are virtually shut down. As noted earlier, both of these large sources of commercial real estate credit are virtually shut down. The CMBS market is illustrative of the problem. CMBS issuance peaked in 2007 with $230 billion of bonds issued; this dropped to $12 billion in 2008 – a nearly 95% decline. Thus far this year, there has been no new issuance.

The result is that this large sector of the overall economy now faces a liquidity crisis of mammoth proportions where even performing loans on strong assets in good markets face extreme difficulty in refinancing their debt. Transaction volume is also down about 80% year over year creating additional valuation problems and adding stress on local budgets that depend on healthy commercial real estate markets to fund needed local programs.

We appreciate the unprecedented steps the Congress, the Federal Reserve and the Treasury Department have taken to try to address the vast liquidity crisis that is crippling the economy, destroying jobs and causing a free fall in commercial property values.

- **We are encouraged by the creation of the Term Asset Backed Loan Facility (TALF), which will provide attractive financing to investors who purchase newly issued AAA securities backed by commercial real estate loans.** Newly issued AAA commercial mortgage backed securities (CMBS) will be eligible for TALF financing in late June, as will legacy AAA CMBS in July. This program should help reconnect the loan originators with the secondary markets. This program already has been very helpful in addressing the liquidity problem in consumer debt - such as auto loans and credit card debt. For example, newly issued AAA-rated asset backed securities (ABS) were recently priced through TALF at a spread of 155 basis points over LIBOR. That's 100 basis points less than where the market would have priced it, and approximately 400 basis points better than where similar securities were trading at the end of 2008.

  We believe that, once it is functioning for real estate in mid-summer, this program will be helpful in commercial real estate as well. The Federal Reserve Board's recent announcement regarding the much anticipated expansion of the TALF program to legacy CMBS assets brought an even stronger market reaction than when the announcement of the new issue parameters came out. The extension of eligible TALF collateral to include legacy CMBS is intended to promote price discovery and liquidity for legacy CMBS. For example, since the TALF announcement, risk premiums on the top-rated AAA portions of securities with recent loans as collateral have tightened by 500 basis points to 800 basis points over Treasuries. In recent weeks, yields on AAA-rated CMBS relative to benchmark interest rates fell 82 basis points — or 12.3 percent — to their lowest point in six months. The resulting improvement in legacy CMBS markets should ultimately facilitate the issuance of newly issued CMBS, thereby helping borrowers finance new purchases of commercial properties or refinance existing commercial mortgages on better terms.

  I also want to add here that we support the Federal Reserve's recent move to expand the list of acceptable credit rating agency firms to five, instead of three, for the TALF. This should introduce more competition among the firms and provide investors with a better view of the performance of existing CMBS. Moreover, we have long supported reform of the credit rating agencies. Along those lines, the SEC took long overdue steps recently to increase the transparency of the credit rating agencies' rating methodologies, strengthen their disclosure, prohibit them from engaging in practices that create conflicts of interest, and enhance their' recordkeeping and reporting obligations. This action should provide increased confidence to the investor community regarding the strength of underlying securities.

- **We also support the Public Private Investment Program (PPIP) announced by the Treasury and other regulators.** This program will also provide attractive financing to private investors to purchase legacy or toxic assets held by financial institutions. Removing these assets should help to enable banks to return to the business of making sound loans to commercial real estate.

- **Yet, there is still considerable additional work that must be done immediately, to get credit flowing again, repair investor confidence, and set the stage for economic recovery**

  Given the lack of liquidity, we are also encouraging regulators to give lenders and mortgage servicers more flexibility to restructure loans and make modifications when a positive outcome can be generated. As part of this effort, it is important to **amend the real estate mortgage investment conduit (REMIC) rules to facilitate reasonable modifications to the terms of commercial mortgage loans that have been securitized in CMBS**. The current administrative tax rules applicable to REMICs and investment trusts exacerbate the problem by imposing limitations that significantly impede the ability to negotiate and implement a restructuring package on a timely basis. To that end, the Real Estate Roundtable has requested that the Treasury Department issue guidance that would temporarily suspend the current administrative tax rules that, in normal economic conditions, serve to restrict the ability to restructure securitized mortgage loans and related investor.

  Moreover, because of the significant value declines in commercial real estate - estimated by some to be 30% or more - once lending does resume there will be a very high need for additional equity investment into the system. One potential source for this needed equity investment is foreign pension and other non-U.S. fund pools.

  To attract this foreign capital into U.S. real estate, it is important to amend tax rules that create barriers to foreign investment in U.S. real estate. One major impediment to such investment is the Foreign Investment in Real Property Tax Act (FIRPTA). Originally, FIRPTA was passed in 1980 as a way to impede purchases of farm land in the U.S. by non-US buyers - an issue that no longer has relevance. The law subjects foreign investors to U.S. taxation on the sale of U.S. real property by taxing the net gain at regular U.S. income tax rates. Ironically, this tax law only applies to equity investment in real estate and not to debt of any kind. Over the years, FIRPTA has had a chilling effect on foreign investment in U.S. real estate. In fact, the obstacles that are imposed under FIRPTA have led many non-U.S. investors to invest in real estate elsewhere – to such countries as Brazil, China and India - shifting wealth and economic dynamism away from the U.S. market. The **laws relating to foreign investment in U.S. real estate should be reviewed by Congress and corrected in a responsible way** to allow investment into US real estate and still ensure that the real estate is domestically controlled.

