Presentation to:

B- Notes, B- Pieces & Kick-Out's
The Secondary Market For Illiquid CRE Debt

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The Debt Exchange
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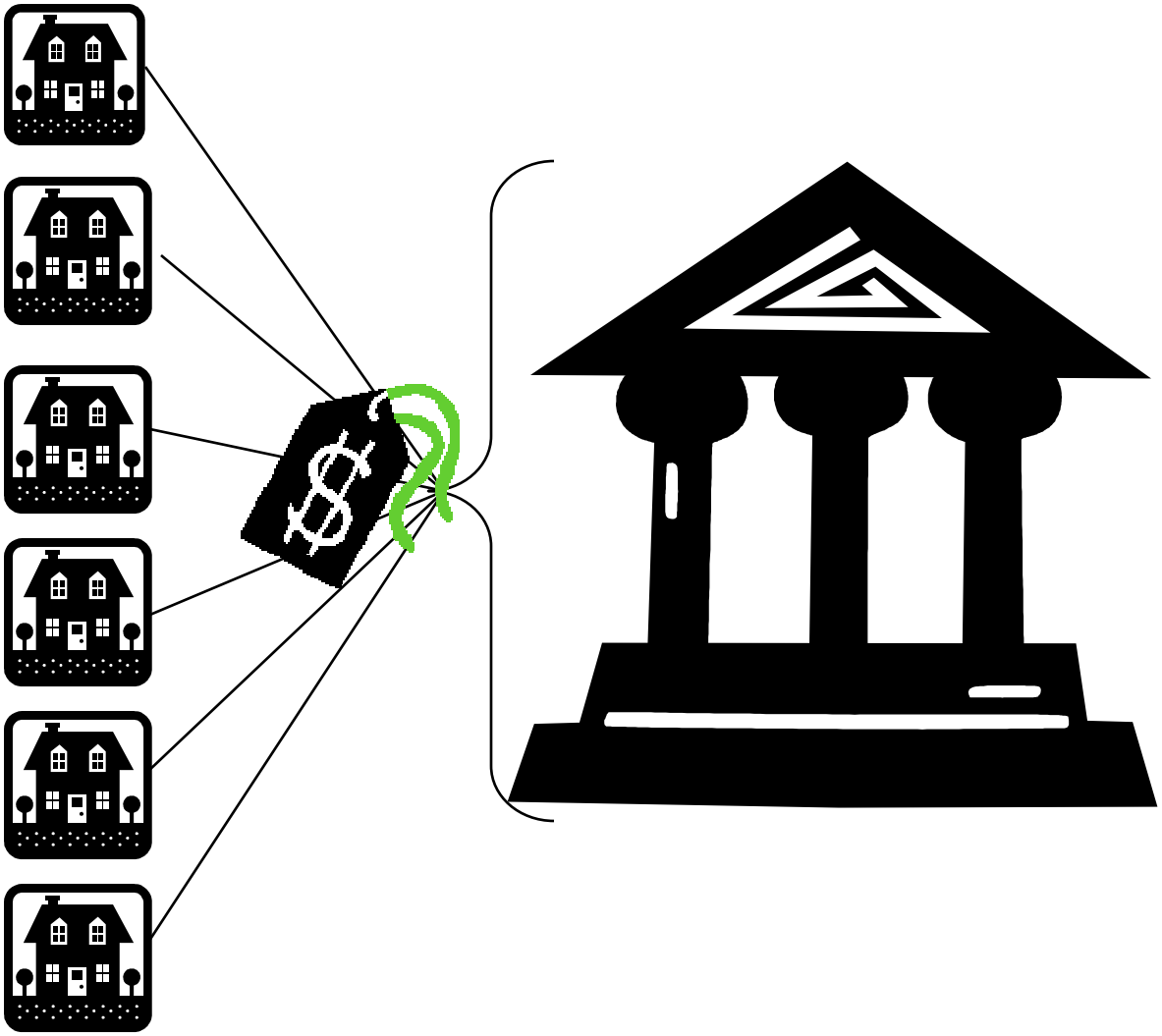
Overview of Presentation

- A Brief history of risk
- Securitizations & the Capital Stack & its illiquid components
- How big is the illiquid segment of the Market
- Players & their roles
- Where do B-Notes & Kick-Out's go to live
- Secondary Market characteristics
- How it works
- Trends in the Secondary Marketplace
- Representative transactions
- Intro to DebtX

A History of Risk – Pre 1978 (ish)



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A History of Risk – The Problem

Pre - 1974

Income:

$100 Million in Home Loans @ 5.50%	**=**	**$5.50 Million**

Expense:

$100 Million in Deposits @ 4.00%	**=**	**$4.00 Million**
Net:	**=**	**$1.50 Million**

Post - 1978

Income:

$100 Million in Home Loans @ 7.50%	**=**	**$7.50 Million**

Expense:

$100 Million in Deposits @ 16.00%	**=**	**$16.00 Million**
Net:	**=**	**$(8.50) Million**

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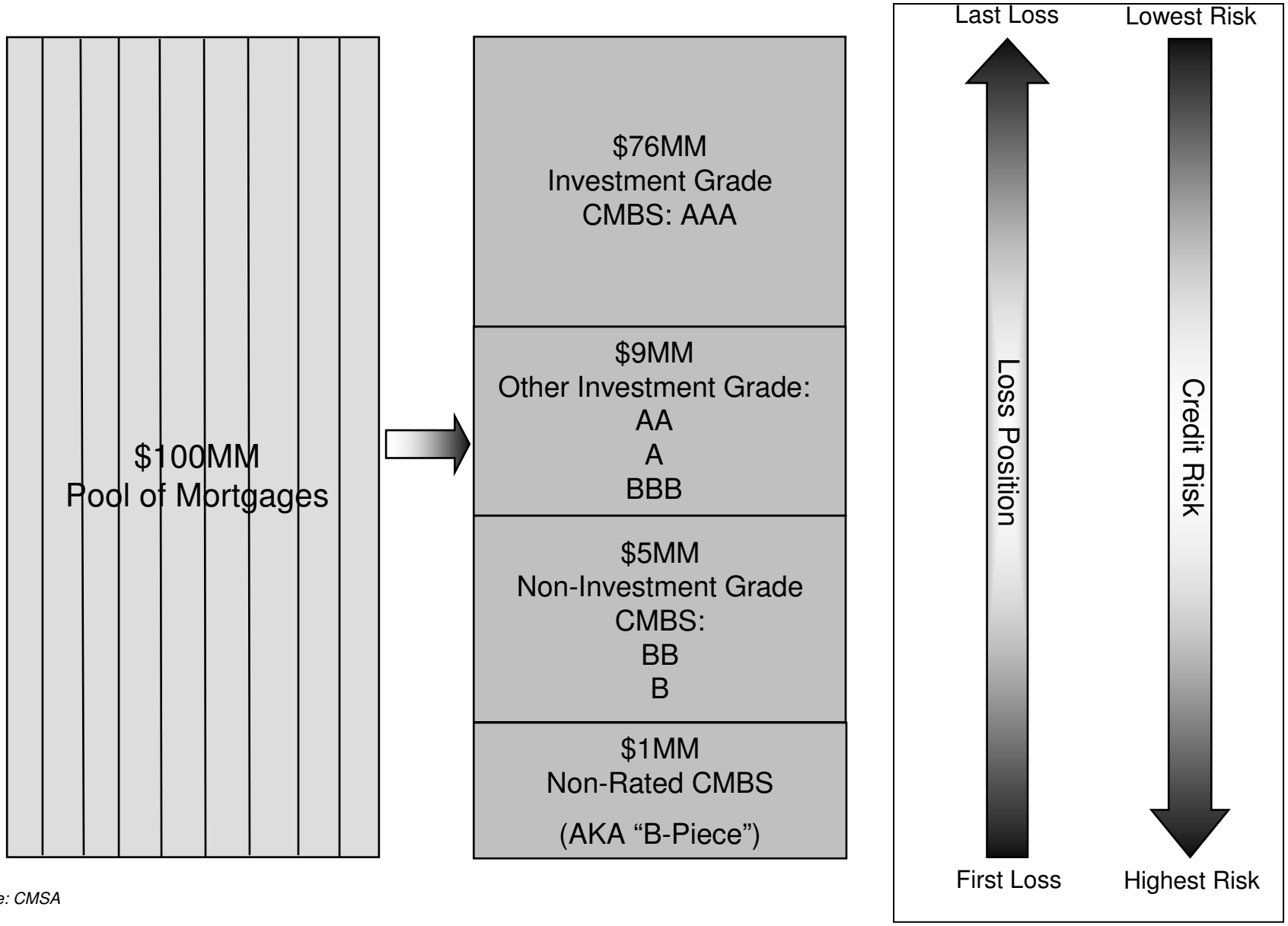
A History of Risk – The Solution (s)

