



Providing commercial real estate due diligence services nationwide since 1993



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## Welcome

McCary Stevens Associates, Inc. (MSA) has been providing institutional clients a broad range of commercial mortgage underwriting, due diligence and loan advisory services since 1993. We are commercial bank and insurance company trained loan officers with a strong credit culture whose services help our clients analyze, invest in, and manage their real estate loans, portfolios and CMBS (commercial mortgage backed) bonds. Since inception, MSA has analyzed over \$50 billion in commercial real estate assets for its clients.

Our clients have included some of the largest financial institutions in the country including: Wells Fargo Bank; Citigroup; ING-Clarion; CIBC; Midland Loan Services; Merrill Lynch; J.P. Morgan; RBS Greenwich Capital; Allied Capital; CIT and American Capital.

Our services include the following:

- Loan Portfolio Review
- CMBS Bond Analysis
- Whole Loan Portfolio Strategic Planning
- Problem Loan Workout
- Executive Loan Review
- REO (real estate owned) Management
- Loan Underwriting

Our services provide the following benefits:

- Leverage staff
- Add real estate underwriting and due diligence experience to the team
- Manage large volumes of data
- Bring an independent perspective and hands-on approach to the process
- Formulate and implement investment strategies in a timely fashion

Trade Associations we have belonged to over the years (click on logo to go to their site):



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## About Us

McCary Stevens Associates, Inc. ("MSA") incorporated in December 1993 as an employee-owned company, and since that time has strategically aligned its buy-side, commercial mortgage underwriting, due diligence and loan advisory services with financial institutions interested in investing in commercial mortgage loans and commercial mortgage backed securities (CMBS). Since inception, MSA has analyzed over \$50 billion in commercial real estate.

MSA's personnel are all highly skilled, commercial bank and insurance company trained commercial mortgage loan officers with prior work experience at Aetna, Cigna, Bankers Trust, Chase, Manufacturers Hanover Trust, and other real estate investing institutions. Each employee has over 15 years of commercial real estate experience.

MSA's first significant client was J.P. Morgan Securities, Inc. in New York City. Since then, MSA has gone on to align itself with a number of other institutional investors including - Wells Fargo Bank, Citigroup, ING-Clarion, CIBC, Midland Loan Services, Merrill Lynch, RBS Greenwich Capital, Allied Capital, CIT and American Capital.

MSA's work continually takes its underwriters to all of the primary, secondary and many of the tertiary real estate markets in the U.S.

Our due diligence services are helpful to both buyers and sellers of commercial mortgage loans and cmbs bonds and can add liquidity to the markets in coordination with the Treasury's Legacy Asset Programs.

**Code of Conduct:** MSA, its employees and principals have adopted a Professional Code of Conduct developed by the CFA Institute. The Code states that managers have these responsibilities to their clients: to act in a professional and ethical manner at all times; to act for the benefit of clients; to act with independence and objectivity; to act with skill, competence, and diligence; to communicate with clients in a timely and accurate manner; to uphold the rules governing capital markets. [Click here](#) to go to the Code. [Click here](#) to go to the CFA Institutes' Code Page.

**Security and Confidentiality:** MSA has adopted the ISO Standard ISO/IEC 17779 Information Security Standards which includes classifying project information and appropriately managing that information. We also provide clients with secure, encrypted, password protected access to our servers giving them 24/7 two-way access to our work. And lastly, all employees must pass a thorough background check prior to working with us.

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## Property Level Due Diligence Services

Our scope of services for property level due diligence includes the following:

- Site Inspections
- Lease Reviews
- Rent Roll Analysis
- Tenancy and Rollover Risk
- CAM Reconciliation
- Property Competitiveness Analysis
- Market Rent Analysis
- Property Operating Statement Analysis
- Property Cash Flow Projection
- Borrower and Sponsor Evaluation
- Tenant Interviews
- Borrower Interviews

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## Loan Level Due Diligence Services

Our scope of services for loan level due diligence includes the following, in addition to Property Level Services:

- Loan Document Inventory and Review
- Loan Sizing Analysis
- Stabilized Proforma Underwriting
- Discounted Cash Flow Analysis
- Loan Structure Analysis (escrows, guarantees etc.)
- Third Party Report Management and Review (appraisal, engineering, environmental, zoning reports)
- Underwriting Sensitivity Analysis
- Financial Ratio Analysis (LTV, DSCR, etc.)
- Loan Strengths and Risks Analysis

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## Portfolio Level Due Diligence Services

Our scope of services for portfolio level due diligence includes the following, in addition to Property Level and Loan Level services:

- Loan Portfolio Review and Analysis
- Historical and Summary Review of Portfolio Loans
- Current Loan Status Summary
- Lien Priority Analysis Relative to Other Lenders
- Capital Stack Analysis
- Complex Loan Structures Analysis (B-notes, participations, mezzanine)
- Strategic Advisory Services Including:
  - Loan Workout Strategy Formulation
  - Loan Disposition Strategy
  - Loan Strategy Implementation

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## MSAnalytics™

About Us

**MSAnalytics™** is an innovative analytical service that evaluates 100% of the real estate collateral in a CMBS bond so investors can make better investment decisions. It differs from all other CMBS analytical services because the methodology relies on a bottom-up, loan-by-loan analysis of critical real estate factors that most directly affect the collateral's ability to pay the mortgage loan.

Property Diligence

Loan Diligence

The **MSAnalytics™** produces an Expected Loss and timing of loss for each loan within a CMBS which can be up-loaded into bond pricing models.

Portfolio Diligence

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To download a copy of the **MSAnalytics™** brochure, [click here](#)

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## Personnel

McCary Stevens underwriters each have between 15 and 30 years experience in commercial real estate underwriting, due diligence and analysis. They have actively worked in all the major, secondary and most of the tertiary markets in the United States and have analyzed all of the property types including apartments, retail, office, industrial, hotel, congregate care, self storage and other specialty property types.

(Click on individual's name for detailed biography.)



David McCary, CRI



John Stevens, CRI



Richard Burton



Phil Gonsalves



John Saunders, CFA



Austin Mooney



Bob Buscher



Ray Todd



Tom Taylor, CFA



Pam Peck

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**David W. McCary, CRI**

Mr. McCary is Co-founder and Principal of McCary Stevens. He has over 20 years of commercial real estate experience. His current responsibilities include overall operation of the company including strategic planning, human resources development, banking, legal and accounting relations, new business development, and investor relations. Prior to MSA, Mr. McCary spent 11 years as a loan officer in the corporate lending and commercial real estate industries. Six of those years he worked in the commercial real estate department at Aetna Life and Casualty in Hartford, Connecticut, and, prior to that, for five years he worked 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.

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**John M. Stevens, CRI**

Mr. Stevens is a Co-founder and Principal of McCary Stevens. He 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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**Richard T. Burton**

Mr. Burton is a Principal of McCary Stevens who joined the company in 1996. He has over 20 years of commercial real estate experience. Prior to MSA, he spent 10 years with Aetna's real estate department originating and underwriting commercial mortgage loans. He also was a commercial mortgage loan workout specialist actively managing a \$450 million problem loan portfolio, negotiating loan restructurings, initiating foreclosures, managing litigation during foreclosure and bankruptcy, testifying in court and directing property receivers. Mr. Burton also worked in the property management area managing wholly owned and foreclosed properties. He directed the foreclosure takeover and management of these properties, and negotiated and / or managed the negotiation of over 1.2 million square feet of leasing in these properties. In addition, he managed the successful sale of numerous properties, designed and directed construction redevelopment projects, negotiated settlements with tenants in bankruptcy, and designed and implemented a property reporting format for all on-site property managers. Prior to his real estate experience, Mr. Burton spent 9 years as an active duty Coast Guard Officer after graduating with a BS in Computer Science from the Coast Guard Academy (1976). His duties included being Assistant Professor at the Coast Guard Academy teaching Strategic Planning, Accounting and Finance. Mr. Burton received his MBA with High Honors from the University of Connecticut (1982).

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**Philip G. Gonsalves**

Mr. Gonsalves is a Principal of McCary Stevens who joined the company in 1999. He has over 15 years of commercial real estate experience. Prior to joining MSA, Mr. Gonsalves was Vice President in charge of underwriting and operations for QuestCap, a conduit originator / underwriter based in Norwalk, CT. While at QuestCap, the company originated and underwrote commercial mortgage loans for its mortgage banking affiliates network. The network comprised 15 active mortgage banking companies representing 30 different regions across the country. Prior to joining QuestCap, Mr. Gonsalves underwrote commercial mortgage conduit loans for PaineWebber, managed a loan portfolio sale for a national lender and helped manage Aetna's commercial mortgage portfolio loans. He also spent six years with Fleet Bank and Centerbank in their commercial mortgage departments both in credit administration / approval and working out commercial mortgage loans. Mr. Gonsalves began his commercial real estate career with a regional appraisal company, valuing both commercial and residential real estate. Mr. Gonsalves earned his BA from Boston College (1983), and has completed numerous Appraisal Institute courses.

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**John R. Saunders, CFA**

Mr. Saunders has 18 years of experience in financing, managing and evaluating commercial real estate. He joined McCary Stevens in 2000 and became a principal of the company in 2004. His responsibilities include business development, project management and quality controls. Prior to joining McCary Stevens he worked at Cigna Corporation in various capacities including commercial mortgage origination, real estate asset management, commercial mortgage portfolio analysis and new business development. Mr. Saunders is a Chartered Financial Analyst (CFA) and a member of CFA Society. He earned a BA in economics from Bucknell University (1985) and an MBA from The University of Connecticut (1990).

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**G. Austin Mooney**

Mr. Mooney is a Principal of McCary Stevens who joined the company in 1999. He 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.

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**Robert C. Buscher**

Mr. Buscher joined McCary Stevens in 2001. He has over 20 years of commercial real estate experience. Prior to joining MSA, Mr. Buscher was a real estate advisor to various insurance, industrial and financial companies including Continental Wingate, United Technologies and The Hartford insurance company in the areas of loan underwriting and lease management. Mr. Buscher also worked at the Boston branch of Criimi Mae where he helped establish a regional underwriting office and oversaw the production and approval of over \$150 million of commercial mortgage loans. Mr. Buscher began his real estate career at MassMutual, where he spent fourteen years including mortgage loan closing and servicing; loan underwriting; research and new product development; equity acquisitions; and management of the Northeastern regional office. Prior to joining MassMutual Mr. Buscher worked as a lawyer in Baltimore/Washington and Western Massachusetts specializing in real estate and housing law. Mr. Buscher earned a BA from The Johns Hopkins University (1970) and his JD from the University of Maryland School of Law (1973).

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**Raymond H. Todd**

Mr. Todd joined McCary Stevens in 2003. He has over 20 years of commercial real estate experience. He spent five years at Chase Manhattan Bank as a commercial mortgage loan officer originating and underwriting commercial mortgage loans primarily out of Chase's Chicago office. Mr. Todd next joined Centennial Development Corp. in Tyson's Corner as Vice President of Finance where he managed this commercial real estate development company's financing needs. Todd next joined Cheslock, Bakker Associates, a boutique real estate investment bank in Stamford, CT where he participated in the underwriting and closing of over \$700 million of commercial mortgage loans, which became collateral for various CMBS securitizations. Most recently, Mr. Todd spent six years with Access Management Company, a New Jersey based manager and developer of self-storage properties, where he was vice president of finance. His responsibilities included managing all finance and accounting. While there, he supported the company's growth from six to twelve properties under management. Mr. Todd earned his BA from the University of Pennsylvania (1977) and his MBA from the University of Virginia (1979).

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**Thomas G. Taylor, CFA**

Mr. Taylor joined McCary Stevens in 2002. He has over 25 years of commercial real estate experience with more than 15 years at financial institutions including Aetna Life and Casualty, the Phoenix Companies, and Security Capital. Prior to joining MSA, Mr. Taylor was a Principal of Old Main Street Investors, a private investment, property development, and consulting company. As a principal, Mr. Taylor was responsible for forming partnerships to purchase commercial real estate, primarily apartment complexes, warehouses, and office buildings from institutional sellers. Additional responsibilities included valuing and positioning portfolios of commercial mortgages for sale for several institutional clients. Prior to forming Old Main Street Investors, Mr. Taylor was a commercial mortgage workout specialist for the Phoenix Companies, where his work included restructuring, foreclosing and selling problem loans with an aggregate principal balance of over \$500 million. Mr. Taylor has also worked as an underwriter in the commercial mortgage loan area of Aetna Life and Casualty and as a commercial mortgage portfolio manager for Security Capital Credit Corporation. Mr. Taylor has completed numerous Appraisal Institute Courses and is a member of the CFA Institute. He has a BA degree from Amherst College (1971) and an MBA from the Wharton School (1977) at the University of Pennsylvania.

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**Pamela S. Peck**

Ms. Peck joined McCary Stevens in 2004. She has over 30 years of commercial real estate experience including 20 years with Cigna, Connecticut National Bank and Barclays Business Credit, combined. While at Barclay's Ms. Peck originated, underwrote and closed commercial mortgage loans in the Midwest and Southeast. At CNB Ms. Peck performed numerous commercial mortgage loan workouts comprising \$100 million in office, industrial and multifamily properties. At Cigna, Ms. Peck was an Asset Manager responsible for over \$300 million in institutional quality office and industrial properties for Cigna's general and advisory accounts. Ms. Peck began her real estate career in New York City as a paralegal for Shea Gould preparing documentation for equity and mortgage loan transactions, coordinating closings and handling bankruptcy related issues. While there, she focused on the zoning and architectural issues related to the air rights and successful development of the Helmsley Palace Hotel. From there she went to Schroder Real Estate where she originated, underwrote and closed approximately \$500 million of office and regional mall acquisitions. Ms. Peck completed numerous real estate and accounting courses at New York University in New York City, received Paralegal training at the Institute for Paralegal Training in Philadelphia and earned her BA in Political Science from the University of Colorado (1972).

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## Completed Assignments

McCary Stevens has completed over \$50 billion in commercial mortgage loan analysis since its inception in 1993. The following details some of our assignments:

- [CMBS Subordinated \(B-piece\) Loan Review and Analysis \(click here for details\)](#)
- [CMBS Individual Loan Underwriting \(click here for details\)](#)
- [CMBS Bond Review and Analysis \(click here for details\)](#)
- [Commercial Loan Portfolio Review and Strategy Formulation \(click here for details\)](#)
- [Commercial Loan Review \(click here for details\)](#)
- [Residential Land Development and Condominium Loan Review \(click here for details\)](#)

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## CMBS Subordinated (B-piece) Loan Review and Analysis - details

McCary Stevens has completed over \$50 billion in commercial mortgage loan analysis since its inception in 1993. The following details some of our assignments:

- **CMBS Subordinated (B-piece) Loan Review and Analysis:**

- **Project description:** Executive review, site inspection and analysis on more than 1,000 commercial loan assets in 16 CMBS Bond pools over a 4 year period for one client and more than 700 commercial loan assets in 30 CMBS Bond pools for another client. The investor/clients purchased newly formed CMBS bonds at various times. The loan and asset analysis was used to assess the potential default risk of each underlying asset and highlight loans which were at a greater likelihood of future default. These higher risk assets were often excluded or their value discounted from the CMBS bond. The commercial properties reviewed included various loans throughout the country and included all commercial property types. The scope of services included: a) review of each property including site inspection, b) local market analysis and local broker interviews, c) stressed re-underwriting analysis, and d) summary analysis of each property's strengths and weakness.
- **Turn around time and staffing:** Project Manager and as many as 14 senior level underwriters. Each bond analysis was required within a 20-30 day turnaround timeframe.