- And finally, **now is not the time to pursue new anti-real estate investment taxes such as increasing the capital gains rate, or the proposed tax hike on partnership "carried interest."** Both these ideas are anti-investment and should be set aside at least until the economy rights itself.

Conclusion

In summary, conditions in the nation's commercial real estate markets today are quite challenging. Property fundamentals are sliding due to weakness in the overall economy. Defaults and foreclosures are expected to increase due to the paralyzed credit markets. Together, the resulting value declines and debt dislocations threaten to undermine any nascent economic stabilization now underway.

Despite this sour situation, as our Second Quarter 2009 Real Estate Roundtable Sentiment Index showed, these eroding conditions are tempered by a slight uptick in the expectations of senior real estate executives.

The positive lining in the current situation is that unlike the late 1980s, commercial real estate markets went into the current downturn in relative equilibrium, with healthy occupancy levels. Assuming that job creation results later this year and next from the economic stimulus legislation Congress approved earlier this year; and, assuming that a foundation is found in housing, property fundamentals could be stabilized and start to improve by mid-2010.

However, the overriding concern lies in the credit markets. Here, it is important that government continue to take appropriate steps, along the lines of the TALF and PPIP, to restore functionality to credit markets and create an environment conducive for business and investors to invest and deploy capital. At the same time, it is important that unnecessary barriers to equity investment be lowered and that taxes on risk taking not be increased.

Thank you for the opportunity to testify today.

The CHAIR. Thank you.
Mr. Pearson.

STATEMENT OF KEVIN PEARSON, EXECUTIVE VICE PRESIDENT, M&T BANK

Mr. PEARSON. Good morning, Madam Chair and panel.

I appreciate the opportunity to——

The CHAIR. Could you pull that a little closer?

Mr. PEARSON. Yes. I appreciate the opportunity to speak with you today.

For those of you that are not aware, M&T Bank is a regional bank headquartered in Buffalo. We conduct our business primarily through our main subsidiary, M&T Bank. We have branch operations that span from New York, Pennsylvania, Maryland, Virginia, Delaware, New Jersey, West Virginia, and the District of Columbia.

Jumping right into our commercial lending activities, since that is the purpose of today, you should think of M&T Bank as a bank providing the whole spectrum of commercial products and services to middle-market companies, small business, real estate developer/operators. We have some specialties within the bank where we focus on Government banking, as well as healthcare. Broadly speaking, this has been our focus, as well as our retail side, for many, many years.

Just to shift to our loan activity, because this is something that I am sure you would be interested in. Comparing the first quarter of 2008 to the first quarter of 2009, our commercial balances increased by 4.9 percent. Specific to the New York metro area, our balances grew by 6 percent.

I would like to comment on the overall lending environment. As we look out today, we recognize that this is a time when consumer and business spending and investment is being scaled back due to the ongoing U.S. recession. We are seeing diminished demand for commercial facilities across the entire footprint of the bank. This decrease is consistent with some of the findings that were referenced earlier.

While we have seen a drop in demand, we recognize that a significant number of commercial borrowers have been unable to find financing because of the pullback, if not outright shuttering, of many sources of non-bank credit. Collectively, we could refer to them as the “shadow banking system.”

The growth in the secondary market has been significant. As a frame of reference, in ’78, commercial banks and thrifts held 71 percent of all private, nongovernmental U.S. loans. With the advent of new forms of credit delivery, particularly those tied to the capital markets and loan securitization, the banking system’s share of outstanding private sector credit has declined steadily, falling to less than 40 percent at year end 2008.

Retrenchment of the securitized lending markets, particularly in terms of commercial real estate financing, is causing some borrower demand to gravitate back toward bank balance sheets. However, many of these loan requests are transactional in nature and do not fit well within the traditional relationship-oriented focus of M&T’s community bank model.

As for lending standards, we continue to approach our lending activities in the same manner that we have conducted them in recent years. This entails building long-term mutually beneficial relationships with borrowers located generally within our geographic footprint, lending to credit-worthy businesses and people with whom we have banking relationships, and limiting nonrelationship-based activity in markets where we have no branches.

M&T has not significantly tightened lending standards over the past 18 months, nor did we generally loosen our standards in the run-up to the current economic disruption. As an example, M&T is a long-time lender to the New York City commercial real estate market, with a long institutional memory of the late 1980s real estate crash.

As such, we maintained our disciplined underwriting assumptions throughout the expansion and subsequent decline in New York City real estate activity. These assumptions focus on conservative cash flow, rental growth, and cap rate assumptions, and the use of recourse where appropriate.