- The Risks
  - Loss at Whole Loan level as Loans were held in "Portfolio" by Banks
  - No way to control risks and losses by Individual Investors
  - Differing Documentation, no standardization
  - Differing Underwriting Standards, by Property, by Geography, etc.
- Interim Solution – "Pass Through" Structure, sold as General Obligation of the Bank
- Long Term Solution – proper recognition of loss – The "Pay Through" Structure (1986 Tax Act)

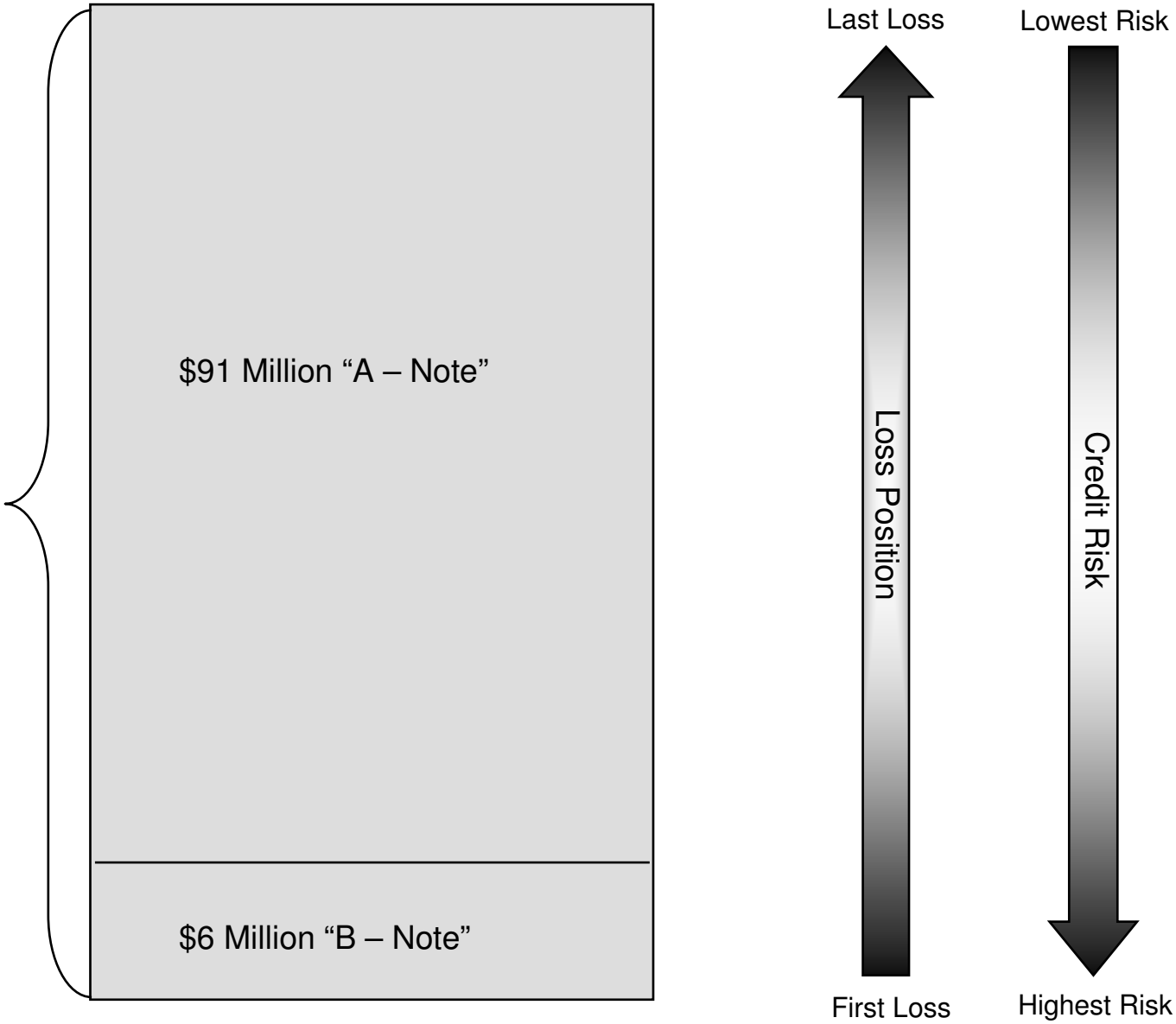
Hypothetical Structure: Credit Tranching