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- **CMBS Individual Loan Underwriting:**

- **Project description:** 109 commercial loans underwritten over a 4 year period for one client, 175 commercial loans underwritten over a 3 year period for another client and 55 loans for another client over a 5 year period. Clients originated loans for sale into CMBS bond securitizations. Loans involved office, retail, apartment, and hotel property types located in various markets throughout the country. Loan sizes ranged from \$5 million to \$100 million. The scope of services included: a) review and analysis of all property financial statements, leases and sponsorship financial statements, b) site inspection of the underlying property, c) coordination and review of third party appraisal and engineering reports, d) assessing the market conditions and competitiveness of the property, e) analysis and review of sponsorship financial and credit strength and f) preparation of presentation report to investment committee which included a detailed report of all findings. Each loan assignment required constant client coordination and discussion as materials were delivered and reviewed.
- **Turn around time and staffing:** Project Manager and 6 senior level underwriters, each working at various times. Each loan required 50-100 man-hours over the course of a 30-60 day time period. As many as 10 loans were processed at any one time.

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- **CMBS Bond Review and Analysis:**

- **Project description:** Executive review, site inspection and market analysis of 1,134 securitized loans in 15 different CMBS Bond pools. The investor/client wanted to execute a strategy to analyze existing CMBS bond instruments for possible investment. Properties secured various commercial loans throughout the country and included all commercial property types. The scope of services included: a) review of each property including site inspection, b) local market analysis and local broker interviews, c) determination of a market proforma, and d) summary analysis of each property's strengths and weakness.
- **Turn around time and staffing:** Project Manager and 14 senior level underwriters, each working at various times throughout the project. Project required an estimated 10,000 man-hours and was completed in 60 days.

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- **Commercial Loan Portfolio Review and Strategy Formulation:**

- **Project description:** Detailed review of an \$840 million loan portfolio with 38 loans secured by 98 properties (single asset and portfolio loans). McCary Stevens provided the investor/client with a thorough review of each asset, a competitive assessment of each property, a review of the underlying market conditions, a 5-year DCF analysis and a recommendation on the best exit strategy for each loan. Incorporated in the strategic analysis was a review of the participation and/or mezzanine loan and rights of the client under the participation/mezzanine loan agreement. Debt positions included first mortgage, participating junior B-Notes and mezzanine debt. Most loans were floating rate mini-perm loans with short term maturities however some loans were development/construction loans. Assets included all types of commercial properties and a number of land developments.
- **Turn around time and staffing:** Project Manager and 9 senior level underwriters. Project required an estimated 2,000 man-hours and was completed in 60 days.

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- **Commercial Loan Review:**

- **Project description:** Reviewed over 150 commercial loans for inclusion onto a line of credit funded by another institutional lender. Loan assets were continuously included and removed from the line of credit. The scope of services included: a) review of each previous loan underwriting, b) an update on the performance of the property to date, c) determination of an in-place proforma, and d) summary analysis of each property's strengths and weakness.
- **Turn around time and staffing:** Project manager and 3 senior loan underwriters at various times throughout the contract period.

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- **Residential Land Development & Condominium Loan Review**

- **Project description:** Executive file review of 29 underperforming residential and condominium loans mostly located in Florida, California and Nevada. Project had a one week turn around requirement. The investor/client needed to understand the potential loss reserve requirement for each loan. The scope of services required an executive summary report for each loan which included: a) a historical outline of the loan since original loan closing, b) market description and analysis, c) local market participant interviews, d) estimate of market value of the underlying asset and potential loss reserve, e) identify key risk factors which could impede an orderly disposition of the asset.
- **Turn around time and staffing:** Project manager and 7 senior underwriters. Project had an accelerated delivery schedule with a one-week turnaround requirement.

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## Library

The following Library items are pertinent industry articles and MSA marketing materials:

Industry Articles:

- "CMBS Due Diligence Underwriting: Helping Investors Make Informed Decisions", by John R. Saunders, CFA. ([Click here](#) to open or download.)
- "Finding A Roadmap", by Thomas Wratten, CMB. A veteran of the cmbs industry offers his unique and time tested perspective on the current credit crunch and how its affecting the commercial real estate finance business. ([Click here](#) to open or download.)
- "Value Investing in Legacy CMBS", by David McCary, CRI and partners. ([Click here](#) to open or download.)

McCary Stevens Marketing Materials:

- "MSA Perspectives" newsletter from McCary Stevens. ([Click here](#) to open or download.)
- McCary Stevens Due Diligence Brochure. ([Click here](#) to open or download.)
- McCary Stevens CMBS Analytics Brochure. ([Click here](#) to open or download.)

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McCary Stevens Associates, Inc.  
750 Main Street  
Hartford, CT 06103

Main phone number: (860) 761-1000  
Main fax number: (860) 761-1009

Phone extensions:  
David McCary - 101  
John Stevens - 102  
Richard Burton - 103  
Phil Gonsalves - 106  
John Saunders - 107  
Bob Buscher - 110  
Tom Taylor - 109  
Ray Todd - 112  
Pam Peck - 115  
Austin Mooney (in Great Barrington, MA) Cell: 704-277-4284

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# CMBS Due Diligence Underwriting: Helping Investors Make Informed Decisions

*John R. Saunders*



Saunders

The evolution of commercial mortgage-backed securities (CMBS) as a vibrant investment sector has brought many changes to the world of real estate finance. A new and expanding investor base, lower cost of capital for real estate owners, and a discipline to the supply of new buildings are a few of the more notable developments. Less well known is the new application of real estate finance skills known as due diligence underwriting. Due diligence underwriting is focused on collateral credit risk: determining the competitive position of an asset within its market, assessing the quantity and quality of the collateral's cash flow, and determining an asset's ability to generate sufficient cash flow over time to service the mortgage debt.

Collateral credit risk is principally the concern of the below-investment-grade, or B-piece investors. The investment-grade investors assume little or no collateral credit risk by selling this risk to the B-piece. It is essential for investors assuming collateral credit risk to fully understand the collateral and the issues that affect that collateral over time.

In the case of a new bond issue the due diligence underwriter has the unique opportunity to have the first buy-side look at a loan. This independent and objective first look at the collateral is an excellent way to determine what events are taking place at a property and within the market that will impact the collateral's current and future cash flow. How does the due diligence underwriter perform this task so that the investor is able to make informed decisions? Read on for a better understanding of the due diligence underwriting process.

## **COLLECTING AVAILABLE INFORMATION**

The underwriter begins the due diligence process by

accumulating relevant and current information on the collateral to be reviewed. For new issues, the loan file should include the relevant third-party reports, current and historical financial statements, current and historical certified rent rolls, loan terms and structure, borrower information, and the issuer's underwritten executive summary and financial analysis, including a history of the property with the date and amount of the borrower's purchase, and reason for financing.

Often the loan files are not complete. For secondary market transactions the underwriter may only receive information that is available from the master servicer, including property financial statements, rent rolls and structural (escrow) information. In any event, the underwriter must rely on the information available and their own accumulated years of experience assessing real estate properties and their cash flows.

## **RESEARCH**

Next, research must be done to adequately prepare for the site inspection and market tour. The location of the asset, the location of competing properties, and the location of the appraiser's lease comparables are identified. Information on comparable space for lease in the market is available on many Internet sites and can supplement for additional lease comparables. The underwriter will contact local brokers to obtain lease information and market statistics and to gain an understanding of market leasing activity. Published statistics are available on most of the primary and many of the secondary MSAs for macro-economic data, such as demographics, employment history/projections, major industries, employers, etc. This is also true for micro-real estate data, such as vacancy rates for various property types, absorption rates, and market rent trends. For secondary and tertiary markets, the underwriter can research chambers of commerce, local government, and the local brokerage community. Obtaining as much information as possible prior to the site inspection



enables the underwriter to make well-informed observations of the property, the current supply of competitive properties and the potential for future supply.

### KICKING THE BRICKS

The site inspection and market tour is the most critical element of the due diligence process. It enables the investor to see, touch and experience the collateral through the due diligence underwriter. Actual tenants in occupancy are checked against the current rent roll. For some properties, such as multifamily or office assets, it may be impractical or impossible to check all tenants due to size or security reasons. The underwriter will inquire about current leasing opportunities to determine current occupancy and asking rental rates.

“The site inspection and market tour is the most critical element of the due diligence process.”

An on-site presence allows the underwriter to interview tenant employees, customers and leasing agents for multifamily, hotel, self-storage, and mobile-home parks. These interviews are typically basic: “How is business?” “What happened to the tenant next door?” “Who would you say are your direct competitors?” “Do you know who will anchor that new center across the street?” etc. People will often share a surprising amount of important local market information through friendly, patient, and specific questioning.

The underwriter must also carefully review the physical condition of the property, especially with regard to any immediate needs identified by the engineer. Visibility, accessibility, vehicular and pedestrian traffic flow, landscaping, signage, parking, number of buildings, number of stories, the neighborhood, and surrounding uses are all observed and rated (poor/fair/good/excellent) on an absolute basis as well as relative to competing properties within the market. These elements combine to tell a story of how well the property competes in its submarket.

The underwriter takes a thorough market tour to physically inspect competing properties, lease comparables, current leasing opportunities, and potential future developments. The properties are rated (A, B, C±) to determine the competitive position, which may range from highly competitive to noncompetitive to obsolete. The market tour also helps the underwriter conclude the current level of market rents and market occupancy.

Most often, inspections will confirm the conclusions of the appraiser, the engineers and the original

underwriting. There will likely be some variations in market rent and market vacancy assumptions based on the underwriter’s due diligence. For such assets, the major issue is the competitiveness of the property and the likelihood of the property maintaining its competitive position in the market. In contrast, the underwriter’s conclusions for properties reviewed in a seasoned secondary market transaction are likely to differ from the original underwriting, sometimes significantly, due to events that have taken place at the property and in the market since the loan closed.

Occasionally, the due diligence underwriter concludes something completely different than that of the sell-side production team. The following are examples of information learned during site inspections that led to different and less optimistic conclusions:

- A retail tenant was asked, “How’s business?”

“Great” she replied.

“Oh, sales increasing?”

“No” she said, “They (corporate) are closing this store on Friday.”

“This Friday?” (There are three years remaining on the lease according to the rent roll.)

“Yes—and I’m taking a vacation!”

The tenant represented about half of the first level retail income on this mid-rise multifamily asset. Combined with a market vacancy issue, this created a large variance to the originally underwritten cash flow.

- The appraiser stated there were no competing properties within three miles of the subject self-storage facility. A search on an Internet site revealed six self-storage facilities within a three-mile radius. Upon inspection, three of these were determined to be highly competitive with the subject property.
- A suburban office property located in a secondary MSA just outside a primary MSA had a rent roll showing 92% occupancy by three tenants. Upon inspection, the location was determined to be rural with the closest directly competitive property over five miles away. One of the tenants that occupied 25% of the property had vacated the premises.
- A mixed-use property was not a condominium, as reported in the underwriter’s executive summary. Rather, the taxing municipality had not parceled the living units and the property remained a co-op. Also,

*(continued on p. 61)*

the restaurant tenant with 50% of the collateral's leaseable area closed for business four days before the site inspection.

- Site inspections on a portfolio of stand-alone retail properties found several vacancies, one fire damaged building, and a tenant constructing a new store less than one mile down the street from the subject collateral.
- The original market rent conclusion for a suburban office in a secondary MSA was approximately 15% higher than the asking rents in the two new office buildings being constructed across the street.

When evaluating a property's competitive position and its ability to generate sustainable cash flow an underwriter's skill and experience are essential.

#### COMPLETING THE PUZZLE

Back from the road, the underwriter works to complete the collateral review model with all relevant property and market information obtained in the due diligence process. A good model will present the analysis in a concise and efficient format for the investment committee to review and lead to a lively discussion on the collateral and its ability to produce cash flow.

In the model, the financial underwriting flows from the rent roll, which has been verified and adjusted to market. Other sources of revenue are derived from historical performance at the property, with certain non-property specific items, such as interest income, excluded. Operating expenses generally flow from the property's historical performance with some line items being marked to market, including management fee, real estate taxes and, more recently, insurance expense. Capital items, including leasing commissions, tenant improvements and replacement reserves are estimated based on market rates as well as rating agency standards. The resulting underwritten net cash flow is analyzed relative to the collateral's historical net cash flow, the

original underwritten cash flow, and the debt service obligation.

The underwriter concludes the strengths and weaknesses of the collateral and of the loan. Is the property competitive in its market? Is the location and condition a strength or weakness? Does the property have sufficient structure and cash escrows to address the large rollover of tenants in the next several years? Is the property over-leveraged or reasonably leveraged? Does the current market and its trend represent a strength or weakness? Is the borrower well capitalized? Do they have real cash equity in the deal? Has the owner and/or manager shown a willingness to maintain the competitive position of the property? Looking at the big picture—would you like to own this property?

During the investment committee presentation, the underwriter brings the relevant issues to the forefront, presents the photographs taken during the site inspection and market tour, and provides an overview of the financial underwriting. The investor can then analyze the information, challenge assumptions, concur or modify the underwriter's conclusions, and ultimately, make an informed investment decision.

#### CONCLUSION

Due diligence underwriting evolved as a unique group of investors sought to fully understand the collateral credit risks they were taking by investing in CMBS. Today's B-piece investors wouldn't think of buying below-investment-grade CMBS bonds without first deploying a team of competent due diligence underwriters to collect, inspect, analyze, and report on the collateral at hand. With shrinking subordination levels, downgrades and changing real estate fundamentals, how much collateral credit risk is embedded in your CMBS portfolio? □

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*John R. Saunders, CFA, is Vice President at McCary Stevens Associates, Inc.*



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# Finding a Roadmap



long-time veteran of the commercial mortgage-backed securities (CMBS) market—indeed someone instrumental in its founding—Tom Wratten, CMB, reflects on what the CMBS market needs to do to wrestle free from the current credit-market logjam. ❖ This former Air Force fighter pilot, who flew 130 combat missions in Vietnam, is better known in the mortgage world for his critical early work in moving the commercial real estate finance business into the world of securitization. The accolades are many, and go back to the early 1980s. Wratten was the founding chair of the Commercial Real Estate Finance Council for the Mortgage Bankers Association (MBA) and served on the group's board of governors from 1982 to 1992. ❖ Along the way, Wratten chaired the first MBA Commercial Real Estate Finance/Multifamily Housing Convention and was chair of MBA's commercial mortgage securitization committee. He also served as a founding chair of the precursor organization to what is now the Commercial Mortgage Securities Association (CMSA). Wratten was also founding chair of the securitization committee for the American Council of Life Insurance (ACLI). On top of all that, he served as the founding chief executive officer for Midland Loan Services, Kansas City, Missouri.

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**A veteran of the commercial mortgage-backed securities business offers his unique and time-tested perspective on the current credit crunch and how it's affecting the commercial real estate finance business.**

*Mortgage Banking* interviewed Wratten recently to get his thoughts on the current state of the CMBS market and the credit crunch.

**Q:** *What is happening now in the capital markets, and how is it impacting commercial real estate finance?*

**A:** A collapse in investor confidence has roiled capital markets and precipitated a credit crunch. Much of this considerable distress is the washout of residential mortgage markets. [Those events] are well-documented at this point. Obviously, the subprime meltdown spilled over and fomented a broad investor apprehension of all mortgage investment vehicles, which was further amplified by the financial crisis at Bear Stearns & Co. Inc., New York.

