


Value Investing Opportunities in Legacy CMBS

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The Investment Opportunity

Background:

- **CMBS bonds issued by CMBS Trusts total over \$680 billion.** Commercial Mortgage Backed Securities (“CMBS”) have been a popular investment for sophisticated investors and financial institutions seeking attractive long term returns for the past 18 years. See Chart A.
- **CMBS bonds are usually secured by a diversified pool of commercial real estate loans (typically between 100 and 300 loans) secured by first lien mortgages and mostly 10 year loan maturities.** Property types include retail, office, apartment, industrial and hotels. Most properties have been in operation for several years and were considered stabilized when the CMBS loan was closed.
- **CMBS bond credit ratings range from AAA (investment grade) to B- (below investment grade) for each CMBS issue.** See Chart B. Higher credit rated bonds receive first priority cash flow from mortgage loans and therefore have a lower risk and lower return. The lowest rated bonds receive last priority cash flow from the mortgage loans and therefore have a higher risk and higher return. See Chart C.

Current CMBS Bond Market:

- **CMBS bond prices have declined dramatically since the summer of 2007.** See Chart D. The recent widespread credit market dislocation resulted in numerous CMBS bond rating downgrades. The prospect of continued lower economic activity combined with liberal underwriting standards used in recent vintage CMBS loans has resulted in increasing delinquencies. Recent vintage 60 day+ delinquencies as of July 2010 (per JP Morgan and Trepp) have ranged from approximately 2% to 22% while averaging approximately 8.25%. Consequently, pricing of below AAA rated bonds (rating at issuance), has declined significantly with prices ranging from \$0.05 to \$0.50 on the dollar depending on the tranche. These lower prices provide significant value investing opportunities.

Value Investment Strategy:

- **The pricing between CMBS bonds is fairly consistent even though the quality of the real estate loan collateral varies significantly between CMBS Trusts.** There is a wide variation in the underlying loan collateral quality between similarly rated and priced CMBS bonds.
- **Hartland, in conjunction with its parent company, McCary Stevens Associates, Inc. (“MSA”), has developed a proprietary analytical process to assess the quality of the loan collateral securing the CMBS bond.** Hartland uses a unique bottom-up methodology, using its own proprietary process and experienced mortgage underwriters to estimate the ability of each loan to pay its debt service through its respective loan maturity.
- **Through its analytical process, Hartland estimates the timing of potential loan debt service defaults and potential loss severities on a loan by loan basis.** Hartland “stresses” the cashflow potential and timing from each property. The result is a more granular view of the loan collateral and the potential impact on cash flow paid to bondholders over time, which has a significant impact on overall yield.
- **Hartland uses the results of its proprietary process to identify value investing opportunities in the cmbs market.** Hartland can distinguish between a CMBS Trust which has loan collateral with a higher risk profile and a CMBS Trust which has loan collateral with a lower risk profile. Hartland can weigh the risk/reward characteristics between the various bonds and also weigh the risk/reward characteristics between different rated bonds within the same CMBS Trust.
- **Hartland’s ability to uniquely analyze publicly traded CMBS bonds will allow it to select bonds which have more favorable risk/return characteristics which the CMBS bond market has not priced in.**

Hartland's Advantage:

- **Independent, Buy Side Credit Culture:** Hartland's principals are experienced, insurance company trained, buy-side commercial mortgage underwriting and due diligence professionals. They formed their own independently owned company in 1993 (McCary Stevens Associates, Inc.) and have been providing underwriting and due diligence services to CMBS investing clients ever since. They are well positioned to evaluate commercial mortgage loans serving as collateral to CMBS bonds from an investor's perspective. They have re-underwritten over \$50 billion in CMBS commercial mortgage loans on behalf of their institutional clients.
- **Experience with Multiple Real Estate Market Down-cycles:** Hartland's principals have personally experienced at least one and some two or three, real estate market down-cycles over the last 30 years. This experience provides Hartland with the perspective needed to effectively evaluate commercial mortgages and their likely performance over time.
- **Only Senior Analysts on Staff:** Hartland comprises one of the largest and most experienced underwriting and due diligence teams in the country based in Hartford, CT. Its underwriters each have between 15 and 30 years experience in the commercial real estate industry.
- **Active Management:** Constant surveillance of market conditions will enable Hartland to take advantage of commercial mortgage investment opportunities as soon as they arise. By anticipating changing market conditions, Hartland will make adjustments to investment buy/hold/sell decisions to enhance total investor returns.
- **Significant Barriers to Entry:** Very few investment managers have the expertise and capacity to perform a bottom-up, loan by loan foundational, buy-side underwriting in this segment of the distressed commercial real estate market. Even fewer are able to devote the ongoing resources to properly analyze thousands of collateralized loans in more than 200 CMBS bond issues. Hartland has already devoted thousands of man-hours towards differentiating and identifying hundreds of legacy CMBS bond purchase opportunities. And Hartland plans to continue its surveillance of this asset class to identify ongoing value opportunities in this continually changing environment.

Chart A

CMBS Market Has Grown Significantly to \$680 Billion

- The issuance of CMBS increased dramatically over the past 10 years and a liquid secondary market developed.
- The credit crisis, however, has reduced new issuance to zero and lowered liquidity across the secondary market. While this environment provides better investment opportunities to investors, it requires a hold-to-maturity patience.
- CMBS issues are composed of the following ratings (approx.):

| | |
|-------|-----|
| AAA | 83% |
| AA | 4% |
| A | 4% |
| BBB | 4% |
| Below | 5% |