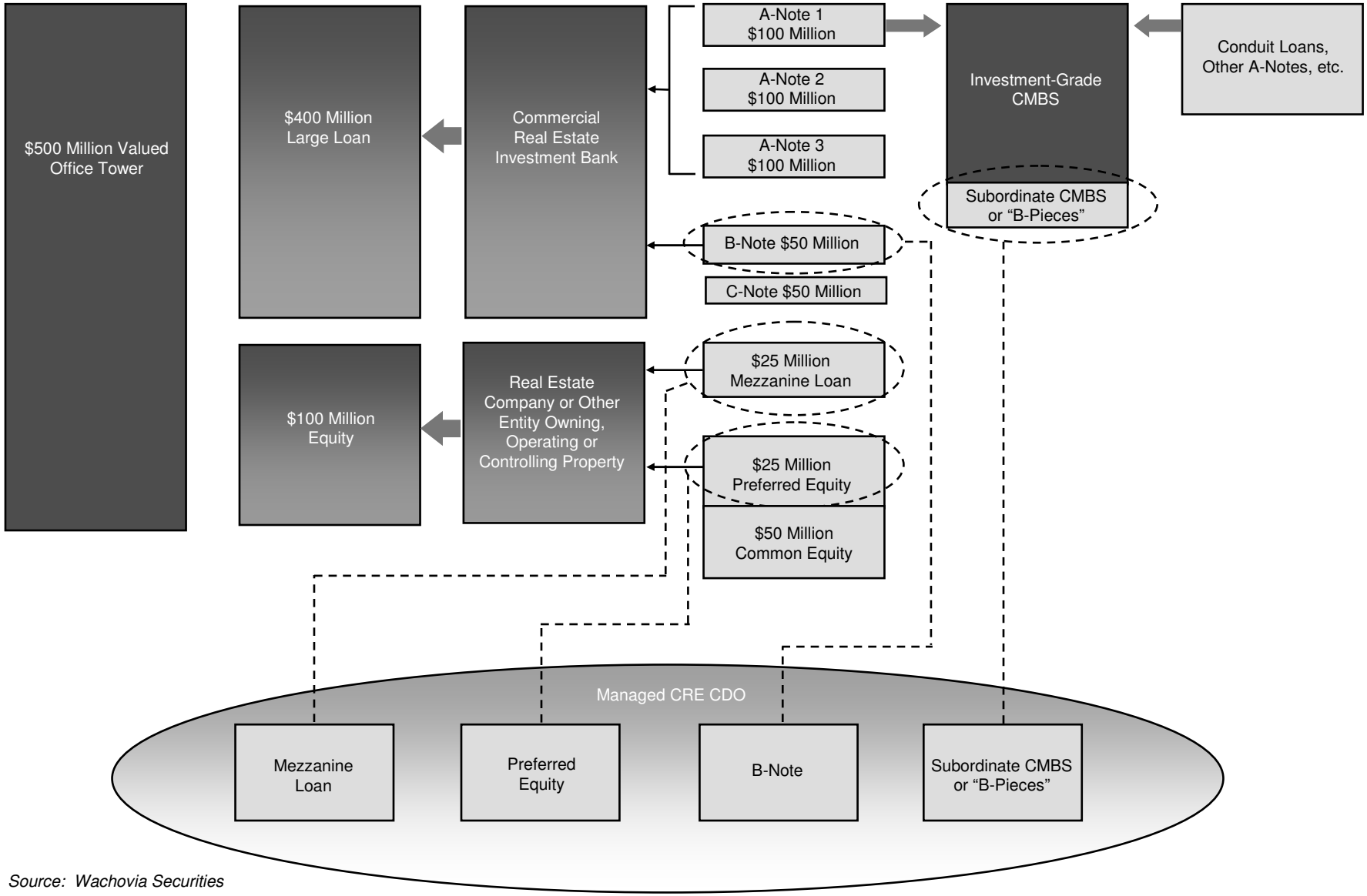
Source: CMSA

Whole Loan Risk

- $100 Million Whole Loan

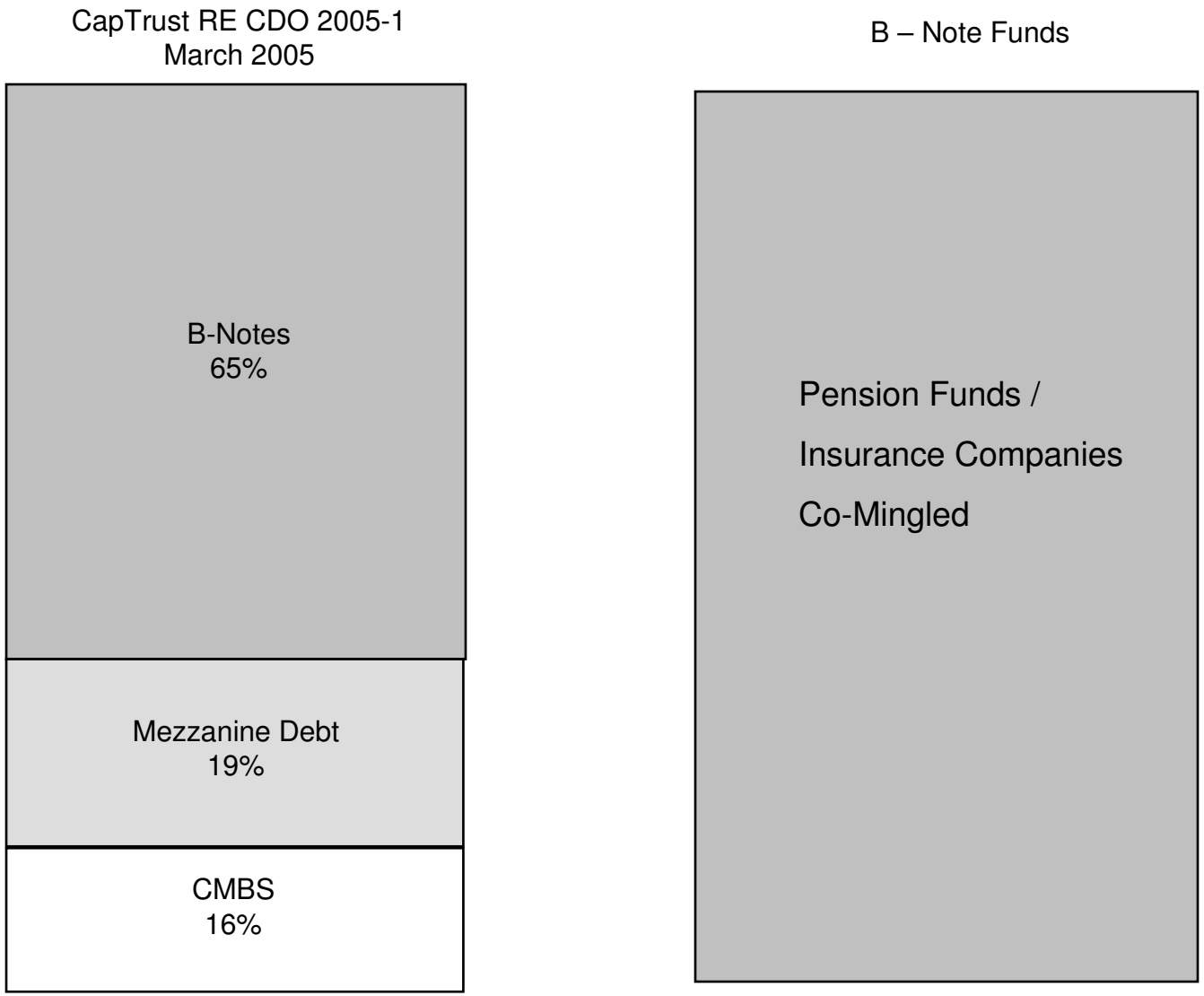


Deconstructing the Real Estate Finance Tower



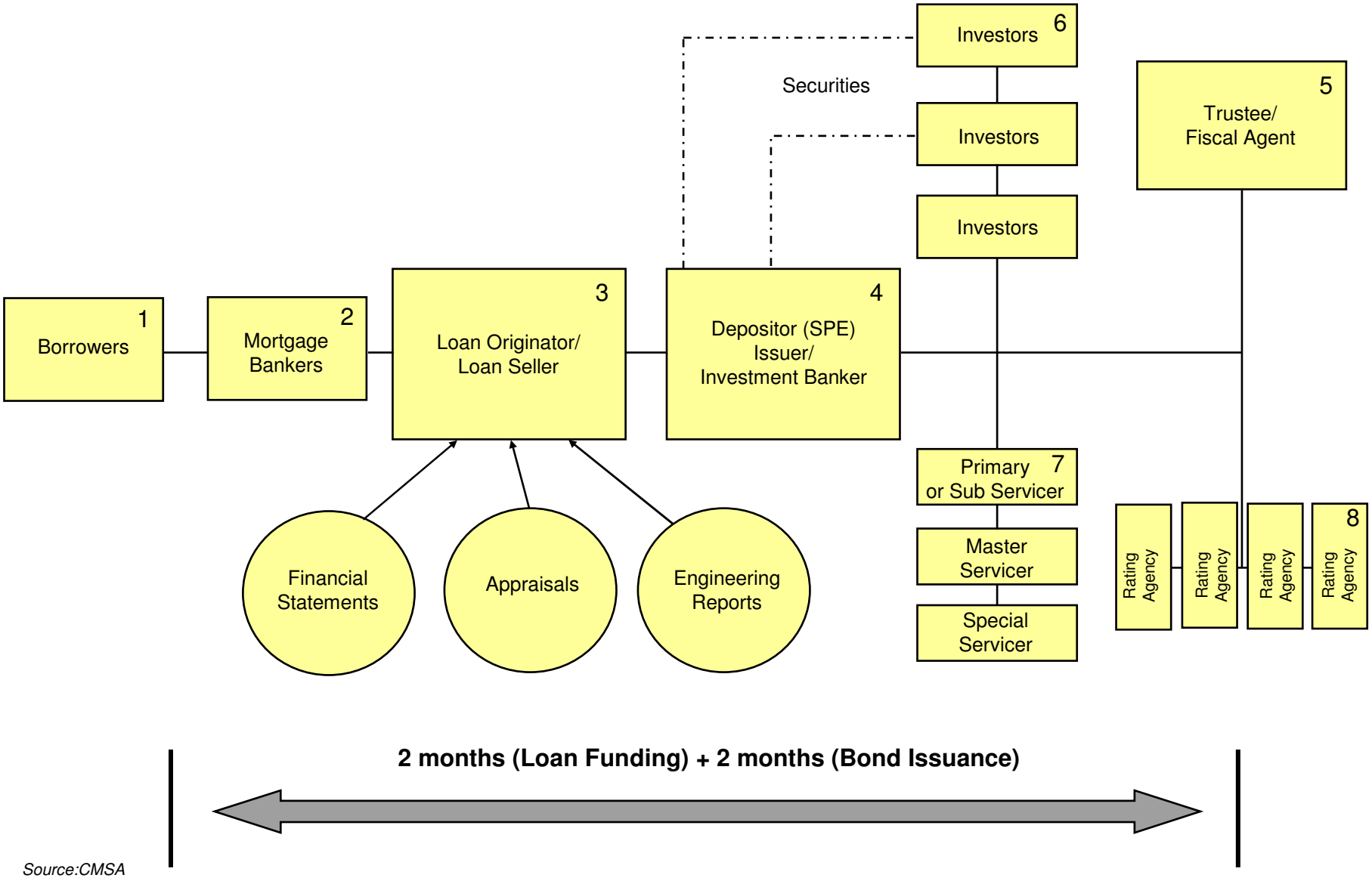
Source: Wachovia Securities