Homeownership is a cornerstone of the consumer-driven American economy. The other cornerstones are job growth, profitable industry and capital formation—each of which help propel commercial real estate. However, residential markets, our larger sibling, are tethered to commercial real estate in ways that often make it difficult to distinguish their woes from ours.

The homeownership rate spent 50 to 60 years in the 60 percent to 65 percent range, following the creation of the Federal Housing Administration [FHA], the Department of Veterans Affairs [VA] home loan program, Fannie Mae, Freddie Mac and, later, the residential mortgage-backed securities [RMBS] vehicles. It worked well until we pushed it to unsustainable levels. Now we must pay the price for that excess.

**Q:** *Have similar market excesses happened before, and what has the industry learned from them?*

**A:** Yes, excesses have occurred several times in various sectors, and often crash the party as unwelcome guests. For example, with barrels of oil now trading hands for more than \$110, one might be inclined to forget the early 1980s, when Penn Square Bank, a small lender peddling energy loans from an Oklahoma shopping center, lit the fuse for a banking industry meltdown. And there were the construction and development real estate investment trusts [REITs] of the early 1970s.

Also recall the aggressive CRE [commercial real estate] syndications and junk bonds of the 1980s, and the savings-and-loan [S&L] crisis of the early 1990s. Let's also not forget the technology meltdown at century's end. And, of course, every student of history can recite the granddaddy of them all—the 1929 stock market crash, which, less well-known, was preceded by a real estate crisis in 1926.

I've just touched the surface of past excesses, some of which have led to national recessions or worse. Only time will tell, but the subprime crisis, higher energy prices and other factors may well have landed us in a recession at this very moment. The economists are still deliberating.

Many of these cycles led to new innovations in CRE finance. Unfortunately, most of these innovations also proved problematic at some point. The 1969–1970 cycle brought us legislation that created real estate investment trusts. The REITs of those years were excessively funded,

which led to a CRE crisis in the mid-1970s, when most (not equity) REITs failed.

CRE markets had recovered and were in balance when the 1980–1982 cycle heralded the 1981 Economic Recovery Tax Act, which authorized the accelerated cost recovery system [ACRS] with its accelerated-depreciation schedules. Those schedules, along with high inflation, encouraged non-economic CRE overbuilding that abruptly ended with the 1986 Tax Reform Act—too late to avoid the impact of overbuilding that led to the S&L crisis and the failure of numerous limited partnerships.

Notably, the 1986 Tax Reform Act created the real estate mortgage investment conduit [REMIC] as a vehicle to enhance the residential capital market.

The 1990–1992 cycle was a true CRE depression, as well as a national recession. Even the most conservative lenders were challenged to sustain their lending operations, and all lenders were subjected to regulatory scrutiny.

The 1980–1982 cycle gave incentives to the life companies to seek ways to promote liquidity in their mortgage portfolios, which formed the basis for today's commercial mortgage-backed securities market. Unfortunately, this initiative faded by the late 1980s. The creation of the Resolution Trust Corporation [RTC] enabled the industry to complete the financial

engineering for a true CRE capital market, and today's CMBS infrastructure was permanently launched. [See Figure 1 for stages of CMBS development.]

**Q:** *Can these crises be eliminated?*

**A:** No, I don't think so. Despite the concerted efforts of regulators and industry groups, the risk of financial excesses is a component of a free market and a risk of investing. These crises certainly cause a government rush to correct after the fact, which often just creates another crisis at a later date. However, much progress on prevention has been made over the decades.

The creation of the Securities and Exchange Commission [SEC] and securities legislation helped dampen, but did not eliminate, the volatility of the bond and stock markets in subsequent decades. Many professional organizations try to self-regulate, and have accomplished notable things—such as the Financial Accounting Standards Board [FASB] effort of the certified public accountants [CPAs]. But even that effort didn't prevent the excesses that caused the collapse of Enron Corporation. Major governmental initiatives will likely take root in the current presidential election environment, and we may see some sweeping changes in the regulatory structure for financial institutions outside and within the CRE capital market.

Such changes will affect how we function going forward. Regulation may curtail some investment banks from prospecting in markets and limit some insurance companies that have large CRE mortgage exposure. On the other hand, foreign capital is now a major contributor to our capital markets, and this flow of money may well take up the slack in domestic capital availability.

*“Residential markets, our larger sibling, are tethered to commercial real estate in ways that often make it difficult to distinguish their woes from ours.”*

This isn't unprecedented, as the United States has long absorbed foreign capital to sustain its dynamic growth. In the postwar era, our great wealth and the diminished capacity of our trading partners enabled and required us to largely self-fund our economic progress. Today the world is catching up, and so much more of the world is benefiting from free markets and relatively freer people. While certainly we can't hang our hat on the prospect of foreign capital to bail out unwise practices, it should be noted and accepted that international investors are here to stay.

I believe we are entering a new phase in the evolution of the CRE capital market. I call it the fifth phase, and have named it the Global Phase [see Figure 1, taken from an article the author wrote for *Urban Land* magazine in 1998, which identifies the other four phases].

**Q:** How do you feel about the CRE capital market and its future prospects?

**A:** Actually, I feel good about it—although I felt we were tempting fate in the last couple of years. From rating agencies, the upgrade vs. downgrade ratio was 1.59 to 1 in March 2008, and delinquencies remain low. Those facts, I hope, don't foretell a CRE debt crisis.

The original goal for a CRE capital market was to create debt liquidity to avoid the credit crunches of the past, like the 1980–1982 and 1990–1992 credit crunches that so devastated CRE values and our industry. To have asset liquidity, you had to create a marketable or tradable form of security, which took a major effort for a fractured, non-standardized, cottage industry to accomplish. After a fledging start in the mid-1980s, the S&L crisis and subsequent advent of the RTC enabled us to complete the final engineering to develop a functioning CRE capital market.

I believe our market has performed admirably over the last decade and will continue to do so well into the future, though

it continues to need engineering updates—just like any industry. I don't believe we will change the capital market platform, but some of the vehicles may need to be altered.

The institutions that “accumulated” the mortgages before the final securitization are now under the microscope by regulators. The result may be a need for a new type of business entity to absorb the “accumulation” role in the market. The infrastructure is in place for a [CMBS] recovery, even though some of the capital may be from new sources.

**Q:** What further engineering of the CRE capital market is needed now, in your view?

**A:** I have two opinions, but first let's review the systemic checks and balances we have built in already.

Almost every aspect of the market is on a transparent bid-and-ask pricing model with multiple participants. This allows appropriate risk pricing and placement of each function and risk. This self-interest discipline has worked quite well, and allowed for the enormous growth of the CRE capital market. It has also placed the various levels of risk in the hands of those qualified to analyze and manage it.

My first concern relates to the rating agency selection process. However, I must defend the rating agencies against any unwarranted criticism. They have been generally conscientious in their duties. Cautionary warnings of a housing bubble were noted by CRE agency executives and analysts long before it burst.

The weakness arises from the appearance that rating agencies are “shopped” by issuers for the highest price possible, not for the best price or best execution. This perception needs to be altered or eliminated. With three predominant agencies, you have at least a minimal population for a bid/ask pricing mechanism that could free the agencies from some, or all, of the pressure for higher ratings. However, that would not eliminate the investor's fiduciary responsibility to analyze both the ratings

**Figure 1** The Four Stages of the Commercial Mortgage Secondary Market

Design Phase (1980–1988)	Engineering Phase (1990–1993)	Manufacturing Phase (1994–1996)	Recycle Phase (1997–2007)
CRE liquidity	Industry unbundled	Private goes public	Portfolio lenders become sellers
Credit enhancement	Services priced	Capital-market discipline	Whole-loan secondary market
CMBS software model	Third-party servicers	Public awareness	Whole-loan risk-rating
Investment banks trained	Asset management	CMBS manufactured	Secondary-market costs identified
Rating agencies involved	CRE analysis refined	Lobby efforts	Centralized forums
Market primed	Due diligence refined	Defined specialties	Centralized market
	Portfolio management proactive	Risk bifurcation	Main Street/Wall Street
	Regulatory action		Private-placement market
	Risk-rating refined		Efficiency established
	Procedures established		New universe in CRE
	CMBS institutionalized		Pricing in-depth
	Information explosion		Risks insured
	Software for all phases		
	Multifamily capital		
	Total process engineered		
	A new profession established		

SOURCE: URBAN LAND MAGAZINE

and the rating agencies' depth of expertise and due diligence. This scrutiny could add another layer of checks and balances to the CRE capital market, and could enhance global investor confidence in the asset class.

My second concern is how [should we] accumulate and hold commercial mortgages in a pool, before the securitization is closed and funded. This role has been filled primarily by investment and money-center banks. However, as we have seen recently, an abrupt credit crisis can place them in great financial peril, as they are left holding long-term assets funded with highly leveraged and volatile short-term capital.

This has happened before in 1988, in 1998 and, to a lesser degree, in 2001. I believe it is a vulnerable link in our capital market infrastructure that needs more engineering. This mismatch can be very profitable for the accumulators. But if they are highly leveraged, a spike in interest rates can jeopardize their balance sheets rapidly.

Let's consider a way to develop an efficient portfolio seller-servicer program that encourages existing (or creates new) portfolio lending institutions to become more active in selling their commercial mortgages into a pool just before the securities issue is to be closed and sold as a rated security.

Considerable work was accomplished by the life insurance industry in the early 1990s on the issue of the mark-to-market value of commercial mortgages. The resulting model of "hold in portfolio to maturity" vs. "hold for resale" of commercial mortgages could possibly be a foundation for an initiative to create a new business model to accomplish this important function for our industry.

I believe we also would have to finally create a whole-loan risk-rating system at the same time to make a portfolio seller-servicer program function effectively. Our early effort to make a whole-loan risk-rating system work was hampered by the lack of reliable data on commercial mortgage historical performance by property type, location, size, loan-to-value [LTV] ratio, rate, maturity and so on. Given today's abundance of data and research, coupled now with highly trained CRE capital market professionals, we surely must have sufficient resources to support a beginning effort to model the accumulator of the future.

**Q:** What do you think the industry should do to unlock the current CMBS credit logjam?

**A:** An important aspect of today's capital market is how the participants interact with each other. Since the 1990–1992 cycle, we have created the Mortgage Bankers Association's [MBA's] Commercial Real Estate Finance [CREF]/Multifamily Housing Convention, which brings together the whole industry to discuss and manage the commercial mortgage creation process. And we launched the Commercial Mortgage Securities Association [CMSA] in 1994 to manage and distribute CRE capital globally. These forums have made data resources and technical efficiencies available to improve the marketplace that didn't exist before

1992. They create venues where we can address industry-wide concerns, both internally and externally, and take action to correct or improve our marketplace.

When the ship is under attack, everyone must coordinate his or her defenses, and that applies here. We have been found guilty by association in regard to the residential crisis, and need to rally the industry to be proactive. I suggest these steps:

■ Continue to work with the other real estate-focused trade associations through the Capital Consortium, representing the multiple participants within the CRE industry. In addition to the MBA, participating organizations include the CMSA, American Securitization Forum [ASF], Real Estate Roundtable and National Association of Realtors® (NAR). Reconvene the Capital Consortium to organize and execute a plan to inform and educate global investors and government regulators about the CRE capital market, its performance, differences, safeguards and systemic checks and balances.

■ Create a task force of experienced professionals from both Main Street and Wall Street to aggressively focus on the role of the accumulator in the CRE capital market. The credit crisis has severely restricted the activity of the current accumulators. This impact is almost solely responsible for the precipitous decline in volume of CRE financing we have experienced in the last year. The CMBS market will not recover until the accumulators recover.

There are too few life companies and bank syndications to offset the accumulators' role currently performed by the investment banks. Let's try to find a way to help solve this problem. We, the industry—particularly the MBA, and lately CMSA—have a track record of task-force effectiveness. Some examples of prior success include the first CRE bankruptcy reform legislation, lobbying the American Council of Life Insurance for new life-company mortgage investment rules, standardized servicing reporting, ratable documents, accounting for CMBS and so on. Let's be proactive for the benefit of our industry and the public.

■ Promote sound asset management at the property level by owners, servicers, investors and managers. When capital liquidity depresses values, the intrinsic value of the property remains relatively unchanged

when maintained properly. Therefore, the right strategy is to strongly focus on maintaining that value and wait for the return of liquidity to maximize value. We should manage assets intensely and focus on value added and net present value analysis.

■ Develop public recognition of the emerging professional standards within the commercial real estate industry—i.e., CMB [Certified Mortgage Banker], CRI [Chartered Realty Investor]. Until recently, the CRE industry was viewed by institutional investors as a local insider business, without transparency or accepted standards for data, disclosure and ethics. The capital market infrastructure has altered that perception considerably. This out-

*"We have been found guilty by association in regard to the residential crisis, and need to rally the industry to be proactive."*

come has enabled us to attract institutional capital worldwide, something heretofore unavailable to the CRE industry. We must continue to enhance this trend and ensure that the global investing public has full trust in our business practices. Without this trust, we will struggle to attract capital from the non-participant institutional sources that have driven the marketplace for the last decade.

■ Analyze the market mechanisms to update or build in more checks and balances to ensure investor confidence in our ethical and professional standards of practice. This will ensure that investors can rely on the accuracy of the data they use to make investment decisions.

■ Create forums and discussion groups within membership constituencies. Focus on those things we can do to improve performance and reporting at the property level, which is the foundation of our industry and the future of the CRE capital market. After property market fundamentals, cost of capital is the most important component of the real estate investment decision. Accurate and plentiful data on the property markets and their trends will become even more important.

**Q:** *Where is the CRE industry headed over the next few years, and what structural changes can we expect?*

**A:** I believe we are entering a new phase for our capital market, and that will likely affect the practices of CRE investors and their mortgage bankers.

The major prior phases include: The Design Phase of 1980 to 1988, which laid the foundation and established the need for a functioning CRE capital market. The Engineering Phase of 1990 to 1993 created the mechanics of the capital market infrastructure and set the stage for the Manufacturing Phase of 1994 to 1996. With the Manufacturing Phase, we went to full production of CMBS and permanently established a fully functioning capital market for CRE debt instruments. We moved into the Recycle Phase in late 1997, as the market began to provide capital and liquidity to support the recurring life spans of typical CRE investments. The international debt crisis of 1998 caught some investment banks off-guard, but the impacts were short-lived and our market moved forward, essentially uninterrupted until the subprime crisis began to spill over in late 2007.

Without rehashing all the details in the evolution of the CRE capital market, let's just say that all the goals were met except one—the risk-rating of individual whole loans. Pooled LTVs, DSCRs [debt-service coverage ratios] and multi-tenant real estate were substituted for whole-loan risk ratings, and single-tenant and specialized properties were waved aside into the private-placement and portfolio markets.

With the maturation of the CMBS market, we have created a well-oiled machine that runs on capital, and that capital has suddenly become restricted and more costly. Given the current regulatory environment, in the near future we may not have the open access to capital we once had. It may be that domes-

tic capital will prove sufficient to handle the demand—but if not, we will have to think globally.

A lot of U.S. dollars are in foreign banks looking for better returns than are available from U.S. Treasuries. CMBS markets may have their problems to sort out, but I would submit that these securities are generally less volatile and risky than your typical alternatives in the equity markets and in some other fixed-income markets.

Foreign investment is a material component of the CRE debt and equity markets, both public and private. If the CRE markets remain stable and the industry enhances the trust of global money managers, there is reason to believe they will see opportunity in our markets and invest accordingly.