With respect to the Treasury's Capital Purchase Program, M&T received the minimum amount available to us, which was 6 percent of our risk-weighted assets, or $600 million. These funds are being used to support lending within our geographic footprint.

As a result of the Provident acquisition announced in the last week, M&T has assumed an additional $151.5 million in CPP funds. Since receiving the funds, M&T has continued to originate, refinance, and renew commercial loans within our market footprint. Although, as mentioned above, we have been seeing signs of weakening loan demand, consistent with what other banks have reported, our plan remains to use the funds received under the CPP to support lending activities consistent with our previously described traditional community banking model.

Thank you.

[The prepared statement of Mr. Pearson follows:]

Prepared Testimony Before the Congressional Oversight Panel
Of the United States Congress

Kevin J. Pearson
Executive Vice President and Metro Area Executive - M&T Bank
May 28, 2009

Good morning Madam Chair and members of the Panel. I appreciate having this opportunity to discuss M&T Bank's commercial lending activity, both in the New York City metropolitan area and across our entire geographic footprint, as well as recent developments in the commercial lending environment.

M&T is a regional bank holding company headquartered in Buffalo, New York that conducts its business activities primarily through its commercial banking subsidiary, M&T Bank, which operates branch offices in New York, Pennsylvania, Maryland, Virginia, Delaware, New Jersey, West Virginia and the District of Columbia. Substantially all of M&T's loans are made to businesses and persons in these market areas.

As of March 31, 2009, M&T had consolidated total assets of $64.9 billion, deposits of $42.5 billion, loans and leases of $48.9 billion and stockholders equity of $6.9 billion. On May 23, 2009, we completed our acquisition of Provident Bankshares, significantly increasing our Mid-Atlantic franchise.

M&T Bank Commercial Lending Activities

M&T's commercial lending area focuses on small-to-mid-sized businesses, commercial real estate, government banking and specialized industries such as healthcare and not-for-profit. Commercial and industrial (C&I) lending activities generally include providing loans for business expansion, working capital, equipment financing, and asset based lending. Additionally, we provide commercial real estate (CRE) financing, including bridge loans, construction loans and permanent mortgage financing.

From the first quarter of 2008 to the first quarter of 2009, M&T's average C&I loan balances increased by 5.4% or $700 million, rising from $13.3 billion to $14.0 billion. Over the same period, average CRE loan balances rose by 4.4% or $800 million, climbing to $18.8 billion. In total, M&T's average C&I and CRE loan balances have increased by $1.5 billion or 4.9%, rising from $31.3 billion to $32.8 billion.

Average commercial loan balances in our metropolitan New York City footprint, which also includes the Long Island, Northern New Jersey, Westchester and Philadelphia markets, increased by 6% between the first quarter of 2008 and the first quarter of 2009.

Lending Environment

I would like to touch briefly on broad economic and competitive factors impacting commercial loan demand, both in the New York City metropolitan area and throughout our overall geographic footprint.

At a time when consumer and business spending and investment is being scaled back due to the ongoing U.S. recession, we are seeing diminished demand for new commercial credit facilities, both from businesses and commercial real estate customers alike. This decrease is consistent with the findings of the Federal Reserve's April 2009 *Senior Loan Officer Survey*, where approximately 60% of domestic banks reported a further weakening of demand for C&I loans from firms of all sizes over the previous three months, a proportion similar to that reported in the January survey.

As an example, through April 2009, the number of new Business Banking loan applications we received was nearly 20% below year-ago levels, while the total dollar volume of these applications was down 12%.

While we have seen a drop in loan demand, we recognize that a significant number of commercial borrowers have been unable to find financing because of the pullback—if not outright shuttering—of many sources of non-bank credit, which collectively comprise the so-called shadow banking system.

The growth of secondary market credit has been significant. As a frame of reference, in 1978, commercial banks and thrifts held 71% of all private, non-governmental U.S. loans. With the advent of new forms of credit delivery, particularly those tied to the capital markets and loan securitization, the banking system's share of outstanding private sector credit has declined steadily, falling to less than 40% at year-end 2008.

Retrenchment of the securitized lending markets, particularly in terms of commercial real estate financing, is causing some borrower demand to gravitate back toward bank balance sheets. However, many of these loan requests are transactional in nature and do not fit well with the traditional relationship-oriented focus of our community banking model.

Lending Standards

We continue to approach our lending activities in the same manner that we have conducted them in recent years. This entails building long-term, mutually beneficial relationships with borrowers located generally within our geographic branch footprint, lending to credit-worthy businesses and people with whom we have banking relationships, and limiting non-relationship based activity in markets where we have no branches.

M&T has not significantly tightened lending standards over the past 18 months, nor did we generally loosen them in the run-up to the current credit disruption.

As an example, M&T is a long-time lender to the New York City commercial real estate market, with a long institutional memory of the late 1980's real estate crash. As such, we maintained our disciplined underwriting assumptions throughout the expansion, and subsequent decline, in New York City commercial real estate activity. These assumptions focus on conservative cash flow, rental growth, and cap rate assumptions, and the use of recourse where appropriate.

