

ADVISOR

Winter 2013

Market Strengthens for Loan Sellers

2012 has been a good year for sellers of Commercial Real Estate (CRE) loans.

Since January, the secondary loan market has experienced rising prices, increasing liquidity, growing investor demand and a narrowing of the bid-ask spread, according to key metrics tracked by DebtX.

“Over the past 12 months, the conditions in the secondary loan market have improved markedly, and that’s been reflected in the willingness of financial institutions to offer loans for sale,” said DebtX Managing Director Kevin Kelley, head of Trading. “A record number of sellers are offering loans at DebtX’s marketplace in the fourth quarter.”

The strengthening of the market has been the result of a variety of factors, including the accelerating recovery in the real estate capital markets, appreciating real estate values, improving economic conditions and continued low interest rates.

Loan Sale Prices Rise

Several price indicators produced in DebtXData, the proprietary analytics platform from DebtX, showed that loan prices were continuing the upward trend that began in mid-2011.

CRE loans in the CMBS universe priced by DebtX have climbed 4.2% between the end of October 2011 and October 2012. DebtX prices more than 50,000 loans in the CMBS universe each month.

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DebtX Study: Sealed Bids Yield Higher Proceeds

CRE loan sale proceeds from sealed bids are 10% to 20% higher than English forward auctions, according to new study from DebtX.

Based on an analysis of non-performing loan sales at DebtX’s marketplace, the white paper, *Sealed Bid v. English Forward Auctions for Non-Performing Commercial Real Estate Loans*, found that a sealed bid generates higher prices because the format leads to outlier offers more frequently.

“DebtX’s research for the first time shows that sealed bids generate higher non-performing loan sale proceeds,” said DebtX Executive Vice President Bruce Hounsell, author of the study. “If maximizing price is the goal, institutions should stop using an English forward auction for non-performing CRE loan sales. A sealed bid format consistently delivers higher proceeds and is a better option for every institution selling a non-performing CRE loan.”

Why English Forward Auctions Fall Short

The study analyzed 401 loan offerings at DebtX’s marketplace for eight quarters from 2010 to 2012. DebtX found that English forward auctions don’t maximize loan sale

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Industry First: DXSyndicate Offers Mobile Access



DXSyndicate®, an integrated deal management platform for syndication and agency professionals, now offers enhanced mobile access and new Covenant Reporting capabilities.

Mobile device users can now access DXSyndicate by logging in online at www.debtX.com/admin with an iPhone, Android, Blackberry or other smartphone or tablet. Mobile users can search and access contact information, as well as bring up investor activity and call notes. Any authorized user with a mobile device can log into DXSyndicate, which is hand-set agnostic.

“DXSyndicate is proud to be the industry’s first syndication platform to offer mobile access,” said Managing Director Geoff Ricks, head of Technology Solutions.

Automated Covenant Reporting Management

DXSyndicate now offers integrated Covenant Reporting Management to centralize, simplify, and automate this Agency function.

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DebtX Case Studies

Top 25 bank sold \$33.5 million non-performing residential/mixed use loan

Seller Goals and Concerns: This top 25 bank held a large, non-performing loan collateralized by a unique residential/mixed use property located in a major U.S. city. Forced to indefinitely classify the loan as a troubled debt restructure, the bank became frustrated by the extended workout period. The bank was also concerned about the property level liability associated with controlling such a large, urban multifamily project.

The bank opted to pursue the sale of the loan in order to free up capital and relieve its lending professionals from tasks and concerns that were not profitable. Aware of the quality and potential of the property, the bank was determined to obtain the highest possible price.

Solutions and Outcomes: DebtX began pursuit of the bank's goals through its commitment to high-quality underwriting and its ability to provide specialized and comprehensive marketing.

DebtX first acquired an in-depth understanding of the property, the neighborhood and the region's real estate trends. Armed with detailed informational materials, DebtX then engaged in an intensive campaign aimed at commercial real estate owners and developers on a local, regional and national level via face-to-face meetings.

Meanwhile, DebtX's underwriting team prepared highly detailed due diligence files. This superior underwriting allowed prospective buyers to gain a clear understanding of the asset and the opportunity.

Final bids were beyond the client's expectation in both number and amount. The loan sale strategies employed by DebtX allowed the bank to move this large single asset off its books at a premium and return to more profitable lending activities.

Super regional bank sold \$75 million mixed performance CRE, C&I and agricultural loans

Seller Goals and Concerns: This super regional bank needed to shed a large portfolio consisting of very diverse assets. The portfolio contained more than 100 small-balance commercial loans of varying performance levels backed by multiple collateral types scattered throughout the United States. These assets had been stuck on the bank's balance sheet for some time without any clear path to resolution.

The bank aimed to reduce its overall level of NPAs in order to free up capital and concentrate on new, more profitable lending. With this goal in mind, the bank was under pressure to sell the entire portfolio at the highest possible price.