B-Note Homes, the Commercial Real Estate CDO & "Funds"



Source: Wachovia Securities / My buddy Richie K.

The Participants in a Securitization



Source:CMSA

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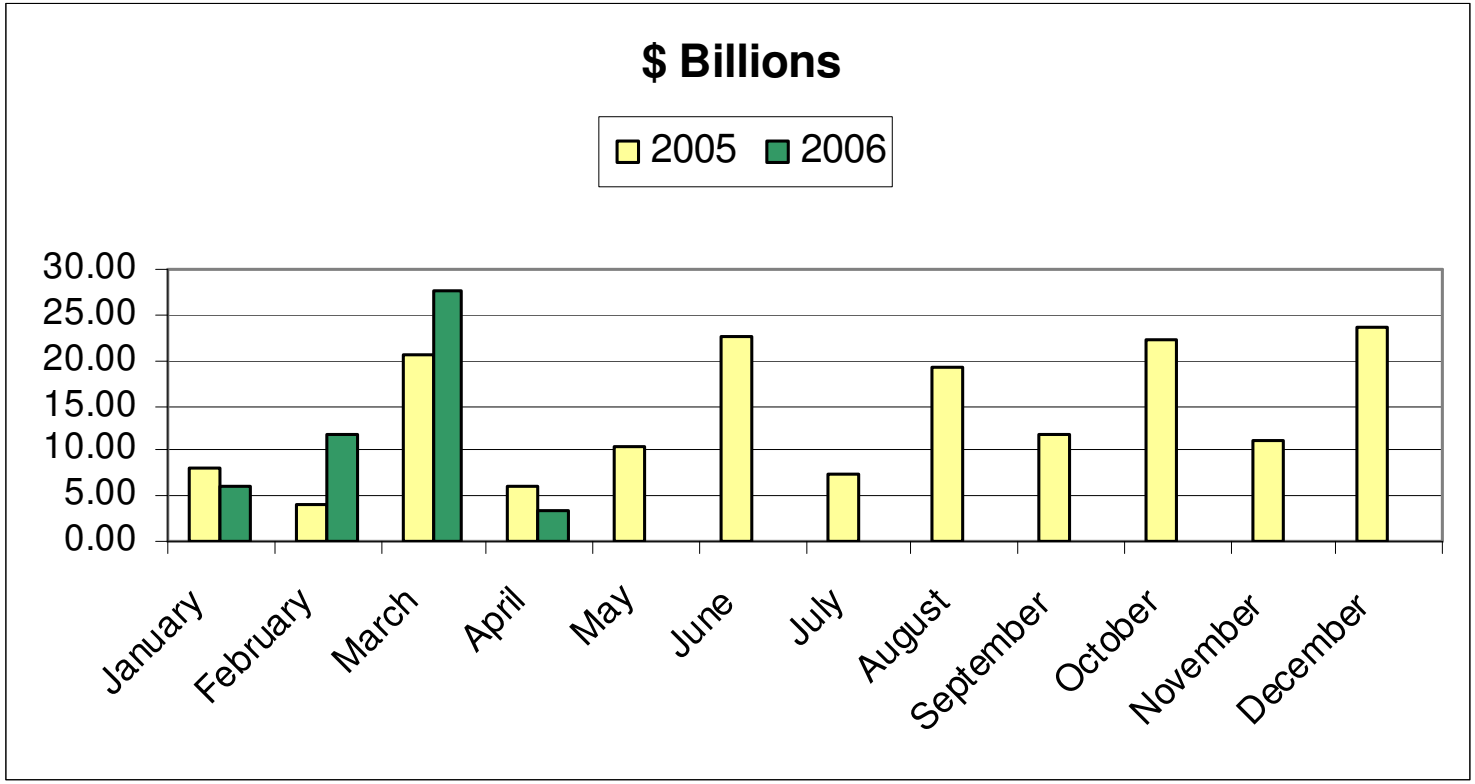
Domestic CMBS Volume