Participation in Capital Purchase Program

With respect to Treasury's Capital Purchase Program (TPP), M&T received the minimum amount available to us, which is 1% of our risk-weighted assets, or $600 million. These funds are being used to support lending within our geographic footprint. As a result of the Provident acquisition, M&T has assumed an additional $151.5 million in CPP funds.

Since receiving the funds, M&T has continued to originate, refinance and renew commercial loans within our market footprint, although as mentioned above, we have been seeing signs of weakening loan demand consistent with what other banks have reported. Our plan remains to use the funds received under the CPP to support lending activities consistent with our previously described traditional community banking model.

The CHAIR. Thank you very much, Mr. Pearson.
Mr. Rogus.

STATEMENT OF MARK ROGUS, SENIOR VICE PRESIDENT AND TREASURER, CORNING INCORPORATED

Mr. ROGUS. Thank you, Madam Chairwoman.

And thank you to the panel for inviting me. It is my privilege to speak to you today.

My name is Mark Rogus. I am the senior vice president and treasurer at Corning. I joined Corning in 1996, following a 10-year career as a banker at Wachovia Bank. In my current role, I have a wide array of responsibilities, including all of the capital market activities for the company, cash management, trade credit, investments, i.e., the defined benefit programs, as well as our global insurance activities.

Corning Incorporated is a 157-year-old company. We are headquartered in western New York State in the town of Corning. Our stock is publicly traded on the New York Stock Exchange, and we enjoy at market cap of about $22 billion. We have about 24,000 employees globally and a very large presence in the State with about 5,000 employees here just in New York.

I want to remark that I did provide slides to the panel, and I will send my script that I have written sort of on the fly to the panel as well so it can be entered as testimony.

The CHAIR. Thank you.

Mr. ROGUS. Corning is an innovation-driven technology company. We operate in five operating segments with two significant joint ventures—Dow Corning, located in Michigan, and Samsung Corning Precision, located in Korea. We are a world leader in glass and ceramic keystone components that enable high-technology systems in multiple markets.

Our business strategy is enabled by our focus on research and development activities, which, in turn, relies on the enforcement of a robust set of patent protection legislation in order to maintain our market position in a fiercely competitive global technology marketplace. On average, we invest about 10 percent of our revenues every year in research, development, and engineering.

We have a very rich corporate history. We have delivered many innovations over our 157 years, ranging from the glass envelope that we worked with Thomas Edison on to encapsulate his electric filament to the invention of optical fiber, which is the backbone today of our telecommunication systems and broadband deployment globally.

The committee asked me today to come and speak to you about how has the financial crisis affected our capital needs and whether the availability of credit has changed for Corning over the last 12 months and if there is an impact that has resulted from these changes on our business plans or capital planning.

In my slides, I have categorized four generic areas that treasurers use to support their liquidity requirements. Against the four buckets of capital, Corning entered into the recent financial crisis with significant existing cash balances totaling $3.5 billion at the end of December of 2007.

By the end of 2008, this balance had contracted to $2.8 billion, due largely to continued investment in capital expansion overseas and domestically and through shareholder distributions in the form of dividends and share repurchases.

These cash deposits are supplemented by our internally generated cash flow from our wholly owned businesses, as well as dividends from our 50 percent-owned joint ventures that I mentioned previously.

Second, we do take advantage of a short-term unsecured trade credit provided through our trading partners and used in our normal working capital cycle.

Third, we maintain access to committed and uncommitted credit lines from our banks. For Corning, that total is slightly more than $1.1 billion. It is important to note that these credit lines were put in place before the credit crisis began and, I hope, will mature after the credit crisis ends.

These credit arrangements are also augmented by our access to the public capital markets, and we use the public capital markets for event-driven or opportunistic long-term financing.

So despite the financial crisis that appeared on the radar in mid 2007 and persists today, Corning has been able to meet all of its capital needs, and we have not altered any of our capital structure decision-making or our business plans as a result of the crisis.

As context for my response, though, I would note that we designed our current capital structure based on the lessons that we learned recovering from the tech crisis earlier in the decade. We lowered our tolerance for financial risk and specifically took actions to reduce our use of leverage and increase our cash balances.

While we were not foresightful enough to know that this economic crisis would hit us, our strategy has served us well.

We have successfully avoided a number of specific issues that have resulted through this particular crisis. Our surveillance of our counterparties, however, remains very high, both the bank counterparties and insurance counterparties. We continue to monitor very closely their actions and, frankly, have relied less on banks, preferring to use the public capital markets for our credit capacity.

I do want to note one item that is of concern to Corning, albeit indirectly, that is a direct result of the recent credit crisis.

The CHAIR. Mr. Rogus, if I could just ask you to wrap up? We are over time now.

Mr. ROGUS. Yes. So through our joint venture, Dow Corning, they invested about $1 billion in student loan auction rate securities. Through the good work of the attorney general in New York State, the Securities Exchange Commission, the Commonwealth of Massachusetts, a consent decree was reached that requires broker dealers to make efforts to provide an orderly secondary market for trading these securities.