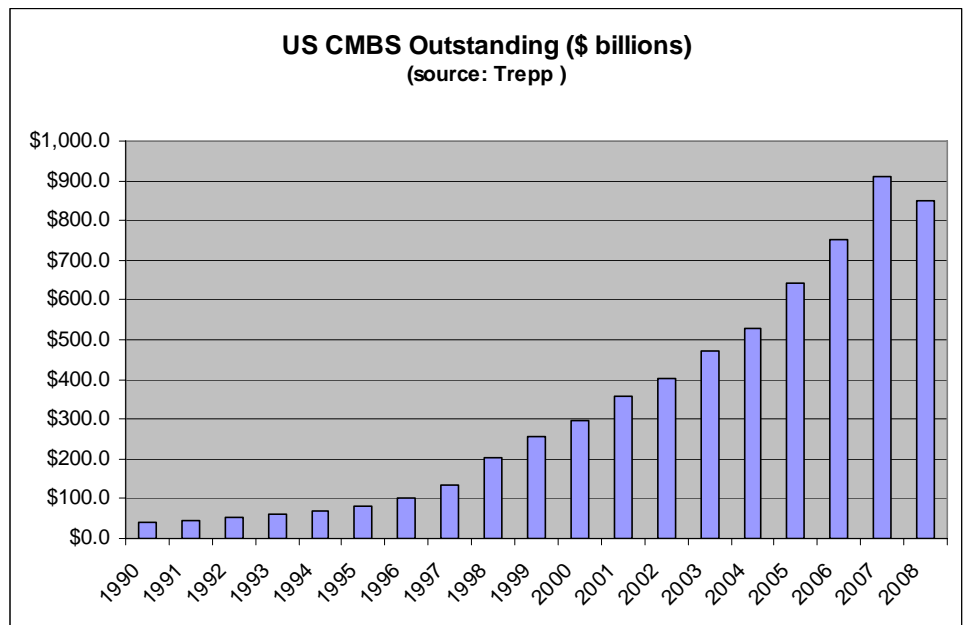
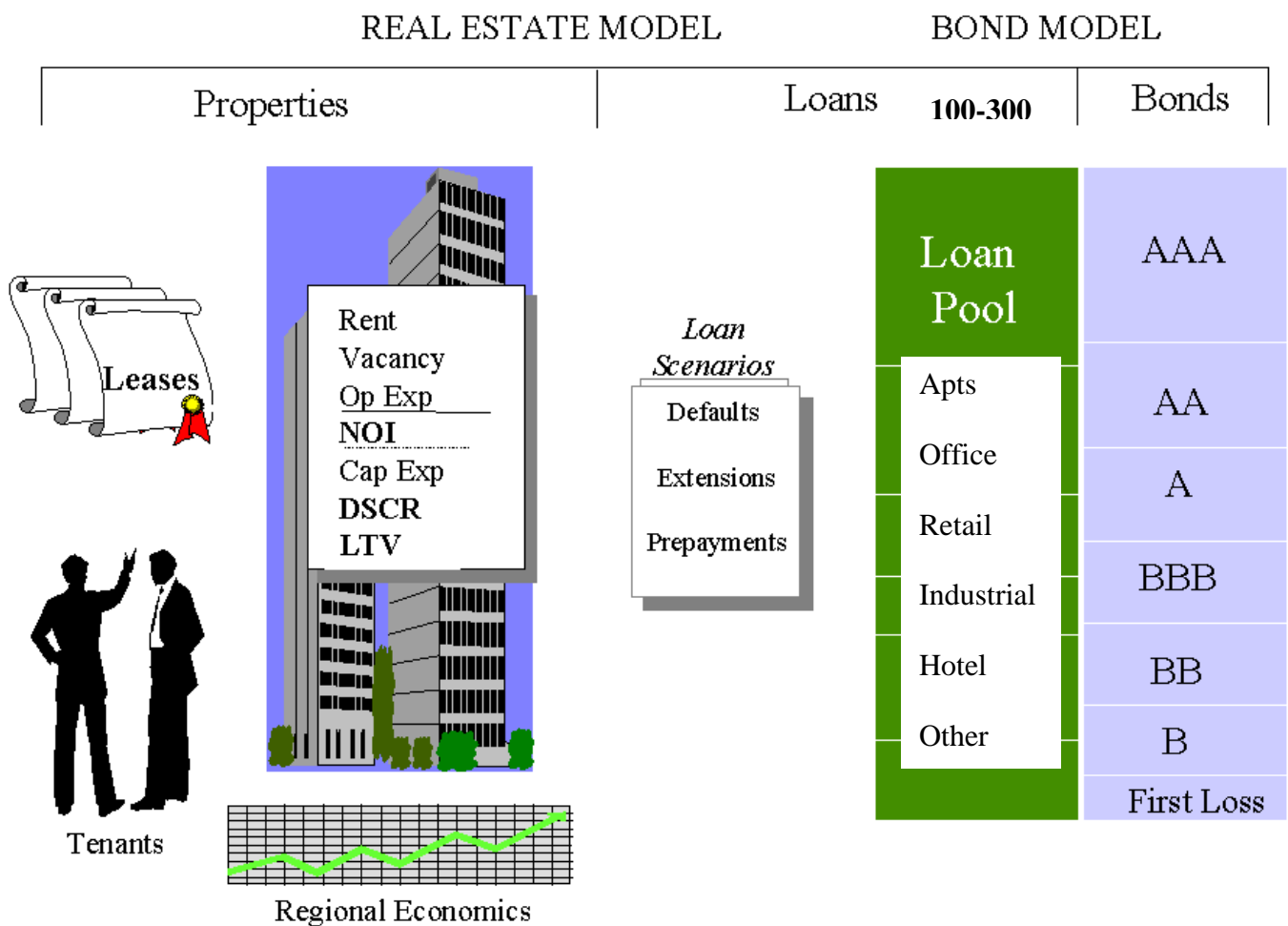