YTD (May15,'06): $52B, versus $41B (May15,'05)

Source: CREDirect.com

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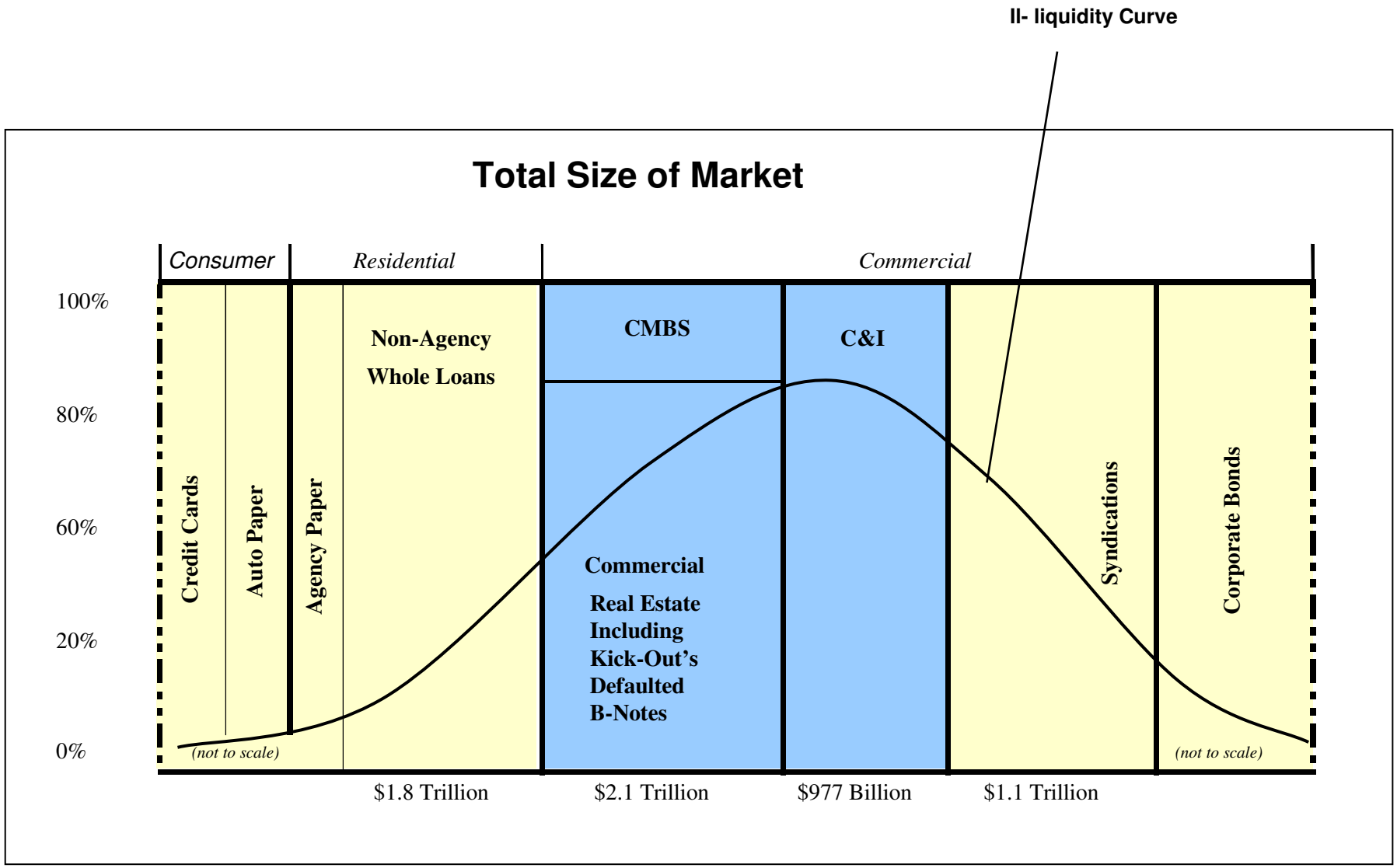
A Large, Growing Market



Source: DebtX SWAG

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The Secondary Market - B-Notes & Kick-Out's

- What are the segments
  - Four main food groups – office, retail, industrial, multi-family
  - Specialty properties – hospitality, health care, other (land development, etc)
  - Yield
  - Loan – to – own (Kick-Out's only)

- Who are the buyers – B-Notes
  - CDO's (Pre-problems)
  - Funds (Pre-problems)
  - Entrepreneurs (Post-problems)

- Who are the buyers – Kick-out's
  - Other banks in search of yield
  - Entrepreneurs
  - Finance companies
  - Wall Street
  - Pension funds through fund sponsors
  - Hedge / opportunity funds
  - Insurance companies
- Who are the buyers – B-Piece's
  - LNR (15), CW/Allied (12), JERoberts (9), ARCap (9)

Illiquid Note Valuations

- Cash flow, cash flow, cash flow
- Debt characteristics
  - Coupon
  - Maturity
  - Monthly constant
  - DSC
  - Documentation provisions
- Underwriting parameters:
  - Property type
  - Property value
    - Occupancy
    - Rent potential
    - Lease roll
    - Market dynamics
- Market requirements
  - Yield
  - Time frame for return
  - Rights & remedies
- B-Piece Buyer considerations
  - All the above for 100 – 300 loans per investment

The Secondary Market – How It Works (Illiquid Kick-Out's & B Notes)