Based upon the lack of progress, I would put forth that we need further action to stimulate secondary market auctions to increase liquidity to institutional holders of these securities. This will significantly impact Dow Corning's ability to continue to invest and pay dividends to its shareholders.

Thank you.

The CHAIR. Thank you, Mr. Rogus.

Mr. Pearson, it sounds like, from your description, that you are part of the new avant-garde group known as "boring bankers." Would that be fair?

Mr. PEARSON. If you were an employee of M&T Bank, you would know we are not avant-garde. There is nothing that has changed in terms of how we have approached business, though some are trying to model after us.

The CHAIR. Fair enough. So that is why I wanted to ask you in particular about your assessment of TALF and its effect on restarting, or stimulating perhaps would be the right word, commercial lending. Could you give us your views on that?

Mr. PEARSON. I am not—M&T Bank does not have any conduit or securitization apparatus. So we have——

The CHAIR. That is what makes your opinion important on this.

Mr. PEARSON. We have watched from afar through the years, and particularly the last several years, of loans making their way through the system that we would never have underwritten. Those what I would define as riskier loans don't exist at M&T Bank.

The way that I see the TALF today is that it is a good first step, but I think that we have a long way to go. The fact that the AAA securities could effectively be pledged as collateral for liquidity, that is the program that is on the table today, simply frees up liquidity for a segment of the CMBS world, those AAA holders.

There are the other, if you will, tranches in the capital stack all the way down to the B note and equity holders, where much of the problem in the CMBS world is. From my vantage point, bringing that group into the program will help to bring capital back into the system. The TALF, as it is designed or described today, I think, is a good step. But I am not sure that that solves the problem.

The CHAIR. And do you think—if I can just follow up a little bit, do you think that is a need for an expanded Government program, or that is really going to take recovery of the markets for people to want to venture into B territory?

Mr. PEARSON. I assumed that a question along these lines would come up today, and I have been thinking about this and consulting with some of my colleagues. And what I would say is that the first thing that needs to be accomplished is that we bring confidence back into the system.

We have many customers who have a lot of money sitting on the sidelines, and they are going to sit on the sidelines until they have confidence that the system, in fact, will start to work again. So I think confidence has to be the first thing that we restore.

Beyond that, unfortunately, I hesitate responding because I am not expert enough in that area.

The CHAIR. Fair enough. Thank you.

Actually, if I could just turn to you on it, Mr. DeBoer? You mentioned at the conclusion of your testimony that you support the TALF, but I am sure you also heard Mr. Parkus's note. 25 percent of commercial financing is through the TALF. And I wonder if you might speak to the experience we have had with three rounds of TALF. Is the need here for greater funding, greater support through the current vehicle or through a richer variety of programs to stimulate or support lending in the commercial area?

Mr. DEBOER. Right. Well, first of all, the TALF, in and of itself, is not the total solution. It is just—it is a first step, and it is a first step because it helps price discovery. Right now, there is no price discovery on the AAAs to speak of.

If people don't know what the values are of AAAs, they don't know what the values of the rest of the capital stack are to price off it. So if you can restart and light the fuse on the AAAs and get price discovery, the theory is that you can then price the rest of the capital stack off of the AAAs, which currently have no price.

And as we have seen in the ABS market, we have seen spreads come down substantially in the asset-backed securities market, which is the only thing so far that the TALF has been used for. We have seen spreads come down. We have seen additional financing in the ABS market, even outside of the TALF. There have been non-TALF deals done in the ABS market where, prior to TALF coming to being, there was none over the previous, I think, 18 months. So that is significant in and of itself.

Should there be a richer variety or mixture of securities in the TALF? We do support the legacy securities to be in there. We think that Mr. Parkus identified all the proper reasons why that is a good idea.

The CHAIR. Thank you.

Mr. DEBOER. Yes.

The CHAIR. Thank you.

Senator Sununu.

Senator SUNUNU. Mr. DeBoer, one of the other things you mentioned in your testimony was the recent expansion in the number of credit rating agencies allowed to participate in the TALF. I think it went from three to five. Why is that important, and what impact do you think it might have, both on the program and in the broader context of competition in the credit rating agency market?

Mr. DEBOER. Yes. Well, we think competition among the rating agencies is a good thing, and so expanding from three to five, we think, is a positive move just because more out there means more competition and more transparency. We think that is a very positive thing.

I would put a little add-on to that point as well. We also are very supportive of what the SEC has done recently and continues to do in terms credit rating agency reform to make more transparency to try and address the conflict of interest situations that may or may not be out there.

But again, this may go to my colleague's point about confidence in the market. Investors need to feel that these securities are what they say they are, and so that goes to the basis of can we depend on what the credit rating agencies are saying and telling investors? So all of this hangs together, I think, in a well thought out plan.

Senator SUNUNU. Thank you very much.

I am going to defer to my other colleagues, given our time constraint.

The CHAIR. Thank you, Senator.