Chart B

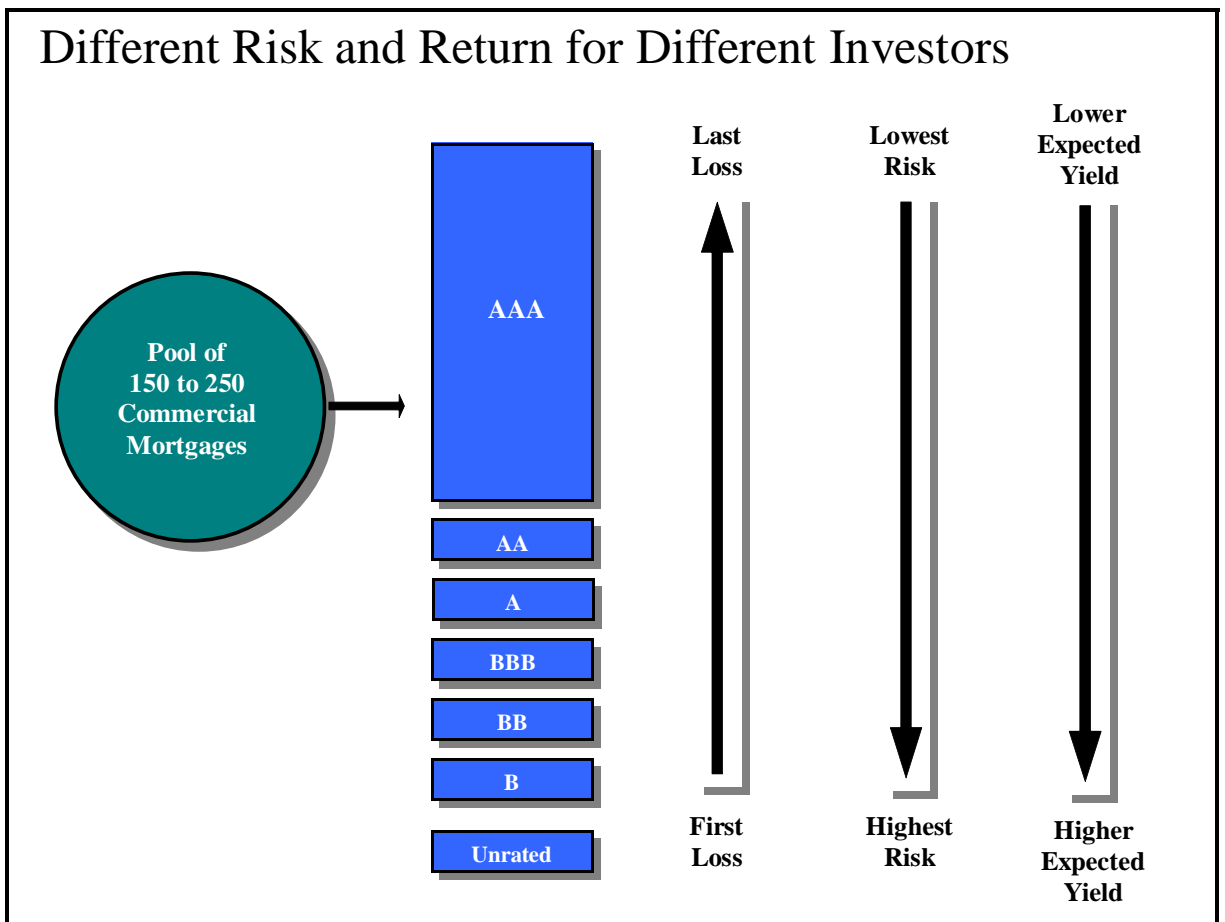
CMBS Collateral Diversified by Property Type, Location & Borrower



(Source: Trepp)

Chart C

CMBS Cash Flows From AAA to Unrated
While Losses Flow in Reverse From Unrated to AAA