To enhance our attractiveness to any source of capital, we must make available facts, data and informed analysis about our CRE markets. To borrow from the stock market, alpha and beta tabulations on a whole-loan basis may be in our future. Commercial real estate finance is an essential component of our national economy and a major contributor to its well-being.

**Q:** *What do you think market participants should do right now?*

**A:** When the capital markets finally adjust and settle back down, market liquidity will price the business risk associated with owning commercial real estate and their debt instruments at the appropriate level. Only the effects of the 1990–1992 cycle lasted longer than two years, and several companies and individuals actually prospered during that time.

Having solid core assets is the fastest, and finest, recovery tool we can possibly have. Be a real professional—not only with your capital sources, but also with your borrowers. Keep asset management and reporting quality as the highest priorities in both relationships.


For the most part, we are not responsible for this credit event, so let's not be a victim of it. Don't isolate yourself. Participate in industry forums and events, stay informed about the capital markets and pass along that knowledge to your clients. Build your professional skills and expertise. Be ready for the turnaround when it comes, albeit at lower levels initial than 2007.

Commercial real estate is in decent shape. It's our capital market that supports (or controls it) that is having a struggle, just like during the 1980–1982 era. In the past we have altered the business model after every cycle, but I don't think we will this time. Let's take this opportunity to improve our current model and infrastructure. The capital will return. Remember, our population growth rate is approximately 1.1 percent per year. That level of growth dictates an underlying national demand for all the jobs, homes, stores, offices and everything else humans can occupy or use, equal to, say, the population of Atlanta every year.

My final advice: Stay in the market until 2010. **MB**

*“With the maturation of the CMBS market, we have created a well-oiled machine that runs on capital, and that capital has suddenly become restricted and more costly.”*

# Value Investing Opportunities in Legacy CMBS

 Hartland Realty Advisors, LLC  
c/o McCary Stevens Associates, Inc.  
750 Main Street  
Hartford, CT 06103  
860-761-1000

## 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 leads many to believe delinquencies will increase in the future. Consequently, pricing of lower level AAA rated bonds (rating at issuance), otherwise known as “AJ’s”, have moved from 100% of face value in April 2007 to a low of 20% of face value in March 2009 and back up to 32% in July 2009. BBB rated bonds have moved from 96% of face value in April 2007 to a low of 6.5% in May 2009 and back up to 7.0% in July 2009.
- **CMBS bond yields have increased dramatically since the summer of 2007.** AJ’s recently trading at a discounted price of 32% produced a yield to maturity of approximately 25% (before losses). BBB bonds recently trading at a discounted price of 7.0% produced a yield to maturity of approximately 95% (before losses).

### 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:

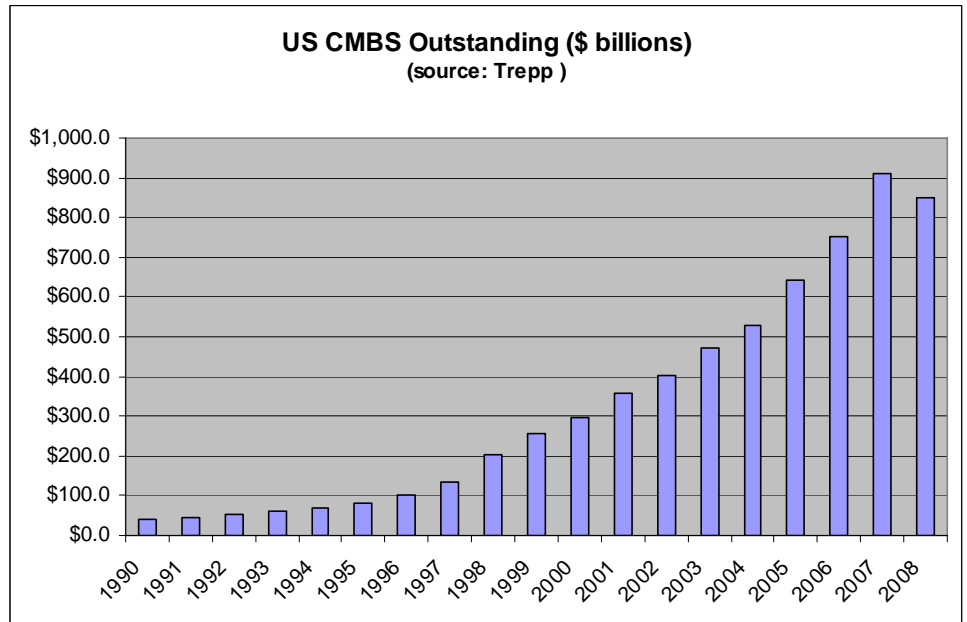
- **Independent, Buy Side Credit Culture:** Hartland's principals are experienced, insurance company trained, buy-side commercial mortgage underwriting and due diligence professionals. They formed their own independently owned company in 1993 (McCary Stevens Associates, Inc.) and have been providing 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 ten full-time underwriters each have between 15 and 30 years experience in the commercial real estate industry (see biographies below).
- **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

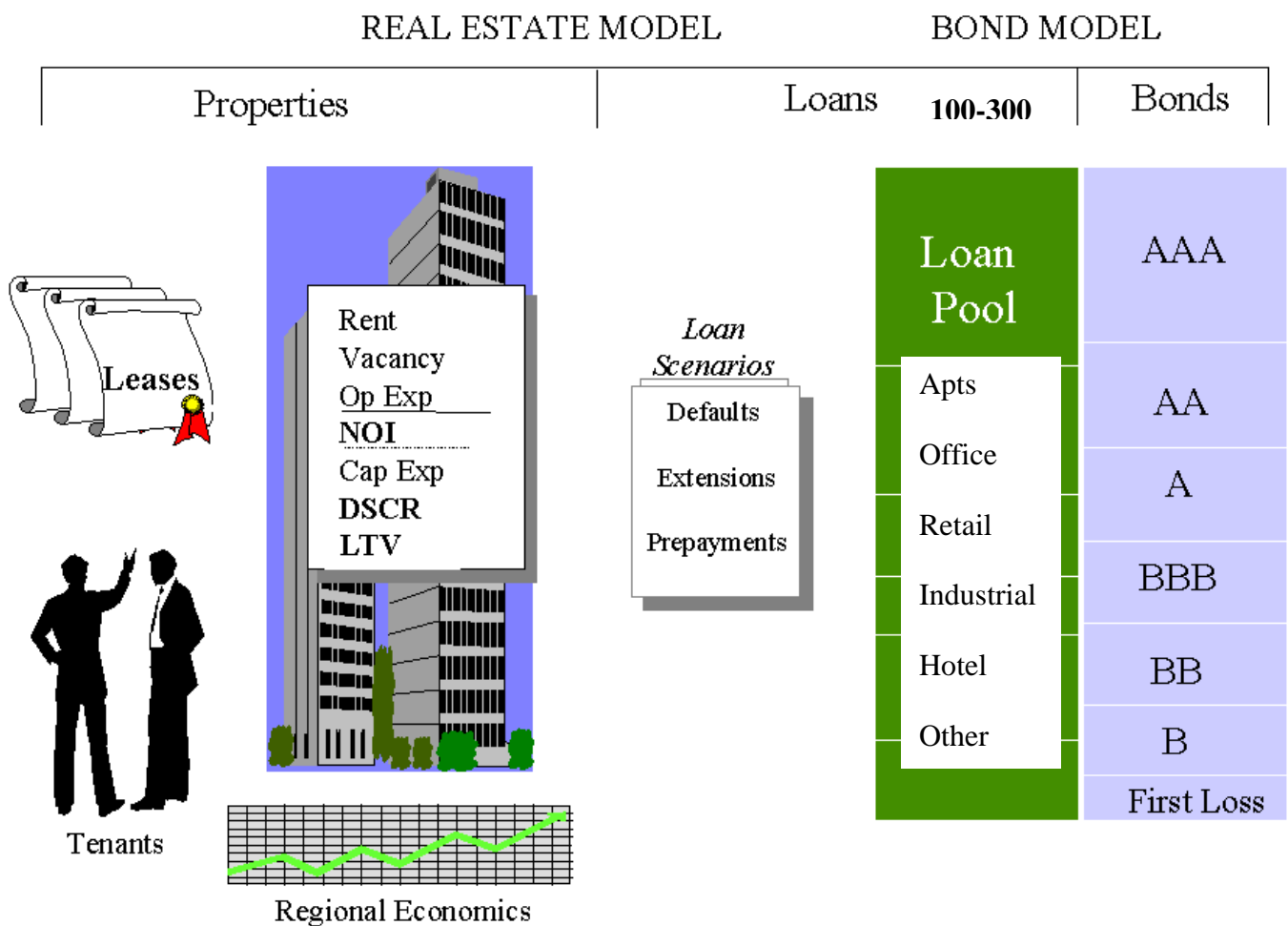
- The issuance of CMBS increased dramatically over the past 10 years and a liquid secondary market developed.
- The credit crisis, however, has reduced new issuance to zero and lowered liquidity across the secondary market. While this environment provides better investment opportunities to investors, 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

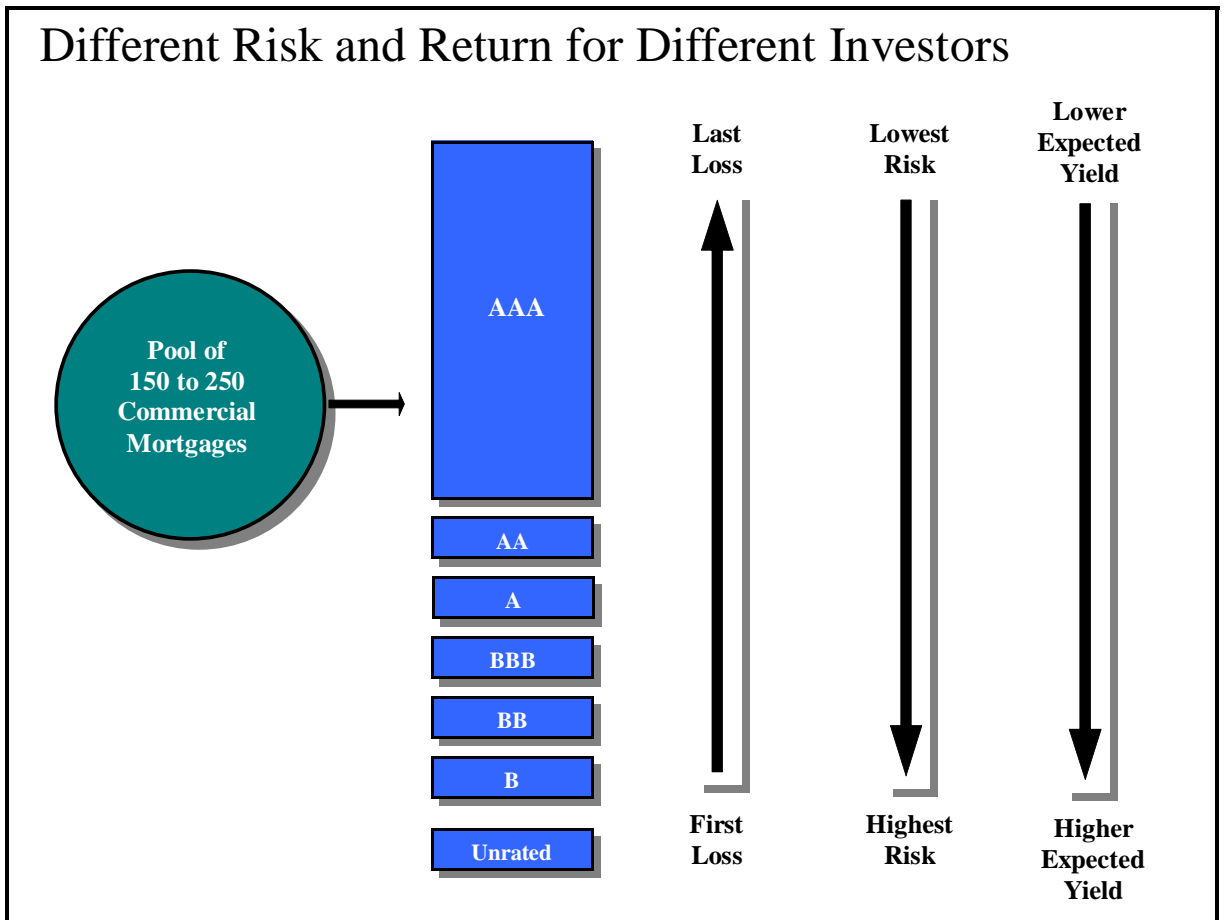
### CMBS Collateral Diversified by Property Type, Location & Borrower



(Source: Trepp)

## Chart C

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

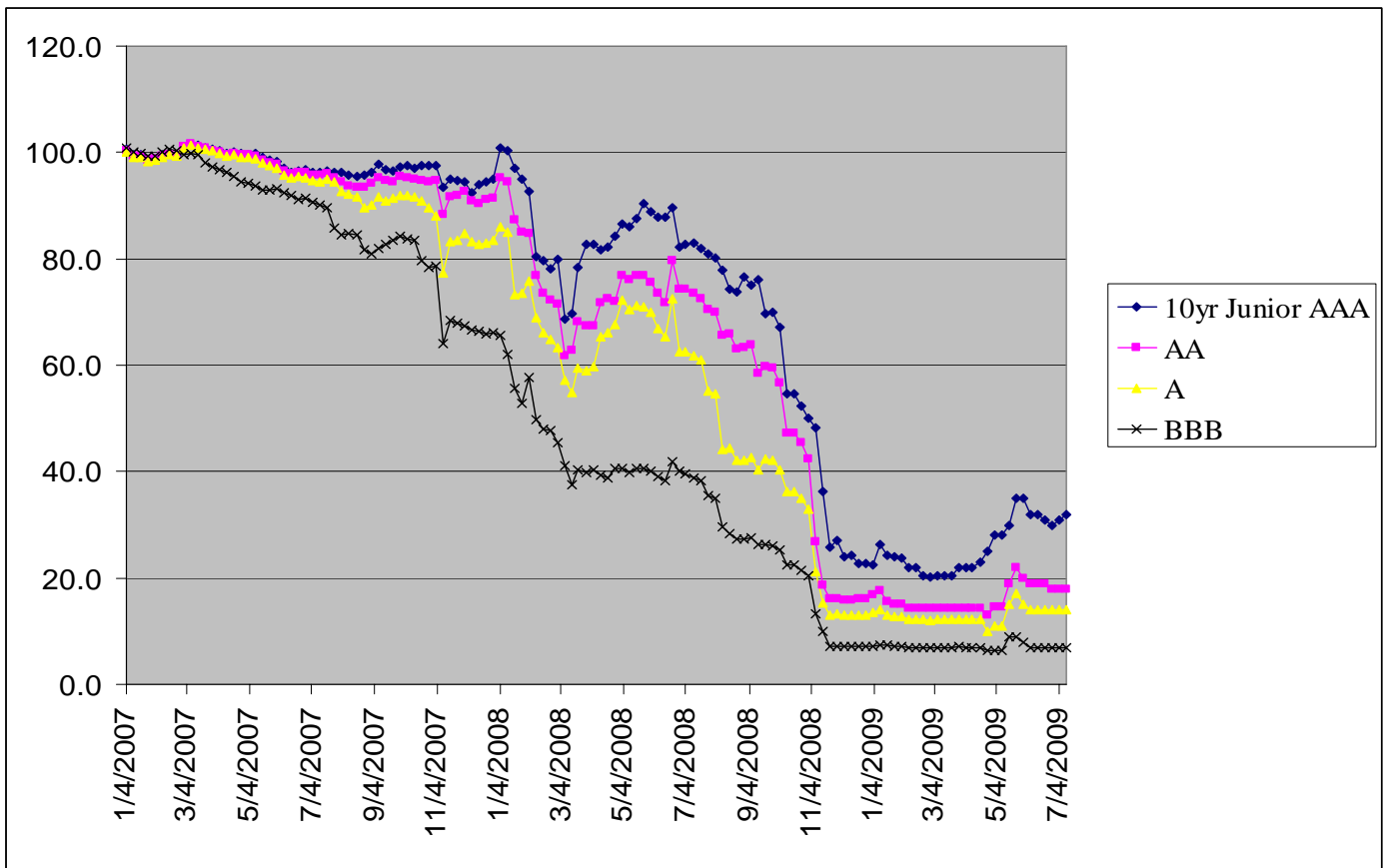


(Source: CMSA)

## 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

### **Richard Burton – Partner**

Partner of Hartland and MSA, joined 13 years ago in 1996. Mr. Burton has over 20 years of commercial real estate experience. Prior to MSA, he spent 10 years with Aetna's real estate department originating and underwriting commercial mortgage loans. He also was a commercial mortgage loan workout specialist actively managing a \$450 million problem loan portfolio, negotiating loan restructurings, initiating foreclosures, managing litigation during foreclosure and bankruptcy, testifying in court and directing property receivers. Mr. Burton also worked in the property management area managing wholly owned and foreclosed properties. He directed the foreclosure takeover and management of these properties, and negotiated and / or managed the negotiation of over 1.2 million square feet of leasing in these properties. In addition, he managed the successful sale of numerous properties, designed and directed construction redevelopment projects, negotiated settlements with tenants in bankruptcy, and designed and implemented a property reporting format for all on-site property managers. Prior to his real estate experience, Mr. Burton spent 9 years as an active duty Coast Guard Officer after graduating with a BS in Computer Science from the Coast Guard Academy (1976). His duties included being Assistant Professor at the Coast Guard Academy teaching Strategic Planning, Accounting and Finance. Mr. Burton received his MBA with High Honors from the University of Connecticut (1982).