Superintendent Neiman.

Mr. NEIMAN. Thank you.

I would like to follow up with Mr. DeBoer and hope to get time for both a C&I question and a commercial real estate question. You know, I have analogized the commercial real estate problem to many of the same contributing factors to the subprime crisis—weak underwriting standards by lenders, cheap financing, large role for securitization process, overinflated appraisals, overinflated rent rolls equivalent to overstated income, limited equity, an assumption that real estate values are going to increase and you will be able to refinance in the future.

In fact, the only distinction was raised in a discussion I had with a very large New York real estate developer. He said, well, there is one big distinction, and that is that the borrowers in these cases were not taken advantage of. They were sophisticated and knew exactly what they were doing.

One, do you agree with those comparisons? And maybe even though if they are the same contributing factors, what does that say about the solutions? We heard from Mr. Parkus simply the extension of the maturity date is not the appropriate approach. Are there others that we should be considering?

Mr. DEBOER. First of all, I don't disagree with what you are saying, particularly as it relates to '05, '06, '07 vintage loans. Poor underwriting, low equity, overly optimistic projections on performance. Having said that—and I also agree these are sophisticated borrowers.

Having said that, what has happened now, just like in the subprime market where it spread beyond those types of borrowers, this now is a contagion that affects all borrowers in all parts of the country regardless of whether their assets are performing, whether there is strong debt coverage when you come for renewal or not. And that is the problem that we are talking about.

Going forward, as I mentioned, I think these changes in the credit rating agency world and the underwriting world are significant. The TALF applies to newly issued AAAs. We assume that a newly issued AAA will have stronger underwriting criteria. The industry certainly wants that. We want strong underwriting, good equity, good policy. As we go forward, this will be a positive thing.

The problem is getting from today's world, where there is no credit because there was too much credit, to getting and translating to a world where there is adequate and appropriate credit for transactions that need that credit. And it is that bridge that the TALF hopefully will provide and get us to that area of that response, sir.

Mr. NEIMAN. Mr. Pearson, from a bank's perspective, do you have any particular views?

Mr. PEARSON. I will start by saying that I agree with your assessment that the '05 to '07 vintages in the CMBS world very analogous to the subprime issues on the residential side. Just to give you a data point, we had a difficult time growing our real estate portfolio in the New York City market during that period of time because it didn't make sense, whether it was pricing, valuations, cap rates.

I might also offer up that those sophisticated borrowers that you are referring to may have actually cashed out all of their equity with the CMBS financing. So they may today not have any real dollars at risk. There are quite a number of examples in this marketplace that are in the press that we could point to.

My view, going back to some of the comments from Mr. Parkus, is that while we do have some maturity risk, as has been pointed out, we also have the ability to sit down with our borrowers and talk through how we will sovle the problems. This is a benefit banks have and how M&T approaches maturity risk.

The ability to work with borrowers does not exist in the CMBS world. I was speaking with a client who is very active in the CMBS world, and he has a $6 million loan, 50 percent loan to value, cash flowing property, needs it extended. It is coming to maturity in a month.

He can get through to the master servicer, but the special servicer will not return his call.

Mr. NEIMAN: Sounds familiar.

Mr. PEARSON Right? So——

The CHAIR. Sounds like lots of people with subprime mortgages.

Mr. PEARSON. Yes, exactly. It is very similar. So when we talk about this refinance risk, I think that it is very, very important that the banking system, if you will, be looked at on a more granular basis to try to understand a particular bank's lending philosophy before we decide that we are going to experience the 50 to 70 percent losses on our mortgages.

The CHAIR. Thank you very much, Mr. Pearson.

Mr. Silvers.

Mr. SILVERS. That was a really helpful exchange.

The CHAIR. Yes.

Mr. SILVERS. And I want to follow up on it a little bit because before Mr. Neiman took my question, I was—I really wanted—Mr. Parkus's comments in response to my questions pained me because I am concerned about what happens if we restructure what appears from his charts to be these underwater real estate loans, how people get hit.

I want to ask both Mr. Pearson and Mr. DeBoer to talk about are the solutions—are there solutions here, rather than have the whole range of institutions that have invested in these properties get hammered, particularly on the equity side? Do you agree with Mr. Parkus's comment that drawing out the time horizon is not helpful?

But, B, are there solutions of the type that Mr. Pearson was beginning to talk about, involving making renegotiation, rational renegotiation easier here? We have been very frustrated about this in the residential real estate area, where the same set of problems exist. But to each of you.

Mr. PEARSON. I will just address your couple of questions. First of all, I would tell you that the banks, broadly speaking, do have an ability to renegotiate loans or extend loans. Perhaps adding a 5 year option to a maturing deal. What we are going to look at the underlying cash flows of the property. We may run into valuation problems on some loans because the comps that the appraisers are going to use might depress the values.

We need to look at each deal in its entirety, and make a prudent lending decision, which is what everybody expects us to be doing. Mr. Silvers, you were probably not as pained as I was when Mr. Parkus made his comments because while I agree the banking system has maturing risk, I think it is very dangerous to use a broad brush when talking about losses that may be realized across the banking system.