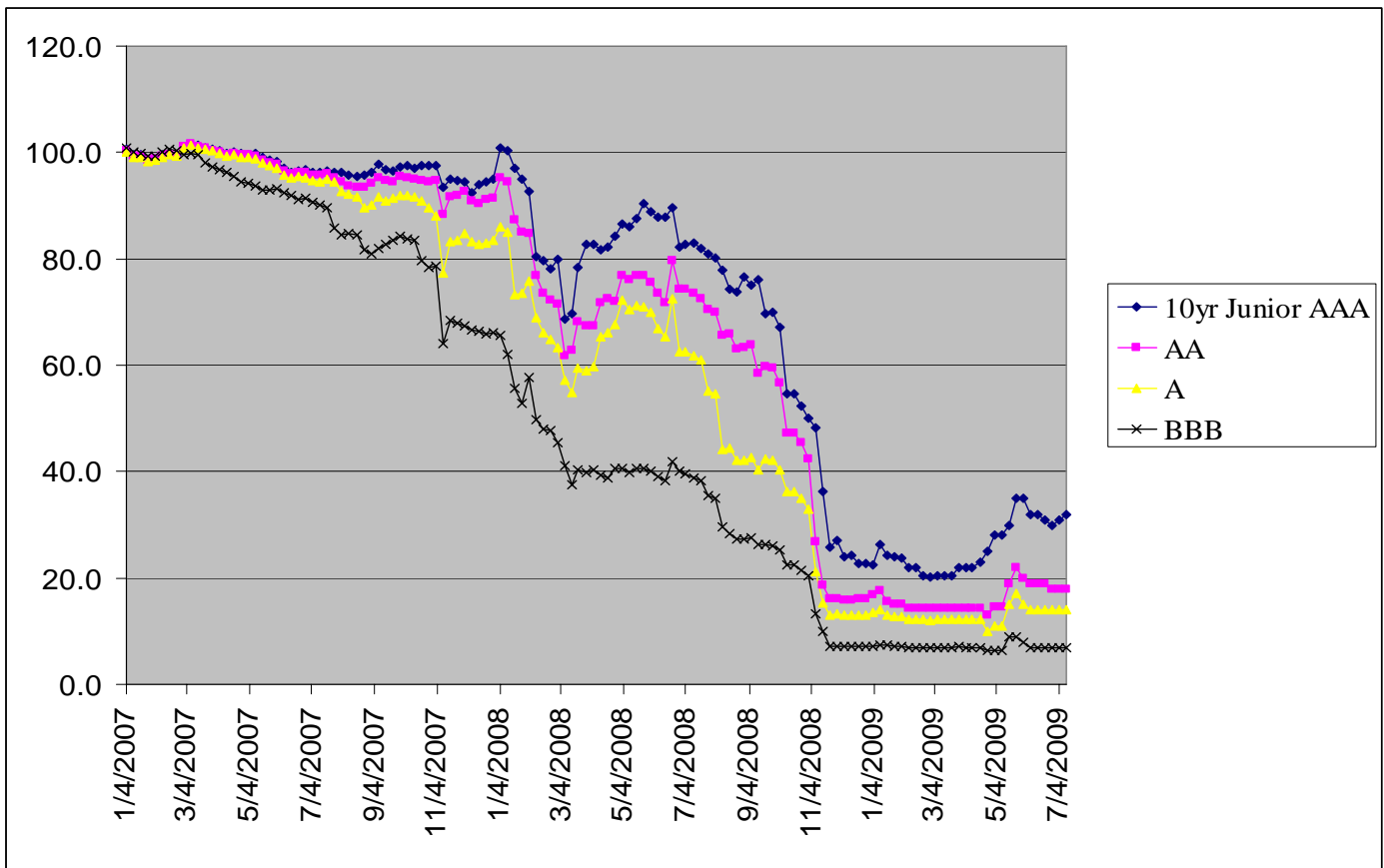
(Source: CMSA)