### **Robert Buscher**

Mr. Buscher joined Hartland and MSA 8 years ago in 2001. He has over 20 years of commercial real estate experience. Prior to joining MSA, Mr. Buscher was a real estate advisor to various insurance, industrial and financial companies including Continental Wingate, United Technologies and The Hartford insurance company in the areas of loan underwriting and lease management. Mr. Buscher also worked at the Boston branch of Criimi Mae where he helped establish a regional underwriting office and oversaw the production and approval of over \$150 million of commercial mortgage loans. Mr. Buscher began his real estate career at MassMutual, where he spent fourteen years including mortgage loan closing and servicing; loan underwriting; research and new product development; equity acquisitions; and management of the Northeastern regional office. Prior to joining MassMutual Mr. Buscher worked as a lawyer in Baltimore/Washington and Western Massachusetts specializing in real estate and housing law. Mr. Buscher earned a BA from The Johns Hopkins University (1970) and his JD from the University of Maryland School of Law (1973).

## Biographies, continued

### **Philip Gonsalves – Partner**

Partner of Hartland and MSA, joined 10 years ago in 1999. Mr. Gonsalves has over 15 years of commercial real estate experience. Prior to joining MSA, Mr. Gonsalves was Vice President in charge of underwriting and operations for QuestCap, a conduit originator / underwriter based in Norwalk, CT. While at QuestCap, the company originated and underwrote commercial mortgage loans for its mortgage banking affiliates network. The network comprised 15 active mortgage banking companies representing 30 different regions across the country. Prior to joining QuestCap, Mr. Gonsalves underwrote commercial mortgage conduit loans for PaineWebber, managed a loan portfolio sale for a national lender and helped manage Aetna's commercial mortgage portfolio loans. He also spent six years with Fleet Bank and Centerbank in their commercial mortgage departments both in credit administration / approval and working out commercial mortgage loans. Mr. Gonsalves began his commercial real estate career with a regional appraisal company, valuing both commercial and residential real estate. Mr. Gonsalves earned his BA from Boston College (1983), and has completed numerous Appraisal Institute courses.

### **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.

## Biographies, continued

### **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.

### **Pamela Peck**

Ms. Peck joined Hartland and MSA 5 years ago in 2004. She has over 30 years of commercial real estate experience including 20 years with Cigna, Connecticut National Bank and Barclays Business Credit, combined. While at Barclay's Ms. Peck originated, underwrote and closed commercial mortgage loans in the Midwest and Southeast. At CNB Ms. Peck performed numerous commercial mortgage loan workouts comprising \$100 million in office, industrial and multifamily properties. At Cigna, Ms. Peck was an Asset Manager responsible for over \$300 million in institutional quality office and industrial properties for Cigna's general and advisory accounts. Ms. Peck began her real estate career in New York City as a paralegal for Shea & Gould preparing documentation for equity and mortgage loan transactions, coordinating closings and handling bankruptcy related issues. While there, she focused on the zoning and architectural issues related to the air rights and successful development of the Helmsley Palace Hotel. From there she went to Schroder Real Estate where she originated, underwrote and closed approximately \$500 million of office and regional mall acquisitions. Ms. Peck completed numerous real estate and accounting courses at New York University in New York City, received Paralegal training at the Institute for Paralegal Training in Philadelphia and earned her BA in Political Science from the University of Colorado (1972).

## Biographies, continued

### **John Saunders, CFA – Partner**

Partner of Hartland and MSA, joined 9 years ago in 2000. Mr. Saunders has over 13 years of commercial real estate experience. Prior to joining MSA, he spent 10 years with Cigna's real estate department. Mr. Saunders purchased, originated, underwrote and closed commercial mortgage loans for Cigna's general account. In addition, he performed numerous commercial mortgage loan collateral reviews assessing property, market and economic risks and assigning individual quality ratings to each loan for total return analysis and risk management. Mr. Saunders also managed a \$350 million equity real estate portfolio for Cigna and its pension clients, for a number of years, coordinating all key property management activities including, leasing, financing, budgeting, capital improvements and disposition. Prior to Cigna, he worked for three years with Aetna Life and Casualty's fixed income group where he managed the department's banking relationships and income collections for its mortgage-backed security holdings. Mr. Saunders is a Chartered Financial Analyst (CFA) and a member of the Association for Investment Management and Research (AIMR). He earned a BA in economics from Bucknell University (1985) and an MBA from The University of Connecticut (1990).

### **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).

## Biographies, continued

### Thomas Taylor, CFA

Mr. Taylor joined Hartland and MSA 7 years ago in 2002. Mr. Taylor has over 25 years of commercial real estate experience with more than 15 years at financial institutions including Aetna Life and Casualty, the Phoenix Companies, and Security Capital. Prior to joining MSA, Mr. Taylor was a Principal of Old Main Street Investors, a private investment, property development, and consulting company. As a principal, Mr. Taylor was responsible for forming partnerships to purchase commercial real estate, primarily apartment complexes, warehouses, and office buildings from institutional sellers. Additional responsibilities included valuing and positioning portfolios of commercial mortgages for sale for several institutional clients. Prior to forming Old Main Street Investors, Mr. Taylor was a commercial mortgage workout specialist for the Phoenix Companies, where his work included restructuring, foreclosing and selling problem loans with an aggregate principal balance of over \$500 million. Mr. Taylor has also worked as an underwriter in the commercial mortgage loan area of Aetna Life and Casualty and as a commercial mortgage portfolio manager for Security Capital Credit Corporation. Mr. Taylor has completed numerous Appraisal Institute Courses and is a member of the CFA Institute. He has a BA degree from Amherst College (1971) and an MBA from the Wharton School (1977) at the University of Pennsylvania.

### Raymond Todd

Mr. Todd joined Hartland and MSA 6 years ago in 2003. He has over 20 years of commercial real estate experience. He spent five years at Chase Manhattan Bank as a commercial mortgage loan officer originating and underwriting commercial mortgage loans primarily out of Chase's Chicago office. Mr. Todd next joined Centennial Development Corp. in Tyson's Corner VA as Vice President of Finance where he managed this commercial real estate development company's financing needs. Todd next joined Cheslock, Bakker Associates, a boutique real estate investment bank in Stamford, CT where he participated in the underwriting and closing of over \$700 million of commercial mortgage loans, which became collateral for various CMBS securitizations. Most recently, Mr. Todd spent six years with Access Management Company, a New Jersey based manager and developer of self-storage properties, where he was vice president of finance. His responsibilities included managing all finance and accounting. While there, he supported the company's growth from six to twelve properties under management. Mr. Todd earned his BA from the University of Pennsylvania (1977) and his MBA from the University of Virginia (1979).

## Contact Information

### ***David McCary, CRI***

Hartland Realty Advisors, LLC  
c/o McCary Stevens Associates, Inc.  
750 Main Street  
Hartford, CT 06103  
(860) 761-1000 x101  
(860) 573-1482, cell  
[mccary.david@mccarystevens.com](mailto:mccary.david@mccarystevens.com)

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## In This Issue:

- CMBS Delinquencies rise.
- Due Diligence Underwriting – As important today as it was in 2003.
- CMBS Loss estimates – A Bottom-Up Analytical Model.

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- CMBS Loss Modeling 3
- CMBS Spreads 3
- Recent Assignments 4

## CMBS Delinquencies Rise Q1 2009

According to Fitch Ratings, loan defaults for CMBS mortgages jumped in the first quarter 2009. The cumulative default rate rose to 3.29% in the first quarter from 2.7% at year end 2008.

In terms of dollar volume, first quarter 2009 defaults represented \$2.6 billion of loans versus \$3.2 billion of defaults in all of 2008.

Fitch expects CMBS defaults to exceed 5% by year end 2009. Specially serviced loans totaled \$23.7 billion at the end of

the first quarter according to Fitch.

A significant portion of the increase in delinquencies has come from later CMBS vintages that reflected higher leverage and looser underwriting standards.

The trend is expected to increase significantly in the second quarter of 2009 due to the bankruptcy filing by General Growth Properties (GGP). 150 properties that are included in various CMBS

issues are part of GGP's bankruptcy filing.

Similarly, Fitch Ratings CDO delinquency index indicated that CMBS CDO delinquencies increased to 7.8% in April 2009 from 6.5% March. More than 75% of all Fitch-rated CDO's have at least one delinquent loan.

Fitch Ratings has placed 137 classes from 19 CMBS CDO's on Rating Watch Negative due to their implementation of revised criteria announced in late 2008.

## B-Notes, Participations, Junior Tranches – Do they have value today?

The commercial real estate financing frenzy that occurred into 2008 led to the proliferation of complex debt instruments including B-Notes, participations and subordinate tranches in highly structured large loan transactions.

These vehicles gave investors a chance to own debt at various levels in the credit stack with generally higher spreads reflecting higher risk in the capital stack.

As the market has weakened, and some of the highly structured loans

are moving closer to default, do these subordinate positions have value?

Each situation is unique and requires a thorough analysis of the underlying collateral, the market as well as a careful reading of the loan documents. Investors in participating and subordinate debt need to know what their rights are and what potential obligations remain in the participation or inter-creditor agreements.

In some cases, it is prudent for the investor to

engage legal counsel to review the relevant documents.

The legal review should summarize the investor's control events, loan cash flow waterfalls, rights in the event of default, outstanding reserves, future funding obligations, etc.

When the loan structure, market, collateral and cash flow are understood, it is possible to reasonably determine a position's value and the potential options available to the investor to maximize the value of their position.



John Saunders, CFA  
Principal  
McCary Stevens Associates, Inc.

## CMBS Due Diligence Underwriting: Helping Investors Make Informed Decisions

*In 2003, McCary Stevens Principal John Saunders, CFA, published this article in CMBS World. Given today's climate, the article is even more relevant today for analyzing all types of commercial mortgages. Excerpts from his article are below.*

***"With downgrades and changing real estate fundamentals, how much collateral credit risk is embedded in your CMBS portfolio?"***



The full article is available on-line at:  
[www.mccarystevens.com/library](http://www.mccarystevens.com/library)

The evolution of CMBS as a vibrant investment sector has brought many changes to the world of real estate finance. A new and expanding investor base, lower cost of capital for real estate owners, and a discipline to the supply of new buildings are a few of the more notable developments.

Less well known is the new application of real estate finance skills known as due diligence underwriting. Due diligence underwriting is focused on collateral credit risk: determining the competitive position of an asset within its market, assessing the quantity and quality of the collateral's cash flow, and determining an asset's ability to generate sufficient cash flow over time to service the mortgage debt.

The underwriter begins the due diligence process by accumulating relevant and current information on the collateral to be reviewed. The loan file should include the relevant third-party reports, current and historical financial statements, current and historical certified rent rolls, loan terms and structure, borrower

information, and the issuer's underwritten executive summary and financial analysis, including a history of the property with the date and amount of the borrower's purchase, and reason for financing.

Next, research must be done to adequately prepare for the site inspection and market tour. The location of the asset, the location of competing properties, and the location of the appraiser's lease comparables are identified.

Information on comparable space for lease in the market is available on many Internet sites. The underwriter will contact local brokers to obtain lease information and market statistics and to gain an understanding of market leasing activity.

The site inspection and market tour is the most critical element of the due diligence process. It enables the investor to see, touch and experience the collateral through the due diligence underwriter. Actual tenants in occupancy are checked against the current rent roll.

An on-site presence allows the underwriter to interview tenant employees, customers and leasing agents for multifamily, hotel, self-storage, and mobile home parks. These interviews are typically basic: "How is business?" "What happened to the tenant next door?" "Who would you say are your direct competitors?" "Do you know who will anchor that new center across the street?" People will often share a surprising amount of important local market information through friendly, patient, and specific questioning.

Due diligence underwriting evolved as a unique group of investors sought to fully understand the collateral credit risks they were taking by investing in CMBS.

Today's investors wouldn't think of buying below investment-grade CMBS bonds without first deploying a team of competent due diligence underwriters to collect, inspect, analyze, and report on the collateral at hand. With downgrades and changing real estate fundamentals, how much collateral credit risk is embedded in your CMBS portfolio?

## CMBS Loss Modeling

CMBS Investors recognize that there will be loan losses over the life of any issue. Traditionally, investment grade buyers used a Constant Default Rate (CDR) analysis while B-Buyers re-underwrote every loan in an issue and assigned specific default assumptions to each loan.

Over time, several “top-down” econometric models were developed for

investment grade buyers. These models provide more time sensitive assumptions but rely heavily on macro economic assumptions.

In an effort to focus loss modeling on the specific real estate asset, McCary Stevens developed a proprietary “Bottom Up” CMBS model. The model considers numerous critical real estate and loan

structural factors that impact loan performance.