I am not suggesting that we won't experience pain. We are caught in the down draft, and even if we have good underwritings, more than likely there will be some problems. So I really believe it is blocking and tackling that is required and the banking system can do that. The CMBS market is strapped and stretched right now, and they cannot do that.

Mr. SILVERS. Would that suggest that policymakers maybe ought to try to focus on seeing if the CMBS market can—if something can be done in the CMBS market to make it easier to act like the banks?

Mr. PEARSON. To the extent that some involvement and support could be there without undermining or changing the contractual arrangements that exist that are critical to a functioning economy and commercial real estate world, I think that is something that should probably be looked at.

Mr. SILVERS. Mr. DeBoer.

Mr. DEBOER. Great question. The short answer is, yes, policymakers should do something, and they can do something. The CMBS loans are almost entirely held in a REMIC structure, the real estate mortgage investment conduit structure. The reason that you cannot get a special servicer to sit down and talk is because the rules basically don't allow them to renegotiate these loans that are held in a REMIC until there is an imminent default coming up.

So somebody who is sitting there looking at a loan that is going to roll in 2012 can't go now and renegotiate it. Even if they want to put in additional equity, even if they have a cash flowing property, they can't do it.

And so, we have been talking to the Treasury Department about allowing some rule modification to give more flexibility to the investors, to the borrower, and to the special servicer to renegotiate these loans up front where a positive result can occur for all people.

Now, obviously, the issue about changing contractual relationships and affecting senior bondholders vis-á-vis junior bondholders is very, very important. But sometimes they all want to do this, but the rules simply don't allow them. So, yes, you can.

As far as looking at existing problems, the TALF is a forward-looking issue, and that is what we should be focusing on from a policy perspective, not in a sense bailing anyone out, but in a sense bailing out the credit markets to make it work and allow it to work. That is what we are looking at.

And just one other comment. But securitization, in and of itself, is not a bad thing. In fact, it is a very good thing. It will allow more credit in an expanding economy that we have that needs this credit. The problem is that the underwriting and some of the criteria to do securitizations was not as tight as it possibly should be.

But we shouldn't get in a mindset where securitization, per se, is a bad thing. It is a good thing if it is done in the right ways.

The CHAIR. Mr. DeBoer, thank you very much.

If you will bear with us, we are going to do one more round of questions in deference to our host. Superintendent Neiman is going to take 5 more minutes for questions, and then we will call this hearing to a close.

Thank you.

Superintendent Neiman.

Mr. NEIMAN. I appreciate that very much because I think we are very fortunate to have a large corporate lender, a large regional bank here, and it would be a shame to leave without understanding what the new bank funding market in the future is going to look like and understand what the current restraints are.

And I think, Mr. Rogus, when you and I talked in advance, there were some concerns over the bank funding market in the future, whether it would entail more restrictive terms, whether lines would be lower than they are today. I think you expressed some concerns over even the lines that you have.

Today's Times has a story of a survey of small business companies who claim that in applying to—over 1,500 surveyed said when they have applied to small banks for loans in the past, they were three times more likely to get credit than those who applied to larger banks.

So I would like to get a sense from you and Mr. Pearson are those concerns real, and in the future, will there be differences in both the availability in terms of credit, as well as from a corporate sense in terms of funding from capital markets versus the banking market?

Mr. PEARSON. Do you want to go first?

Mr. ROGUS. Sure. So it is a great question. I do believe that the fundamental changes that have occurred in bank lending practices will persist after this credit crisis is over.

My colleague's remarks from the Fed on the deceleration of the tightening of credit spreads has not resulted in a loosening of credit standards. They may have stabilized, but they have stabilized at a level that is, in my opinion, in a large corporate context, punitive. And it forces treasurers in my position to seek other avenues of capital. That is a fact.

So as I sit in my seat today thinking about the future is to rely less on the banking infrastructure to provide that level of capital to a large company and to simply get the capital and put it on my balance sheet in the form of cash.

It is not clear to me that credit lines for large, multinational corporates will continue to serve a valid purpose in the future. Or said differently, I think treasurers will take a much more conservative stance on that point.

Mr. PEARSON. To add to that, the way that I think about this is that there is a break point probably in terms of the borrowing needs of the particular company. And perhaps it is by the time you move up into the couple of hundred million dollars of borrowing and more that looking for alternative sources is going to become more critical.

I think it is very important that everybody be aware that smaller companies than Corning, a company who might borrow $100 million to $200 million would suggest that they are having more difficulty with credit is that a bank like ours, who has the ability to underwrite—meaning commit, say, $100 million with the idea of selling it down and bringing in participants—we are not able today to take on that underwriting risk because we are not comfortable that we have banks or investors that will come into that particular syndication.

So today I would tell you that on the $50 million and less, I think there is a little bit more freeing up of underwriting, if you will. We have looked at a couple in the last week where we would be willing to take a little bit of underwriting risk.