Chart D

Investment Grade CMBS Prices Have Declined Significantly

With the Recent Credit Market Distress:
AJ Bonds now 32% of face value returning approx. 25% YTM
BBB Bonds now 7% of face value returning approx. 95% YTM

(Source: Trepp)



Biographies

David McCary, CRI – Partner

Co-founder and Partner of Hartland and MSA (founded 1993). Mr. McCary has over 20 years of commercial real estate experience. His current responsibilities include overall operation of the companies including strategic planning, human resources development, banking, legal and accounting relations, new business development, and investor relations. Prior to MSA, he spent 11 years as a loan officer in the corporate lending and commercial real estate industries. He spent six years in the commercial real estate industry with Aetna Life and Casualty in Hartford, Connecticut, and, prior to that, spent five years as a corporate lending officer with Manufacturers Hanover Trust Company in New York City. While at Aetna Realty, Mr. McCary was Assistant Portfolio Manager of Aetna's CERESA I and II closed end pension client accounts. He was also an Investment Officer originating and underwriting over \$300 million in commercial mortgage loans from across the country. Mr. McCary is a member of the Commercial Mortgage Securities Association (CMSA) having served on its Executive and Nominating Committees, the Hartford CFA Society and the Chartered Realty Investors Society (CRI). A Middlebury College graduate (1980) with a BA in Economics, he earned his MBA in Finance from Dartmouth's Amos Tuck School of Business (1987), graduating with the Arnold F. Adams Award in Entrepreneurship.

Austin Mooney – Partner

Partner of Hartland and MSA, joined 10 years ago in 1999. Mr. Mooney has over 30 years of commercial real estate experience. Prior to joining MSA, Mr. Mooney was Chief Executive Officer of FGH Realty Credit Corp., a Dutch owned finance company totaling 53 employees actively making construction and interim loans on all property types in the greater New York City area. While CEO, Mr. Mooney developed a number of support services including a separate appraisal company, an in-house legal department, a property management company and a construction services company to manage FGH's mortgages and owned properties. After FGH and prior to MSA, Mr. Mooney was Director of Mortgage Origination at First Wall Street Capital Corporation where he originated both debt and equity financings for clients nationwide, and later provided commercial mortgage underwriting services to CitiCorp's conduit program. Other New York City banks Mr. Mooney worked for prior to FGH included Chemical, Bankers Trust, Marine Midland and Natwest, primarily in their real estate lending departments. Mr. Mooney was a member of the Real Estate Board of New York, serving on the Finance Committee, and the Mortgage Bankers Association. Mr. Mooney earned his BS in business administration from Wagner College (1968) and has completed numerous MAI courses.

Biographies, continued

John Stevens, CRI – Partner

Co-founder and Partner of Hartland and MSA (founded 1993). Mr. Stevens has over 30 years of commercial real estate experience. Prior to MSA, he spent 15 years in Aetna's commercial mortgage real estate area underwriting and investing in commercial mortgage loans. He was Region Head for the West Coast Region (including California, the Pacific Northwest and Mountain States) and later was responsible for loan production in the Mid-Atlantic Region. Mr. Stevens was also a voting member on Aetna's commercial mortgage investment committee. During market downturns, he restructured maturing loans, negotiated early loan prepayments, appraised real estate collateral securing mortgages, identified event risks in mortgage portfolios and developed strategies to mitigate loan losses. Prior to joining Aetna, Mr. Stevens was a commercial real estate analyst at State Mutual Life in Worcester, MA, where he underwrote mortgages, acquired real estate equity properties, and managed owned properties in the Midwest, Mid-Atlantic and Southeast. Prior to that, Mr. Stevens worked for MassMutual Economic & Realty Research, Inc. as a Real Estate Analyst. He is a Board Member of the Urban Suburban Affordables (a Hartford Area Non-Profit housing organization). A Pittsburg State University (1970) graduate with a BA in Economics, he earned his Masters Degree in Urban Economics at the University of Missouri (1971).

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