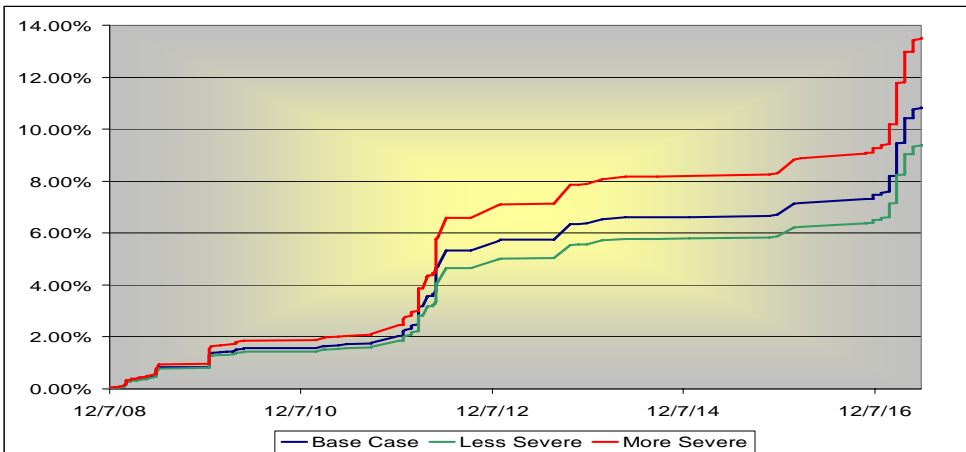
Loan loss assumptions are concluded on each property that can be uploaded into various bond valuation models. It reflects current property performance as well as future default risk events. Each loan receives a unique probability of default, loss severity and timing of the loss.

The timing of the loss for each loan is based on the unique property and loan characteristics for that asset.

By modeling each loan from the “Bottom Up”, a CMBS investor has a comprehensive view of the underlying collateral. The resulting loss projection provides a more detailed insight into the potential critical loss scenarios for each unique CMBS issue.

The “Bottom-Up” loss modeling provides an important complement to the “Top-Down” analysis and allows investors to make better investment decisions.

*Sample Bottom Up loss estimates over time for a specific CMBS issue.*



## CMBS Spreads

CMBS spreads continue to be very wide and have shown very little movement for fixed rate CMBS since Q4 2008.

There has been some tightening of spreads in some of the AAA classes as a result of the recent modification of TALF

financing to longer terms that tend to be found in CMBS issues.

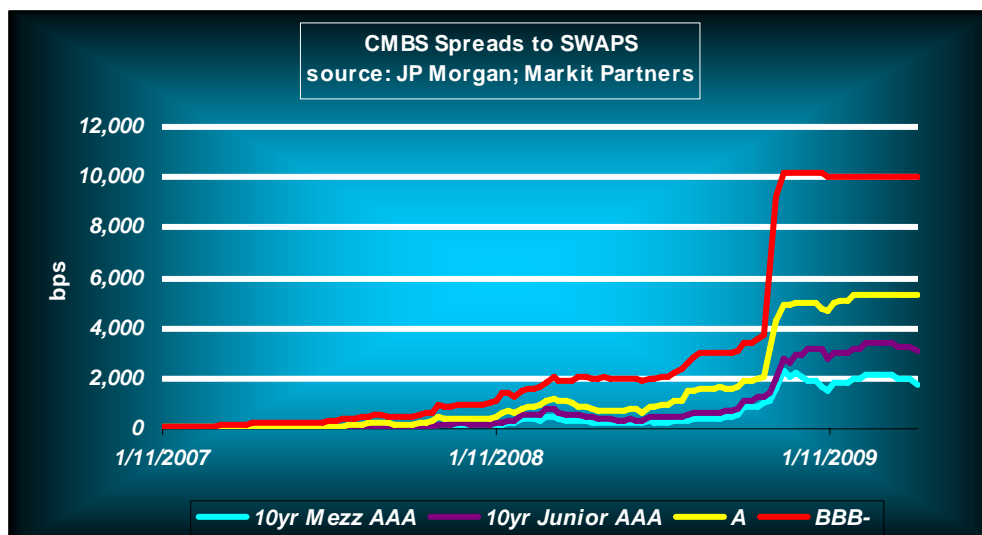
On May 19,2009, it was

announced that certain AAA rated Legacy CMBS assets qualify for TALF.

On May 27, 2009, Standard and Poor’s Ratings Services announced that it was seeking comments on its new CMBS ratings criteria.

Industry sources believe that the new criteria will result in a downgrade to a significant portion of the super-senior AAA bonds that would be eligible for TALF funds.

Junior classes of CMBS, currently not eligible for TALF, remain at close to historically wide spreads.



**McCary Stevens  
Associates, Inc.**  
*Commercial mortgage  
underwriters*



*Providing Commercial Real Estate  
Due Diligence since 1993.*

**750 Main Street  
Hartford, CT 06103**

**PHONE:  
(860) 761-1000**

**FAX:  
(860) 761-1009**

[www.mccarystevens.com](http://www.mccarystevens.com)

**Richard Burton** - ext. 103  
[burton.msa@mccarystevens.com](mailto:burton.msa@mccarystevens.com)

**Philip Gonsalves** - ext. 106  
[gonsalves.msa@mccarystevens.com](mailto:gonsalves.msa@mccarystevens.com)

**David McCary, CRI** - ext 101  
[mccary.msa@mccarystevens.com](mailto:mccary.msa@mccarystevens.com)

**G. Austin Mooney** – 704 541-8862  
[mooney.msa@mccarystevens.com](mailto:mooney.msa@mccarystevens.com)

**John Saunders, CFA** - ext .107  
[saunders.msa@mccarystevens.com](mailto:saunders.msa@mccarystevens.com)

**John Stevens, CRI** – ext 102  
[stevens.msa@mccarystevens.com](mailto:stevens.msa@mccarystevens.com)

**Robert Buscher** - ext 110  
[buscher.msa@mccarystevens.com](mailto:buscher.msa@mccarystevens.com)

**Pamela Peck** – ext 115  
[peck.msa@mccarystevens.com](mailto:peck.msa@mccarystevens.com)

**Tom Taylor** - ext 109  
[taylor.msa@mccarystevens.com](mailto:taylor.msa@mccarystevens.com)

**Ray Todd** – ext 112  
[todd.msa@mccarystevens.com](mailto:todd.msa@mccarystevens.com)

## Recent Assignments

McCary Stevens Associates, Inc. (MSA) is an independent Commercial Mortgage underwriting and consulting firm.

Since inception, MSA has analyzed over \$50 billion in commercial real estate assets for its clients in all major and most secondary markets nationwide.

MSA's clients have included some of the largest financial institutions in the country including: Allied Capital; American Capital; CIBC; CIT; Citigroup; Five Mile Capital; JP Morgan; ING/Clarion Capital; Midland Loan Servicing; Merrill Lynch; RBS Greenwich Capital; Wells Fargo Bank; and, UBS.

MSA has recently completed the following assignments:

- Site inspected, updated local market data and developed a market proforma for over 1,100 properties collateralizing securitized loans in 15 CMBS Issues in a 60 day timeline.
- Reviewed loan files, updated market data, re-underwrote with cash flow projections and presented asset resolution strategies for an \$800+ million nationwide portfolio of first mortgage loans, construction loans, B-Notes and Junior Participation loans.

## About McCary Stevens Associates, Inc.

McCary Stevens Associates, Inc. (MSA) has been providing institutional clients a broad range of commercial mortgage underwriting, due diligence and loan advisory services since 1993.

We are experienced and seasoned commercial bank and insurance company trained loan officers with a strong credit culture.

Our services help our clients analyze, invest in, and manage their real estate loans and loan portfolios.

Our services include the following:

- Loan Portfolio Review
- CMBS Bond Analysis
- Loan Portfolio Strategic Planning and Analysis
- Problem Loan Workout
- Executive Loan Review
- REO Management
- Loan Underwriting
- Asset Management



**McCary Stevens Associates, Inc.**

**Real Estate Lending Advisory Services  
Commercial – Condominium – Residential**

**McCary Stevens Associates  
750 Main Street, Suite 1308  
Hartford, CT 06103  
860-761-1000**



# McCary Stevens Associates, Inc.

## Our Company

**Background:** Founded in 1993 and located in Hartford CT, McCary Stevens Associates, Inc. is one of the most highly regarded loan advisory service companies in the country providing a broad range of services to analyze and manage different types of real estate loans, loan portfolios and CMBS bonds. McCary Stevens avoids conflict by providing independent loan advisory and analysis services to loan originators and CMBS bond investors on a fee for service basis only. All employees are senior real estate professionals with significant real estate and lending experience. McCary Stevens is an employee owned qualified small business and also a veteran owned business.

**Employees:** McCary Stevens is known as one of the most experienced, reliable and stable real estate loan service companies in the country. We have a staff of 10 full time employees. Each staff member has between 15 and 30 years of real estate investment experience. We also have 6 part time consultants with similar experience. The full time staff at McCary Stevens has been very stable. All employees have been with McCary Stevens between 5 and 15 years. There has been no employee turnover over the past 5 years.

**Experience:** McCary Stevens brings a depth of experience rarely found in professional real estate loan advisory companies. Its staff has been trained at leading commercial mortgage lenders including Aetna, Cigna, JP Morgan, and Citicorp. All have expertise in different types of complex loan transactions. Several have actively managed problem loans in prior bear markets including the late 1980's and early 1990's. McCary Stevens' staff experience includes:

- CMBS Bond Analysis
- CMBS Loan Underwriting
- Distressed Debt Analysis
- Loan Portfolio Analysis
- Residential Acquisition and Development Loan Analysis
- Loan Underwriting
- Problem loan workout and negotiation
- Real Estate Owned (REO) asset management
- Managing lender foreclosure actions
- Lender litigation management
- Property valuation
- Property acquisition and disposition

**Advisory Services Completed:** Over the past 15 years McCary Stevens has completed real estate loan advisory services on commercial, condominium, and residential land loans totaling more than \$25 Billion. Our real estate advisory services work has taken us to every state and all primary and secondary metropolitan markets in the country. We have provided real estate lending advisory services to some of the largest financial institutions in the country including: Wells Fargo Bank, Citigroup, ING-Clarion, CIBC, Midland Loan Services, Merrill Lynch, J.P. Morgan and RBS Greenwich Capital.



# McCary Stevens Associates, Inc.

## Real Estate Lending Advisory Services:

**Loan Portfolio Review & CMBS Bond Analysis** – Provide a qualitative and quantitative summary analysis of a loan portfolio or portfolio of loans securing a bond by reviewing the underlying real estate characteristics, market conditions and sponsorship strength to estimate the probability of default and potential loan impairment. Given the depth of our past experience in this service, McCary Stevens has developed its own proprietary evaluation methodology to quantitatively assess loan risk within any pool of loans including a CMBS bond.

**Loan Portfolio Strategic Planning** – Provide an overview of the loan portfolio and recommend strategies for liquidation, management, and performance improvement.

**Problem Loan Workout & Management** – Recommend and facilitate the conditions to work out distressed debt. Actively monitor and manage the terms of the workout, report the progress toward restoring the loan to a performing loan status.

**Executive Loan Review** – Review, analyze and deliver an up-to-date qualitative and quantitative analysis of each loan including file review, site inspection, current financial information, market analysis and current cashflow analysis of the property.

**Distressed Debt Analysis** – Analyze a property's ability to service the debt. Include an assessment of the property's competitiveness in the market, strength of sponsorship, market conditions and likelihood of a workout solution.

**REO Management** – Provide oversight of Real Estate Owned foreclosed properties. Implement an investment strategy to maximize investor return, manage the local on-site personnel and provide accurate reporting results.

**Loan Underwriting** – Provide a detailed investigation and analysis of the loan and the underlying asset, coordinating third party appraisal and engineering reviews, collecting and documenting all the necessary financial and supporting documents from property ownership and document the results of the investigation.



# McCary Stevens Associates, Inc.

## **Benefits of Real Estate Loan Advisory Services:**

**Leverage Staff** – McCary Stevens can leverage your internal staff allowing limited internal resources to concentrate on more strategic efforts.

**Add Significant Real Estate Investment Experience to Your Team** – Complex loan assets require an experienced and thoughtful analysis which McCary Stevens can provide with senior real estate professionals.

**Manage Large Volumes of Data** – Complex loan assets have large amounts of data which need to be synthesized, organized and analyzed before a course of action can be decided. McCary Stevens has the skills and experience to incorporate data into a presentation which is easily understood, enabling the client to make an informed decision.

**Bring a Hands-On Approach to the Process** – Our staff can critically inspect the underlying asset, conduct a thorough market investigation and determine a property's competitiveness in the market. We have experience in almost every primary and secondary market in the U.S.

**Solidify and Implement Investment Strategies and Options** – Our critical analysis can be an important part of an effective decision. We also have the resources to manage the decision through to resolution if necessary.

## **Scope of services will be customized to fit specific needs but may include:**

- Identification of loan resolution scenarios
- An analysis to determine relative loan value
- Analyze historical and current property performance
- A historical and projected cash flow analysis
- A thorough property site inspection
- An updated local market investigation
- Interview tenants and borrowers
- Market surveillance
- Tenant lease reviews
- An extensive review of the loan business file
- Review of the loan legal file to identify key business terms
- An on-site Borrower file review
- Tenant analysis
- Management and review third party reports
- Selection and management of local property manager
- Foreclosed property asset management through disposition



# McCary Stevens Associates, Inc.

## Client List

Over the past 15 years, McCary Stevens has served a long list of clients. Our goal with each of our clients is to provide the highest level of service, helping each client leverage its internal resources. Some of our clients have continuously relied on our services in order to keep their internal staffing at lower levels. Some of our clients have used our services for specific projects which required additional staffing. Our list of clients, both past and present, include:

<b>Allied Capital</b>	Client since 2001.
<b>American Capital Asset Strategies</b>	Client since 2005.
<b>CIBC</b>	Client since 2002.
<b>Citigroup</b>	Client since 2003.
<b>Countrywide Commercial</b>	Client since 2005.
<b>Five Mile Capital</b>	Client since 2007.
<b>GMAC</b>	Client since 2001.
<b>ING-Clarion</b>	Client since 2003.
<b>JP Morgan Bank</b>	Client since 2003.
<b>Merrill Lynch Capital Markets</b>	Client since 2001.
<b>Midland Loan Servicing</b>	Client since 2006.
<b>Morgan Stanley</b>	Client since 2003.
<b>RBS Greenwich Capital</b>	Client since 1999.
<b>UBS</b>	Client since 1999.
<b>Wachovia</b>	Client since 2004.
<b>Wells Fargo Bank</b>	Client since 2004.

## Selected List of Completed Projects

Below are selected major projects and/or extended working relationships we have had with various clients over the years and a summary description of the services provided. This is representative of the types of services provided and is not all inclusive.



# McCary Stevens Associates, Inc.

**Project Title:** **CMBS Subordinated (B-Piece) Loan Review & Analysis**

**Project Description:** Executive review, site inspection and analysis on more than 1,000 commercial loan assets in 16 CMBS Bond pools over a 4 year period for one client and more than 700 commercial loan assets in 30 CMBS Bond pools for another client. The investor/clients purchased newly formed CMBS bonds at various times. The loan and asset analysis was used to assess the potential default risk of each underlying asset and highlight loans which were at a greater likelihood of future default. These higher risk assets were often excluded or their value discounted from the CMBS bond. The commercial properties reviewed included various loans throughout the country and included all commercial property types. The scope of services included: a) review of each property including site inspection, b) local market analysis and local broker interviews, c) stressed re-underwriting analysis, and d) summary analysis of each property's strengths and weakness.

**Turn Around Time and Staffing Level:** Project Manager and as many as 14 senior level underwriters. Each bond analysis was required within a 20-30 day turnaround timeframe.