But I really believe that it is that company that has borrowing needs from the $100 million to $200 million where the banking system needs to focus its efforts and get the system working again to provide credit. And I am sure that my colleague to the right knows that one of the things that is critical for banks to lend is that we have deposits.

And the difficulty that we have is to expect the banks just to lend when we have very limited deposits coming from a large borrower. That means we have to turn to other sources of funding, whether it is gathering deposits or other term or overnight funding. So I think that we have got some work, some challenges in this particular respect for things to free up.

But banks like ours, you know, we are continuing to be out there. Now we are partnering up. We are going to another large bank who will underwrite $50 million, we will underwrite $50 million. We come together to solve the company's problems.

Mr. ROGUS. The only thing I might add to your comments is I agree there is a bifurcation in the market. Large corporates, I think, will probably tend to steer to the capital markets. Small or middle-market businesses, which we rely on in some part in our supply chain, will, in fact, need the banking system to regain its footing. This is one of the larger risks; that treasurer's can't see what is happening down in the supply chain; where our suppliers are actually getting their credit, and whether the credit standards are tightening or loosening?

My other comment my panel colleague's remark about securitization—as a potential investor in these securitized bank loans. I think that you will see large pension funds shift to quality and move away from these risky asset classes. Treasurers will not invest in assets that have historically been liquid and reasonably priced and get caught holding illiquid securities in when their pension are cash funds.

And so, sales of syndicated loans once were an interesting investment because they provided some modicum of a incremental yield. I suspect large corporate investors won't be buying those instruments anymore.

Mr. PEARSON. One last comment?

The CHAIR. Yes, go ahead, Mr. Pearson.

Mr. PEARSON. Just to draw a distinction for everybody that as you are gathering information and drawing your conclusions, it is very important to understand that the super regionals or regional banks like ours really never were the large credit providers to the Cornings. It would have been Citi, Chase, the five largest banks in the country, where they could underwrite $500 million at a shot.

So I think it is important that the focus be in the area where the problem is as opposed to expecting the regional banks to have done something that we never did and, frankly, never should in terms of taking that type of exposure.

The CHAIR. Thank you, Mr. Pearson.

And reflecting our panel's engagement, Mr. Silvers has asked for indulgence to ask just one more question, and then we truly will adjourn.

Mr. Silvers.

Mr. SILVERS. Yes, Mr. Rogus, you actually began to touch on my question, which was I appreciate even more than I did before I came here the thoughtfulness with which your enterprise is run. But the question of supplier and customer access to credit for enterprises smaller scale than yours is one that I would hope you would talk about more broadly with respect to enterprises less fortunate than yours in certain respects.

I would also invite Mr. Pearson to elaborate on the comment he just ended with, which strikes me as intertwined with this, which is where is the problem here in the banking system in C&I lending and how might policymakers think about fixing it?

Mr. ROGUS. So from my vantage point, I think the risk to large employers like Corning, given the evolution of the supply chain, is those elements where our transparency is limited. So while we might have 10,000, individual suppliers that we draw from, our ability to surveil those 10,000 suppliers is almost negligible.

What we do spend a lot of attention, though, is on looking at the super regional banks and their willingness to lend. And what we see generally has been positive. We haven't had any of our suppliers come to us. And typically, they would. They would come to us and ask us to be the bank.

They would say we are not getting lending from our local banks. Can you please give us extended terms, allow us to not—give us the money ahead of time. Give us an advance. Do something like that.

The good news is we are not seeing that, at least in our experience.

Mr. PEARSON. How—if I have got your question right, how to break the logjam that exists perhaps certainly on the larger companies in the whole country. The difficulty is that the investor pool that, A, Citibank or the large banks would draw from, they could be banks. They could be other equity funds or equity-sponsored funds. It would be buying paper, et cetera. That has dried up because of those entities having problems elsewhere.

So it may not just be somebody saying, well, we are going to tighten things up and affect Corning or others. It is a broad liquidity issue or problems they are facing elsewhere.

And also I will say this in jest, probably the pricing even for some of the best companies out there got down to a level that for a bank just to have loan exposure with no ancillary business made it very hard to meet our profitability returns. What I will say is that as far as the C&I, the basic middle-market companies out there, I think it is important to continue having these kinds of conversations with bankers because what I will tell you, interestingly enough, we are competing for deals.

So I can't think of one company that has left the bank. That there are credit problems, perhaps people left, but we are keeping our customers. And as for new prospects, we are bringing them in, but there is competition.

So I think that it is important that all of this information kind of be corrected and interpreted correctly as best as possible.

Mr. SILVERS. Thank you.

The CHAIR. Good. Thank you very much.

Thank you, Mr. Rogus. Thank you, Mr. Pearson. Thank you, Mr. DeBoer. Appreciate your being here today.

Appreciate your staying, Mr. Parkus and Dr. Schuermann.

Thank you all for being here, and this meeting of the Congressional Oversight Panel, is now adjourned.

[Whereupon, at 12:23 p.m., the hearing was adjourned.]