- Sale Types
  - Negotiated
  - Competitive

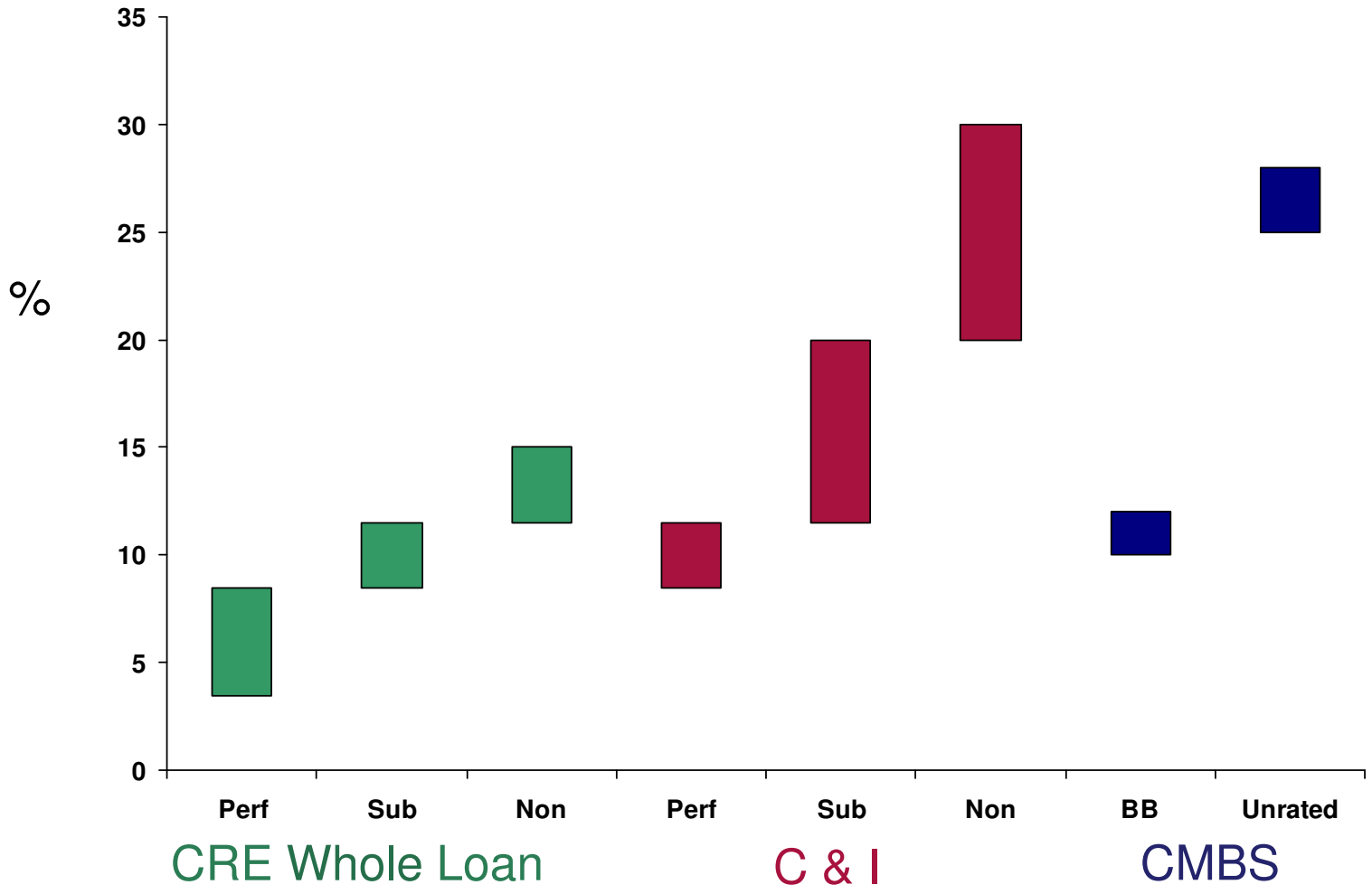
- Negotiated
  - Limited # of buyers practical
  - Opportunity for re-trading
  - Time-line can be compressed (unless buyer starts re-trading)

- Competitive
  - More buyers the better
  - Time-line defined
  - A Reserve Price is usually set
  - Asset Sale Agreement identified at the beginning of the process
  - Better results when bids are binding, non-conditional
  - Higher certainty of closing due to back-up bids

Trends In The Marketplace

- Exit Fallen Angels
  - Health Care
  - Franchise
  - FCTL's
  - Entertainment
  - Weakened retail (Anything in WalMart's path)
  - LIHTC CDC Sponsored deals (bank arena)
  - Sale of kick-out's to "clear the books"
  - Fall from favor of "We're a big balance sheet, we can hold it"

Attractive Yields in the Secondary Market



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Partial list of clients

B-Note Train Wreck

INCOME & EXPENSE ANALYSIS

Collateral Name:	ABC Commerce Center	**Principal Balance:**	$2,969,832
Property Type:	Office/Industrial flex	**Loan per NRSF:**	$7.21
NRSF:	411,885		

		Appraisal		Underwritten		What Happened
		Cash Flow	Per sf	Cash Flow	Per sf	Comments
Income						
Gross Potential Rental Income		$4,986,979	$12.11	$4,641,577	$11.27	$4,105,097
Percentage Rent		$0	$0.00	$0	$0.00	$0
Reimbursements		$769,833	$1.87	$769,838	$1.87	$769,838
Adjustments to Contracted Rent		$0	$0.00	$0	$0.00	$0
Other Income		$0	$0.00	$0	$0.00	$0
Net Rental Income		**$5,756,812**	**$13.98**	**$5,411,415**	**$13.14**	**$4,874,935**
Overall Vacancy		$548,568	11% of GPR	$865,826	16.00%	$865,826
Effective Gross Income		**$5,208,244**	**$12.64**	**$4,545,588**	**$11.04**	**$4,009,109**
Expenses						
Real Estate Taxes		$305,785	$0.74	$305,785	$0.74	$305,785
Insurance		$60,000	$0.15	$60,000	$0.15	$60,000
Salaries & Benefits		$0	$0.00	$0	$0.00	$0
Utilities		$377,764	$0.92	$377,764	$0.92	$377,764
Repairs & Maintenance		$245,524	$0.60	$245,524	$0.60	$245,524
Cleaning/Cleaning		$201,495	$0.49	$201,495	$0.49	$201,495
Management Fees		$149,871	2.88%	$181,824	4.00%	$181,824
Other Expense		$0	$0.00	$0	$0.00	$0
Admin./Acctg./Legal		$40,000	$0.10	$40,000	$0.10	$40,000
Total Operating Expenses		**$1,380,439**	**$3.35**	**$1,412,392**	**$3.43**	**$1,412,392**
NOI		**$3,827,805**	**$9.29**	**$3,133,197**	**$7.61**	**$2,596,717**
Structural Reserves		$0	$0.00	$62,160	$0.15	$62,160
T.I. and Leasing Comm.		$0	$0.00	$188,000	$0.46	$188,000
Cash Flow		**$3,827,805**	**$9.29**	**$2,883,037**	**$7.00**	**$2,346,557**
Debt	$29,500,000					
Interest Rate	6.875%					
Amort	30					
Payment	$2,347,518	$2,347,518		$2,347,518		$2,347,518
Debt Service Coverage		1.63 x		1.23 x		1.00
B-Note	**$2,250,000**					
Rate (@L+350)	**8.70%**					
Payment	$345,979	$345,979		$345,979		$345,979
Excess Cash Flow		$1,134,308		$189,540		($346,940)

(1) TI & LC expense is based on 65% renewal probablility; LC 4%/2% new/renewal; TI $6.00/$2.00 new/renewal office and $3.00/$0.50 industrial/flex space (all

Deal summary

Seller: Money Center Bank / CMBS Depositor

Asset: $27.8MM Sub-Performing Assisted Living facilities

Description: The assisted living facilities were geographically diverse, with three on the West Coast totaling 100 units, seven in the Southwest totaling 280 units and three on the East Coast totaling 117 units. All loans were paying current, though considered sub-performing due to erratic operating results. The loans had weighted average coupons of 7.97%, five years to maturity, and debt service coverages ranging from 1.15x to 1.45x.