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**Project Title:** **CMBS Individual Loan Underwriting**

**Project Description:** 109 commercial loans underwritten over a 4 year period for one client, 175 commercial loans underwritten over a 3 year period for another client and 55 loans for another client over a 5 year period. Clients originated loans for sale into CMBS bond securitizations. Loans involved office, retail, apartment, and hotel property types located in various markets throughout the country. Loan sizes ranged from \$5 million to \$100 million. The scope of services included: a) review and analysis of all property financial statements, leases and sponsorship financial statements, b) site inspection of the underlying property, c) coordination and review of third party appraisal and engineering reports, d) assessing the market conditions and competitiveness of the property, e) analysis and review of sponsorship financial and credit strength and f) preparation of presentation report to investment committee which included a detailed report of all findings. Each loan assignment required constant client coordination and discussion as materials were delivered and reviewed.

**Turn Around Time and Staffing Level:** Project Manager and 6 senior level underwriters, each working at various times. Each loan required 50-100 man-hours over the course of a 30-60 day time period. As many as 10 loans were processed at any one time.



# McCary Stevens Associates, Inc.

**Project Title:** **CMBS Bond Review & Analysis**

**Project Description:** Executive review, site inspection and market analysis of 1,134 securitized loans in 15 different CMBS Bond pools. The investor/client wanted to execute a strategy to analyze existing CMBS bond instruments for possible investment. Properties secured various commercial loans throughout the country and included all commercial property types. The scope of services included: a) review of each property including site inspection, b) local market analysis and local broker interviews, c) determination of a market proforma, and d) summary analysis of each property's strengths and weakness.

**Turn Around Time and Staffing Level:** Project Manager and 14 senior level underwriters, each working at various times throughout the project. Project required an estimated 10,000 man-hours and was completed in 60 days.

---

**Project Title:** **Commercial Loan Review**

**Project Description:** Reviewed over 150 commercial loans for inclusion onto a line of credit funded by another institutional lender. Loan assets were continuously included and removed from the line of credit. The scope of services included: a) review of each previous loan underwriting, b) an update on the performance of the property to date, c) determination of an in-place proforma, and d) summary analysis of each property's strengths and weakness.

**Turn Around Time and Staffing Level:** Project manager and 3 senior loan underwriters at various times throughout the contract period.

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**Project Title:** **Residential Land Development & Condominium Loan Review**

**Project Description:** Executive file review of 29 underperforming residential and condominium loans mostly located in Florida, California and Nevada. Project had a one-week turn around requirement. The investor/client needed to understand the potential loss reserve requirement for each loan. The scope of services required an executive summary report for each loan which included: a) a historical outline of the loan since original loan closing, b) market description and analysis, c) local market participant interviews, d) estimate of market value of the underlying asset and potential loss reserve, e) identify key risk factors which could impede an orderly disposition of the asset.

**Turn Around Time and Staffing Level:** Project manager and 7 senior underwriters. Project had an accelerated delivery schedule with a one-week turnaround requirement.



# McCary Stevens Associates, Inc.

## Company General Info:

McCary Stevens Associates Inc.	NAICS Codes: 522292
750 Main Street, Suite 1308	522294
Hartford, CT 06103-2714	525990
Telephone: 860-761-1000	531390
	SIC: 6531
State of Incorporation: Delaware	6162
DUNS: 879261030	Government Small Business Classification: Veteran Owned

## Company Organizational Chart:

The company consists of 6 shareholders (Principals) and 4 staff employees (Associates). David McCary and John Stevens founded the company and are considered senior principals. David McCary is responsible for overall operation of the company including overall strategic planning, human resources, data systems support, product quality control and all other administrative functions. John Stevens is responsible for the corporate financial administration. Richard Burton, Philip Gonsalves and John Saunders are primary client managers each responsible for several client relationships. The reporting relationship within the company adjusts with each assignment.

<b>David McCary, CRI</b> <b>President</b> <b>Principal</b>	<b>John Stevens, CRI</b> <b>Secretary, Treasurer</b> <b>Principal</b>
------------------------------------------------------------------	-----------------------------------------------------------------------------

<b>Richard Burton</b> <b>Principal</b>	<b>Philip Gonsalves</b> <b>Principal</b>	<b>John Saunders,</b> <b>CFA</b> <b>Principal</b>	<b>Austin Mooney</b> <b>Principal</b>
-------------------------------------------	---------------------------------------------	---------------------------------------------------------	------------------------------------------

<b>Robert Buscher</b> <b>Associate</b>	<b>Thomas Taylor,</b> <b>CFA</b> <b>Associate</b>	<b>Raymond Todd</b> <b>Associate</b>	<b>Pamela Peck</b> <b>Associate</b>
-------------------------------------------	---------------------------------------------------------	-----------------------------------------	----------------------------------------

## Client Management:

Each project is client-managed by a Principal of the company. The client-manager is responsible for coordinating with the client, McCary Stevens staff management, and overall project performance. Larger projects are managed by a senior client-manager and a back-up client manager to ensure continuity in all aspects of the project.



# McCary Stevens Associates, Inc.

## **Company Financial Strength:**

McCary Stevens is employee owned and has been in operation since 1993. The company has no debt and sufficient cash reserves to ensure continuous operation. The company prepares confidential annual financial statements which are available upon request.

## **Company Facilities:**

McCary Stevens occupies 4,000 sf at 750 Main Street, Hartford CT. The building is multi-tenanted and McCary Stevens has been in occupancy since 2000. Access to the McCary Stevens space is via a secure key pad entry system. Each employee has their own unique code which can be tracked upon entry. The offices include two conference rooms, common production areas and 19 workstations. Two computer servers are located in two separate key pad secured closet areas. A 75 square foot secured data storage room is located within the space as well which has its own secure key pad entry lock.

## **Company Equipment:**

McCary Stevens operates a Windows based Small Business Server network with built-in redundancy for both Internet connectivity and file serving. There are two servers connected to 20 client PC's, all behind 2 state-of-the-art Sonicwall firewalls. Virus protection is provided by a state-of-the-art service provider, Computer Associates. Our in-house Microsoft Exchange email server is protected by an email firewall service provided by Reflexion. All printers are networked and reside behind the firewalls.

## **Data Security Standards:**

McCary Stevens has developed and complies with the Information Security Policy ISO/IEC 17799 Information Security Standards. The security policy includes classifying information and data, controlling access to information and systems, processing information and documents, purchasing and maintaining commercial software, securing hardware, peripherals and other equipment as well as other related security measures.

## **Internal Security:**

Servers and Workstations are protected by CA Business Protection Suite which provides protection against virus and spyware as well as strengthening Microsoft's built in firewall protection. McCary Stevens uses a Microsoft Small Business Server 2003 as a primary domain controller, Intranet web server and Exchange email server. A second server is used as the internal file server and is only accessible remotely using an encrypted VPN Tunnel. Shares on the internal file server have adequate permissions to allow only authorized access. Domain based passwords contain a mix of random characters and numbers.

## **Perimeter Security:**

Email is additionally protected by a Reflexion server that prevents spam and email viruses. This functions as an edge server by only processing email that has been screened onto the local Exchange server. Two SonicWall Firewalls provide enhanced packet filtering rules and failover services which include perimeter security services, such as Intrusion Prevention, Gateway Antivirus and Antispyware. Additionally a SonicWall SSL-VPN device has been installed to allow for finer control of resources over an SSL-VPN connection.



# McCary Stevens Associates, Inc.

## **Disaster Recovery:**

Data is backed up to on-site external hard-drives behind security doors and an off-site location over a secure, encrypted VPN tunnel.

## **Monitoring:**

The network is monitored remotely for intrusion attempts and performance issues 24/7. Notifications are sent via email, cell phone and fax to report various conditions that may affect availability or security.





# McCary Stevens Associates, Inc.

**Employee Name** John M. Stevens, CRI

## Employment History

McCary Stevens Associates, Inc. Principal 1993-Present  
Hartford, CT

- **Co-Founder** – started McCary Stevens with focus on commercial mortgage origination and underwriting services. Commercial mortgages underwritten through Q3 2008 total \$25 billion.
- **Treasurer** – responsible for corporate financial, strategic, human resources and other services.
- **Senior Commercial Mortgage Loan Underwriter** for CMBS conduit lenders and CMBS Bond investors. Completed executive review, site inspection and analysis on over 250 properties totaling more than \$2 billion throughout the United States for a variety of clients. Underwrote newly originated conduit loans exceeding \$500 million involving all commercial property types.

Aetna Realty Investors, Inc. Vice President 1978-1993  
Hartford, CT

- **Regional Manager** – Lead real estate origination and underwriting for the West Coast Region (1983-1987) and Mid-Atlantic Region (1987-1993).
- **Production management** – actively lead a regional team and correspondent system to produce high quality loans on a variety of property types including retail, office, multifamily, hotel and industrial ranging in size from \$1 million to \$200 million and totaling over \$4 Billion of commercial mortgage loans.
- **Loan asset management** – actively managed restructuring loans, negotiating prepayments, identifying event risks and developing strategies to mitigate loan losses in portfolio.

State Mutual Life Real Estate Analyst 1975-1978  
Worcester, MA

- **Real Estate Analyst** – responsible for origination and underwriting loans, real estate equity investments, and problem loan workouts in the Southeast Region, plus Chicago and Detroit.

Massachusetts Mutual Analyst 1974-1975  
Springfield, MA

- **Real Estate Analyst** - conducted Real Estate Research demand and supply studies in 15 cities to support lending activities.

US Army Lieutenant 1971-1972  
Ft. Lee, VA

- **Instructor - Army Logistics Management Center** – Taught general management and economics sub-courses in the Senior Logistics Management Development Course offered to senior Department of Army, Department of Defense and military officers.



# McCary Stevens Associates, Inc.

**Employee Name**     **John M. Stevens - Continued**

**Education**

Research Graduate Assistant	Washington University	1971
Master of Arts Degree – Urban Economics	University of Missouri	1971
Bachelor of Arts Degree – Economics	Pittsburg State University	1970

**Professional Associations**

Charter Realty Investors Society, Registered Member (CRI)

**Published**

Co-author, Chapter 10, “The Effect of Aging and Income Transition on Neighborhood Values” in The Effect of Public Policy on Housing Markets, Hugh O. Nourse, D.C. Heath & Company, 1973.





# McCary Stevens Associates, Inc.

**Employee Name**    **Richard Burton - Continued**

**Education**

Master of Business Administration	University of Connecticut	1983
Bachelor of Science Degree Computer Science	U.S. Coast Guard Academy	1976



# McCary Stevens Associates, Inc.

**Employee Name** Philip Gonsalves

## **Employment History**

McCary Stevens Associates, Inc. Principal 1999-Present  
Hartford CT

- **Client Manager** for several large clients including ING-Clarion, Midland Loan Services, Allied Capital, and Merrill Lynch. Client manager activities accounted for at least 40% of the company revenue over the past 5 years.
- **Project Team Leader** on numerous underwriting and due diligence assignments. Coordinated the activities of all McCary Stevens personnel to deliver the product on time and meets client expectations. Projects managed totaled 75 loan pools with over 2,500 mortgage loans and over 150 new loan origination underwriting assignments. Special projects included managing site inspection and re-underwriting of 1,132 commercial loans across the United States in 15 loan pools for a private equity fund and desktop review and re-underwriting of over 700 commercial loans in 30 loan pools.
- **Senior Commercial Mortgage Loan Underwriter** for CMBS conduit lenders and CMBS Bond investors. Completed executive review, site inspection and analysis on over 500 properties totaling more than \$3.5 billion throughout the United States for a variety of clients. Underwrote newly originated conduit loans exceeding \$750 million on over 100 loans involving almost all commercial property types.
- **Company Marketing Director** actively conducting company marketing calls and meetings to solicit new business for the company.

QuestCap, LLC Vice President 1998-1999  
Norwalk, CT

- **Client Manager** for six mortgage banking firms. Company was a consortium of mortgage banking firms that focused on the origination of loans with table funding relationships with various CMBS lenders. Responsibilities included marketing, originating loans, management of the due diligence process, underwriting and approval of loans, closing of the loans and management of the loans through securitization. Network of clients included over 60 originators in twenty offices across the United States.
- **Senior Loan Underwriter** responsible for developing a mortgage sizing and analysis model to screen potential loans for the company. Responsible for structuring and underwriting loans in accordance with funding partners' guidelines.
- **Public Relations Director.** Developed and published a monthly newsletter highlighting underwriting issues, interest rate movements and developments in the CMBS market.
- **Liquidation Manager.** Managed the successful wind down of the company including the orderly disposition of assets and successful closing of all loans under application.



# McCary Stevens Associates, Inc.

## Employee Name Philip Gonsalves - Continued

Paine Webber Underwriter 1996-1999  
New York, NY

- **Senior Loan Underwriter** for the CMBS program. Responsibilities included the initial sizing, structuring and pricing of loans prior to application as well as underwriting loans under application and presenting loans for approval. Underwrote in excess of 100 loans that were approved for funding with an aggregate value in excess of \$200 million.
- **Mortgage Loan Sales Manager** for a third party. Loan sale consisted of 45 loans across the United States with an aggregate balance in excess of \$100 million. The process also included initial file review, valuation of the pool, scrubbing of the files and preparation of investor bid packages. Managed the “war room”.

CenterBank Vice President 1995-1996  
New Haven, CT

- **Manager of the Appraisal and Valuation Department.** Oversaw the valuation of new loan originations and special service assets. Developed various policies and procedures to comply with FDIC directives and regulations. Developed and implemented internal interim valuation models and policies to assist in risk management and reserve allocations.

Fleet Financial Group/RECOLL Management Vice President 1990-1995  
Hartford, CT

- **Manager of the Appraisal and Environmental Services Group.** Supervised a staff of 10 professionals and 5 administrative assistants. Group was responsible for the annual valuation of a 1,000+ property, \$3 billion portfolio on a semi-annual basis. Developed policies and procedures in compliance with FDIC directives.
- **Credit Committee Member** that approved loan restructures workouts and liquidation of loan portfolios.

## Education

Bachelor of Arts Boston College 1983

Numerous Courses and Seminars The Appraisal Institute 1986-1999





# McCary Stevens Associates, Inc.

**Employee Name** John R. Saunders, CFA - continued

## **Education**

Master of Business Administration University of Connecticut 1990

Bachelor of Arts in Economics Bucknell University 1985

## **Professional Associations**

CFA Institute, Charter Holder

Hartford, CT CFA Society, Member

Commercial Mortgage Securities Association (CMSA), Member

## **Published**

“CMBS Due Diligence Underwriting: Helping Investors Make Informed Decisions” *CMBS World*, Volume 5 Number 1 Spring 2003.







# McCary Stevens Associates, Inc.

## Employee Name Robert Buscher - Continued

Massachusetts Mutual Life Insurance, Real Estate 1979-1994  
Springfield, MA Investment Officer

- **Regional Portfolio Manager** - actively managed a 65 property, \$150 million Northeast Regional Real Estate Portfolio.
- **Product Development Manager** - investigated and assisted in the creation of additional Real Estate Investment vehicles including the establishment of a Real Estate Investment Trust as a conduit for the investment of over \$50 million of foreign investment in the United States.
- **Real Estate Loan Underwriter** - negotiated, monitored and closed over \$250 million in commercial mortgage loans. Directed the activities of regional office underwriters and originators as well as in-house counsel.
- **Real Estate Acquisitions Underwriter** - underwrote, negotiated and closed the purchase of over \$100 million of commercial real estate acquisitions for various accounts.

Various Attorney 1973-1979

- **Assistant City Solicitor** for the City of Northampton, MA, handling all legal matters affecting the City.
- **Attorney** in private practice in Springfield, MA handling a wide array of civil and criminal matters.
- **Chief Attorney** for the Landlord/Tenant unit of the Baltimore Legal Aid Society.
- **Legal Services Attorney** at University Legal Services, Washington, DC handling a wide range of civil matters.