Marketing: We conducted a nationwide campaign targeting buyers active nationally, local area banks, buyers focusing on the health care sector, and buyers who purchase opportunistically in search of yield.

Specific efforts included:

- 1,100 letters mailed
- 1,500 emails to Accredited Investors registered with DebtX
- 2 advertisements in industry publications
- 500+ personal phone calls to the most likely buyers

Results: Our nationwide campaign caught the interest of regional and local banks; several national banks who are active secondary market buyers; health care finance companies; entrepreneurial groups; Fannie Mae originators; and investment banks. Numerous investors looked at summary information and passed as the pricing expectations of the seller were at the high end of the supportable range. Some bidders passed due to the recent bankruptcy of the Operator. In the end, we had 177 investors look at summary information, 36 investors look at the review files, and 9 different investors submitted bids. We traded with three different entities, including a West Coast endowment of a university, a private REIT, and a consortium of banks in the local area of the Southwestern facilities. We exceeded the seller's aggressive Reserve by an aggregate of $375,000.

Deal summary

Seller: Investment Bank

Asset: $23MM Conduit Kick-Out Pool

Description: 10+ performing, predominantly fixed-rate, commercial mortgage loans with the majority of WAMs in excess of 8 years. One loan was 60 days delinquent, while another was sub-performing due to a recent fire.

Marketing: DebtX conducted a broad marketing campaign targeting all investors thought to most aggressively pursue this type of mortgage investment including both national banks that buy loans in the secondary market, as well as local/regional banks that may or may not be familiar with buying performing loans. For the more problematic loans, we targeted more opportunistic buyers. Our marketing tactics included:

- Three advertisements placed in industry publications
- 2,500 letters mailed
- 930 e-mails sent
- 850 follow-up phone calls made

Results: The marketing program produced 989 hits to this section on The Debt Exchange web site and 50 firm bids from 14 different bidders, including each of the four national prominent wholesale buyers. In all, 91% of the loans traded to 4 different buyers. For the performing and sub-performing loans, prices ranged from 95% to 99% of Par, with a weighted average of 97.2%. This translated into yield of 8.4%, or approximately 350 bps over the then-current 10-year Treasury. The one non-performing loan sold in the low 90%'s (a 9.1% yield).

Deal summary

Seller: U.S. Real Estate Investment Subsidiary of European Financial Conglomerate / CMBS Depositor

Asset: $3.9MM Seasoned Performing Commercial Real Estate

Description: Two loans representing 2 borrowing relationships. The first loan was secured by a 99-room, limited service hotel in Maryland that was deeply troubled by an occupancy rate of 46% (five year average of 60%), low Debt Service Coverage as a result of an average daily room rate of $49.03 and management problems. This note was set to mature on 1/11/18. The other note was on a shopping center outside of Albuquerque, New Mexico located in a tertiary location. While it had strong LTV and DSC, the anchor tenant, a small grocer, presented a high risk for tenant rollover and occupied 68% of the space. The other 29% of space being occupied was divided among 7 tenants. The note was set to mature on 6/6/23. Both loans were non-recourse.

Marketing: DebtX conducted a broad Marketing campaign targeting all investors thought to most aggressively pursue these types of assets. The asset in Maryland was particularly suited for more entrepreneurial investors who might be willing to operate the hotel if the note failed to perform. As for the shopping center, its location dictated targeting local and regional buyers whose local market knowledge would enable them to become comfortable with the anchor tenant as well as lease rollover and locations risks. Specific Marketing included:

- 200 letters sent with documents summarizing the offer
- 1,400 Emails sent to Accredited Buyers with The Debt Exchange
- 600 phone calls resulting in personal discussions with potential buyers

Results: In the wake of this Marketing campaign, there were 780 hits within the secured area of The Debt Exchange Web site.

Maryland Limited Service Hotel: 22 buyers purchased the loan files available on-line to perform due diligence. Nine firm bids were received, 3 conforming bids were above the Reserve. The note was awarded at 83.11% of Par to one of our most entrepreneurial investors.

New Mexico Shopping Center: 21 investors purchased the loan files available online to perform due diligence. Despite the many challenges of this loan, the winning bid was 89.22% by one of bidders who also bid above the Reserve on the Maryland Limited Service Hotel.

Deal summary

Seller: A National CMBS Investor

Asset: $9.42MM Non-Performing CRE and Multifamily

Description: The offering consisted of 5 loans from 4 relationships and was broken into 4 offerings. Collateral was located in several states, including: Wisconsin, Texas, Arizona, and Illinois. The assets were highly varied, from a dark movie theater to two multifamily units put under receivership. Except for one loan that was part of a relationship in receivership, there was insufficient Debt Service Coverage on the other loans:

Reltnshp.	Loans	Balance	Coupon	Maturity	DSC	Characteristics
1	1	$4.37 MM	7.11%	02/01/08	0.00	Dark Theater
2	1	$2.38MM	8.50%	08/01/09	(0.07)	50% Occupancy
3	1	$1.98 MM	8.21%	12/01/07	0.26	55% Occupancy
4	2	$0.69 MM	8.70%	08/01/10	0.69/1.41	Assets in Receivership
	5	**$9.42 MM**				

Marketing: In addition to posting the offerings within the secure area of the DebtX Web site, a broad marketing campaign was launched targeting all investors thought to most aggressively pursue this type of investment including opportunity funds, real estate owner/operators and entrepreneurial note investors. Specific marketing included:

- 1,500 Emails sent to Accredited Buyers with The Debt Exchange
- 700 phone calls resulting in personal discussions with potential buyers

Results: The marketing program produced over 900 Web site hits from 52 investors and 46 bids from 22 bidders. Despite significant risks these loans represented to potential buyers, their ability to comprehend the full risk exposure and lower their cost of investing via DebtX resulted in bids that returned an average of 42% of current principal balances.

Deal summary

Seller: CMBS Securitizer

Asset: $3.0MM Healthcare loan

Description: The loan was secured by a first lien on 3 nursing homes. Occupancy was hovering just over 60%. The nursing homes were confronting a loss of state revenue subsidies with the passage of a new law (rule 14). DSC was running under 1.0x for the last year.