## Education

Juris Doctorate University of Maryland 1973  
School of Law

Bachelor of Arts The Johns Hopkins 1970  
University





# McCary Stevens Associates, Inc.

## Employee Name Thomas Taylor- Continued

Aetna Life and Casualty Hartford, CT	Director	1988-1992
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- **Senior Loan Production and Underwriter.** Negotiated over \$300 million of new commercial loans in 1988 and 1989 including Aetna's first loan to a targeted national account.
- **Loan Risk Analysis.** Analyzed the default risk of 30% of the region's mortgage portfolio and implemented exit strategies for loans with a total outstanding balance in excess of \$75 million.

Security Capital Credit Glastonbury, CT	Senior Vice President	1983-1988
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- **Loan Portfolio Manager.** Responsible for profitability of intermediate term commercial real estate mortgage portfolio. Portfolio exceeded 20 loans totaling over \$125 million. Responsibilities included supervising staff of four professionals in credit administration and financial analysis for loan underwriting, sales of loan participations, and administration of watch list and problem loans. Active member of senior staff committee which established company policies and strategies. Directed a team which analyzed company's financial needs, developed the company budget and established financial controls to monitor budget variances.

Barclay's American Business Credit Hartford, CT	Vice President	1981-1983
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- **Regional Manager Loan Production.** Leading loan producer and underwriter. Supervised team of five professionals responsible for loan production and underwriting in the southeastern and Midwestern United States

## Education

Master of Business Administration	The Wharton School University of Pennsylvania	1977
Bachelor of Arts	Amherst College	1971

## Professional Associations

CFA Institute, Charter Holder  
Hartford, CT CFA Society, Member





# McCary Stevens Associates, Inc.

## Employee Name Ray Todd - Continued

The Centennial Companies Vice President 1985-1991  
Tyson's Corner, VA

- **Chief Financial Officer.** Managed all company and real estate financing activities. Underwrote, negotiated and closed over \$750 million in construction and permanent loans. Supported the company's growth from \$150 million to \$500 million in assets in five years. Prepared annual strategic financial plan and budgets for twenty-one properties. Prepared rolling twelve month cash flow forecasts on a quarterly basis to manage corporate financial position.

Butcher & Singer Vice President 1984-1985  
Philadelphia, PA

- **Acquisition Specialist.** Analyzed commercial real estate projects for potential acquisition into tax shelter syndication portfolios.

Chase Manhattan Bank, N. A. Second Vice President 1979-1984  
New York, NY

- **Loan Officer.** Managed borrowing relationships with clients based in Chicago, St. Louis and Kansas City, MO. Established four new lending relationships which led to \$100 million in new bank business. Managed workouts on failed condo-conversion projects. Completed Chase credit training program.

## Education

Master Degree in Business Administration The Colgate Darden School, 1979  
University of Virginia

Bachelor of Art in Business Administration The Wharton School, 1977  
University of Pennsylvania





# McCary Stevens Associates, Inc.

**Employee Name**      **Pamela Peck - Continued**


**Education**

Bachelor of Arts in Political Science	University of Colorado- Boulder, CO	1972
Real Estate Certificate	Institute for Paralegal Training, Philadelphia, PA	1973
Numerous real estate courses	New York University-Real Estate Institute	1973-1980



## CMBS Collateral Analysis

A Bottom-Up, Loan-by-Loan Analysis for CMBS Investors



McCary Stevens Associates, Inc.  
750 Main Street  
Hartford, CT 06103  
860-761-1000  
[www.mccarystevens.com](http://www.mccarystevens.com)

## Overview

MSAnalytics provides investors with a comprehensive evaluation of the underlying loan collateral within commercial mortgage backed securities (CMBS) resulting in a projection of individual loan losses over the life of an investment. This gives CMBS investors a more transparent understanding of the cash flow waterfall available to the bondholder leading to better investment decisions.

In the past, investment grade CMBS investors relied on rating agency opinions, macroeconomic analysis and Constant Default Rate (CDR) analysis to assess the risk/return characteristics of CMBS. Below-investment-grade or “B-Piece” investors typically engaged in an extensive re-underwriting of the collateral at origination, which was both time consuming and expensive.

Investors now acknowledge that CMBS buy/sell/hold decisions requires significant collateral and credit analysis. Relying on rating agencies, macroeconomic or CDR analysis simply does not meet their needs and the B-Piece model is too costly.

Constructing an analytical tool that addresses the unique risk/return profile of each and every loan within a CMBS investment represents a significant challenge to many investors due to the cost, time and complexity of the task. Each bond, for example, can have more than 200 individual loans and may include several large and intricate loan portfolios. Evaluating a diversified portfolio of CMBS investments could involve an analysis of thousands of loans. The resources to conduct such an analysis on an investment portfolio, or even on a single trade, would consume significant time and capital.

MSAnalytics is a tool that evaluates the loans and the underlying collateral within CMBS in a cost effective and time efficient manner. MSAnalytics provides investors with greater transparency for their decision making process by utilizing a proprietary bottom-up, loan by loan, property by property methodology that is rooted in commercial real estate underwriting fundamentals. The result is a more granular understanding of the future cash flows available to bond investors.

MSAnalytics was developed by McCary Stevens and is based on its extensive experience in CMBS mortgage loan underwriting and due diligence as well as thousands of hours of research and development time. MSAnalytics can be a critical tool for CMBS investors to identify investments which achieve their overall CMBS investment strategies in a comprehensive, time sensitive and cost effective manner.

## MSAnalytics Process

McCary Stevens has aggregated and compiled publicly available critical loan information on hundreds of CMBS issues including the original Prospectus and its associated Annex A. Current loan and property level information is obtained using Trustee, Master and Special Servicer reporting packages. McCary Stevens consolidates and reviews all data for consistency and coherence. In addition, McCary Stevens regularly conducts its own primary research on commercial real estate markets. Critical loan and property information includes, but is not limited to:

<b>Loan Structure</b>	<b>Property/Market</b>	<b>Loan Performance</b>
Interest Rate	Location	Payment Status
Term	Property Type	Payment History
Payment Schedule	Occupancy Trends	Servicing Status
Reserves	Tenant Concentration	Servicing Commentary
Parri Passu	Tenant Rollover	
Split Loans	Current Cashflow	
Subordinate debt	Current Value	
Cross Collateralization	Demographics	

The critical loan information is evaluated in a proprietary **MSAnalytics** model that evaluates various characteristics of the property, property performance and loan criteria using a methodology developed from McCary Stevens' extensive due diligence, underwriting, and loan management experience. **MSAnalytics** produces a unique risk profile for every loan.

## MSAnalytics Results

The resulting risk profile for each loan includes:

**Probability of Default** – an assessment of the potential default for each loan during its term caused by a number of unique factors. Loans which have been defeased have a 0% Probability of Default while loans with a poor risk profile could be as high as 100%. The key factors in concluding a Probability of Default vary but often involve the following:

- Debt service coverage
- Current occupancy
- McCary Stevens’ underwriters’ market and property knowledge
- Payment status
- Current value
- Tenancy

**Loss Severity** - a projection of the potential loan loss based on specific valuation factors applied to the underlying real estate asset. The key factors in concluding a Loss Severity vary but often involve the following:

- Published loan loss studies
- Refinance sensitivity
- McCary Stevens’ underwriters’ market and property knowledge
- Property value
- Servicer Appraisal Reductions

**Date of Loss** - a determination is made on the projected timing of the Date of Loss for each loan based on a number of factors. The Date of Loss can be any time within the loan term or can extend out to the loan maturity date. The Date of Loss estimate is generally based on the following:

- Loan Maturity
- I/O to Amortizing Payment
- Tenant Rollover
- Debt service coverage
- Servicing Status
- Fully Defeased Loans

## MSAnalytics Expected Loan and Bond Losses

MSAnalytics produces an effective loss for each loan that can be uploaded into a CMBS bond pricing model for bond and cash flow waterfall analysis.

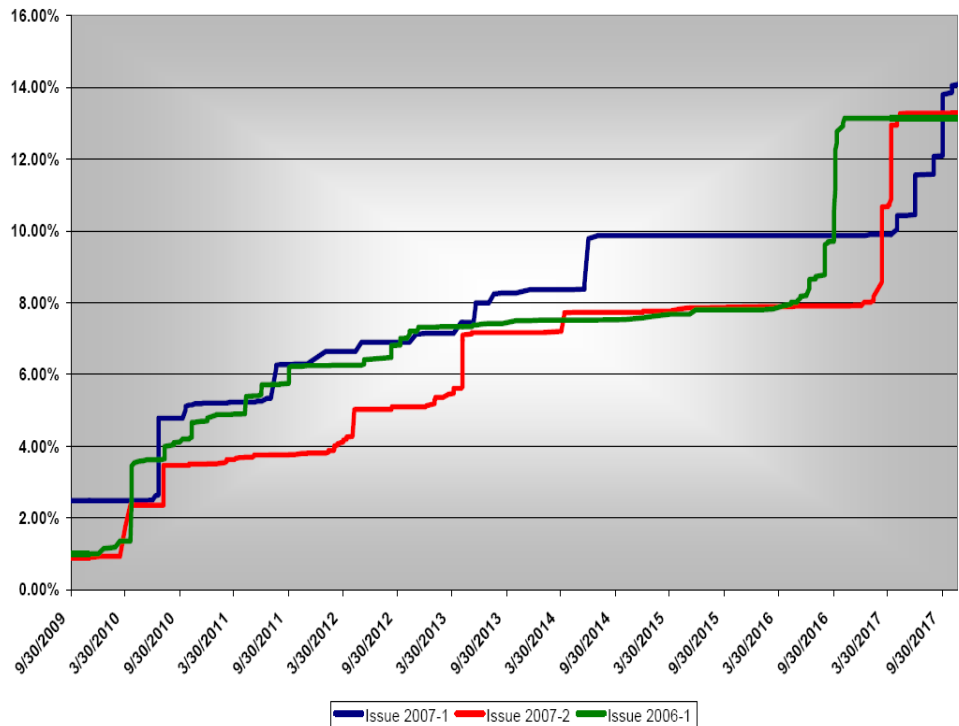
Sample Bond XXXX-2007-1

Loan ID	Property Name	City	State	Prop Type	Probability	Severity	Date	Loss	Balance
1	New York City Office Portfolio	New York	NY	Office	25%	29%	May-09	\$28,830,950	\$394,000,000
2	235 Washington Street	Washington	DC	Office	100%	35%	May-14	\$62,671,350	\$178,500,000
3	2345 East Front Street	Seattle	WA	Office	40%	29%	Oct-09	\$18,585,420	\$161,500,000
4	Bayview Apartments	Atlanta	GA	Apartment	35%	23%	Jul-05	\$10,939,950	\$138,000,000
5	Big Mall USA	Boston	MA	Retail	35%	20%	Apr-17	\$10,673,250	\$150,000,000
6	Boston Financial Center	Walpole	MA	Office	50%	10%	Jun-09	\$6,810,792	\$130,400,000
7	AB River Center	Washington	DC	Retail	35%	32%	May-17	\$12,739,125	\$115,000,000
8	3830 West 82nd Street	New York	NY	Office	80%	51%	Mar-17	\$37,212,448	\$91,000,000
9	Carson Ave	Boston	MA	Office	20%	65%	Aug-17	\$10,348,800	\$80,000,000
10	690 East 9th Street	St. Paul	MN	Office	25%	33%	Jan-09	\$6,332,700	\$76,000,000

## MSAnalytics Expected Loan and Bond Losses Over Time

MSAnalytics produces specific loss timing for each loan that can be rolled up into an expected loss timing schedule for an entire CMBS issue. When plotted on a graph, scheduled losses provide investors with a unique expected loss profile over the remaining term of the CMBS issue. The graph shows three different CMBS issues, one from 2006 and two from 2007, with their cumulative effective loan losses over time reflecting different risk profiles.

MSAnalytics - Cumulative Principal Loss Over Time



## **MSAnalytics Investor Report & Electronic Output**

The results of MSAnalytics are provided in a report summarizing the overall characteristics of the bond's underlying collateral and an Excel spreadsheet file which includes a probability of default, loss severity, and a projected timing of loss for each loan in the CMBS issue. Data can be uploaded from the Excel spreadsheet into various CMBS bond pricing platforms to help formulate appropriate loss adjusted pricing and valuation for various issues. The MSAnalytics electronic output can be customized to meet investor's specific needs.

## **Portfolio Analysis and Bond Pricing Advantage**

MSAnalytics provides investors with a critical tool to differentiate between CMBS issues and their individual tranches. MSAnalytics can quickly provide results on any number of selected CMBS issues allowing investors to analyze various issues, tranches and investment options that best meet their investment objectives.

Investors can use MSAnalytics to determine appropriate CMBS bond pricing when making buy / hold / sell investment decisions. It provides a unique measure of the potential risk/return profile for each investment.

## **Deeper Dive Due Diligence Services**

Investors can separately engage McCary Stevens to complete any number of additional services on selected loans or portfolio of loans to gain even more insight into the risk characteristics of the loan collateral. Additional services are tailored to a clients' needs and due diligence preferences. These services may include re-underwriting loans, market/broker surveillance calls, site inspections or other detailed investigations as appropriate.

## Company Background

Founded in 1993 and located in Hartford CT, McCary Stevens Associates, Inc. is a highly regarded commercial mortgage loan advisory service company providing a broad range of services to analyze and manage different types of real estate loans, loan portfolios and CMBS.

McCary Stevens avoids conflict of interest by providing independent loan advisory and analysis services to loan originators and CMBS bond investors on a fee for service basis only. All employees are senior real estate professionals with significant real estate and lending experience. McCary Stevens is an employee-owned, veteran-owned, qualified small business.

McCary Stevens brings a depth of experience rarely found in professional real estate loan advisory companies with a staff of 10 full time employees. Each staff member has between 18 and 30 years of real estate investment experience.

Over the past 15 years McCary Stevens has completed real estate loan advisory services on commercial, condominium, and residential land loans totaling more than \$50 billion. Our real estate advisory services work has taken us to every state and all primary and secondary metropolitan markets in the country. We have provided real estate lending advisory services to some of the largest financial institutions in the country including Wells Fargo Bank, Citigroup, ING-Clarion, CIBC, Midland Loan Services, Merrill Lynch, J.P. Morgan, RBS Greenwich Capital, Allied Capital, CIT and American Capital.

### Contact Information:

McCary Stevens Associates, Inc.  
750 Main Street  
Hartford, CT 06103  
860-761-1000  
[www.mccarystevens.com](http://www.mccarystevens.com)

Richard Burton	Ext 103	<a href="mailto:burton.CMBS@mccarystevens.com">burton.CMBS@mccarystevens.com</a>
Philip Gonsalves	Ext 106	<a href="mailto:gonsalves.CMBS@mccarystevens.com">gonsalves.CMBS@mccarystevens.com</a>
David McCary, CRI	Ext 101	<a href="mailto:mccary.CMBS@mccarystevens.com">mccary.CMBS@mccarystevens.com</a>
John Saunders, CFA	Ext 107	<a href="mailto:saunders.CMBS@mccarystevens.com">saunders.CMBS@mccarystevens.com</a>
John Stevens, CRI	Ext 102	<a href="mailto:stevens.CMBS@mccarystevens.com">stevens.CMBS@mccarystevens.com</a>