Marketing: The Debt Exchange sent out over 1,500 e-mails and placed more than 500 phone calls, with more than two dozen potential buyers performing due diligence.

Results: Most of these potential buyers dropped out of the process due to pricing expectations outside of their range. However, persistent efforts resulted in a handful of potential buyers whose pricing expectations were high enough to justify extensive due diligence. In the wake of performing a site inspection to this rurally located, Midwest facility, one bid exceeded the seller's established reserve. The bid was unconditional, and was closed on the seller's contract "as–is" within one week. An actual quote from the seller: "Pinch me, this is too easy."

Deal summary

Seller: Investment Bank

Asset: $15.9MM Performing and Restructured Performing Franchise loans

Description: This offering was comprised of 4 loans secured by gas/convenience store franchises in Georgia, New York and Ohio. The loans were offered for sale in a sealed bid format.

Asset	Approx. UPB	# of Loans	Collateral	Loan Characteristics
1	$1.17 MM	1	One fee simple Gas/Convenience store unit located in Georgia	Performing; 10.18% fixed interest rate; 1/1/20 maturity.
2	$1.6 MM	1	One fee simple Gas/Convenience store unit located in New York	Restructured performing; 9.00% fixed interest rate; 2/28/05 maturity.
3	$13.2 MM	2	Ten (9 fee simple/1 leasehold) Gas/ Convenience store units in Ohio and a first security interest in all business assets of the borrower.	Performing; 9.603% WAC; 5/1/16 WAM.
	$15.9 MM	**4**		

Marketing: DebtX offered the loans in a sealed bid format and conducted a broad marketing campaign targeting all investors known to aggressively pursue these types of loans. The marketing effort included 2,600 e-mails sent and over 400 telephone calls to potential buyers.

Results: Investor participation was strong resulting in over 525 website hits from 170 investors. Numerous entities that expressed interest significantly below expectations were encouraged to either increase their pricing dramatically or not bid. Ultimately, DebtX received 20 bids from 10 different investors. The loans were sold to two entities. The two smaller loans, totaling $2.77MM, sold at a price slightly above the Seller's expected price. The third loan, while not of poor credit quality, represented a long-term hold with limited exit strategies. Nonetheless, the Seller accepted the highest conforming bid for this asset as the highest price available in the market.

Deal summary

Seller: A Leading Global Investment Bank

Asset: $4.4MM Seasoned, Performing Commercial Real Estate

Description: This offering was comprised of a single loan on a 168-unit, 73% occupied multifamily property located in Houston, Texas. The note carried a 5.035% fixed interest rate and an 08/01/08 maturity date. The property, built in 1982, was composed of 14 buildings located on 5.5 acres of land. The property has been very well maintained, was completely renovated in 1990 and the borrower has invested over $550M in capital repairs since acquiring the property in 1997.

Recently the Houston multifamily market saw a significant drop in occupancy as a result of first home buyers moving out of multifamily units. In three months, the subject's occupancy climbed from a low of 60% to the existing 73% occupancy. The sponsor has over 20 years of experience in the local multifamily market and controls over 8,000 units.

Marketing: DebtX conducted a broad marketing campaign targeting all investors known to aggressively pursue this type of asset. Included in our calling list were over 100 banks and other Texas investors with a cost of capital low enough to take down the subject loan. Specific efforts included:

- 2,000 Emails sent to Accredited Buyers with The Debt Exchange
- 250 personal phone calls to investors

Deal summary

Seller: A Leading Global Investment Bank

Asset: $3.75MM Seasoned, Performing Commercial Real Estate

Description: This offering was for a single loan on a 30,000 s.f. Class A office building situated on 1 acre located in suburban Seattle, Washington with a fixed rate of 8.01% with yield maintenance, DSC of 1.26x, and a maturity date of 11/01/10. The building was fully leased to four tenants with the largest tenant divulging they would be exiting the building. While having asked the borrower to secure a substitute tenant they indicated they would make all payments on the remaining 3 years of the existing lease.

Marketing: While an asset with desirable financials, the challenge was to promote a single asset located in a market dependent upon technology companies while the technology industry was in the midst of a significant downturn. To offset this issue, local and regional banks were predominantly targeted given their familiarity with the cyclical nature of the technology industry which would enable them to properly measure the risk. Accordingly, DebtX employed an aggressive marketing effort that included:

- 1,400 Emails sent to Accredited Buyers with The Debt Exchange
- 2,200 letters sent to targeted investors
- 400 personal phone calls to potential buyers
- 5 advertisements placed in targeted industry publications

Results: The marketing effort produced 200 Web site hits from 36 investors. The offering resulted in 9 purchases of loan documents to perform due diligence. 7 bids subsequently were entered. The winning bid achieved the Reserve Price set by the seller.

Deal summary

Seller: National CRE Investor and Top 10 Servicer of CRE Loans

Asset: $17.9MM Non-Performing Note Secured by Two Office Buildings

Description: This offering is a single non-performing note secured by two contiguous office buildings located in Winston-Salem, North Carolina. The offices were, in aggregate, 11% occupied and required up to $18 million of asbestos remediation. The note carried a 9.55% interest rate, monthly P&I payments of $182,000 and an 11/01/01 maturity.

Marketing: DebtX conducted a broad marketing campaign targeting all local and regional developers, opportunity funds and traditional note buyers known to aggressively pursue this type of asset. As this is essentially a loan-to-own type asset, DebtX put extra effort into targeting real estate developers as we felt they would pay the most for this asset.

The marketing effort included:

- 2 advertisements; one in a regional daily, the other in The Wall Street Journal
- Over 1,700 Emails sent to Accredited Buyers under confidentiality agreement with The Debt Exchange
- Over 500 follow-up phone calls to potential buyers

Results: An aggressive marketing effort resulted in over 500 Web site hits from 159 investors. Collectively, 52 investors purchased loan documents and performed due diligence. Many of the investors refused to bid as they viewed the collateral as having negative value, after considering the carrying costs and asbestos cost. Many other investors expressed interest in the loan but were at non-competitive levels and as such, DebtX did not solicit bids from them. Ultimately, DebtX received 8 bids. In the end, DebtX pitted a national distressed real estate buyer against a local real estate developer. The “best and final” round resulted in a 20% increase from the initial price bid for the note.

Meet DebtX

DebtX Sales:

Tom Goodwin, Co-Founder, EVP

Boston - Bill Looney, Matt Galligan, Tony Brooks, Gifford West, (Europe), Karen Johnson (DX Mark) , Bill Jakubowski

Atlanta – John Sauer

Boulder – Suzanne Ellis

Chicago – Tom Doughty

New York – Tom Panitz

San Francisco – Jeff Cantor

Oklahoma City – Pat Blount

DebtX Underwriting:

Dan O'Leary, MD

Eric Foote

Sandra Kelley

Kevin Toomey

A cast of thousands

DebtX Trading:

Bruce Hounsell, Co-Founder, EVP

David LeBlanc

David Bucher

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Reeves Ambrecht

Francesco Daniele (Italy)

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