Solutions and Outcomes: The pooling strategy typically recommended by DebtX for portfolios of this size and diversity is to create small, homogeneous pools that will appeal to specific relevant buyers willing to pay a premium. However, in order to take advantage of unusual market conditions, DebtX counseled the bank to sell this portfolio in a single pool. DebtX's deep relationships with the top loan and investment funds allowed the trading team to create a uniquely competitive environment for this group of assets.

DebtX employed a transparent, indicative pricing strategy that forced this group of well-qualified buyers to complete full due diligence prior to the final bid. DebtX's underwriting team presented complete, comprehensive and detailed asset-level information, which prompted multiple buyers to remain actively engaged in the sale and drive up prices.

DebtX generated over a dozen final bids, driving every bidder higher than indicative levels. Five of the final bids substantially exceeded the seller's expectation. The sale brought a considerable premium for the bank and every asset was sold. The entire transaction closed within 10 days, having surpassed every goal set by the seller.

Upcoming Loan Sales

\$9 Million
Non-performing residential
loans located in Florida, Illinois,
Indiana and Ohio
Bid Date: December 19, 2012

\$8 Million
Non-performing CRE and office
loans located in Pennsylvania
Bid Date: December 19, 2012



Innovation. Experience. Results.

Loan Sales in Asia

Q&A with Mark Bourgeois, Director

Mark Bourgeois is head of Strategic Accounts and works with Asian financial institutions interested in selling loans.

How are loans sold now in Asia?

In Asia, most transactions are bulk sales. Brokered sales, like the ones DebtX typically executes to maximize loan sale proceeds, are the exception. Asia is actually very different from Europe. Europe is a common market. In Asia, every country has different regulatory, banking, and legal systems, as well as their own currency. The size of Asia is also staggering. It includes the second and third largest economies of the world. You're dealing with a hemisphere, as opposed to a continent.

Describe the markets in Japan and China.

In Japan, you have three megabanks. They are among the world's largest. Then there are 130 or so regional banks, plus a larger number of credit cooperatives, which are like credit unions. Most of these institutions are selling loans, primarily in bulk. Japanese institutions tend to sell more loans after foreclosure proceedings. The loans tend to be larger because the properties are multifamily projects, rather than single-family homes. In China, the banks are active loan sellers. The market consists of privately run banks and government-owned banks, in addition to a variety of hybrids. They're all selling loans to various degrees. They sell them in slightly different ways. The market for Chinese loans is not as developed as it is in the U.S., but there's a strong desire to take what works in the U.S. and apply it there. Transparency is important. Regulators are trying to create exchanges and institute regulations to build transparency. The Chinese market looks like the U.S. loan market a decade or so ago – lots of direct sales, done in bulk, to a relatively small number of buyers. For sellers, it's often paper-intensive and usually a lot of work.

What is the size of this market?

Official NPL ratios do not tell the whole story and yet they have started ticking up in many markets. The banking cycle has turned and the NPL numbers could be getting huge, in China in particular. At the beginning of the year, the official NPL number in China was \$94 billion. Unofficial estimates put the figure at \$2 trillion. Since then, the official numbers have done nothing but go up. In the 2009-2011 stimulus years, Chinese banks put more than \$3 trillion on their books. Each year, the banks expanded their loan books in an amount equal to adding the entire banking system of India—each year! Volumes like that create a sort of “NPL machine.”

What are loans selling for in Asia?

Let's look at a non-performing loan on a multifamily apartment building in the U.S.: We would expect to see that loan trade for 5% to 20% less in Japan and China than the U.S., but perhaps slightly higher in Korea, which is slightly more efficient. In fact, most of the markets in Asia really struggle to be efficient. Japanese regional banks usually sell loans in bulk every quarter or half-year. Sellers call the same three or four investors and give them the price. Then they hope for the best. The bidding's not nearly as competitive as it could be, and a lot of money is left on the table. There is a lot of room for improved transparency, more competition and a process that's fairer and more open to buyers.

Who are the loan buyers?

The buyers are usually local. There are some national buyers and a smattering of regional buyers. They are typically from the same province or country. For example, in China, if you're selling loans in Guangzhou in the Pearl River Delta, you're going to get buyers from that region. That's because sellers market the sales locally and the lack of transparency often scares off everyone else. While local investors are the largest group of buyers, there are also Pan-Pacific buyers, as well as global funds out of Hong Kong and Japan. Western investment banks looking for special situations and various real estate hedge funds are also active from time to time.

How active is the bidding?

It's not. If a loan is marketed well, instead of seeing one or two or three buyers, you may see 10 buyers. But that's not typical. In Asia, the process doesn't work well for most parties on both sides of the transaction. For example, if I manage the credit book and I'm up north in Hokkaido, Japan – an hour-and-a-half flight from Tokyo – very few investors will come all the way up to look. What the bank ends up doing is rounding up the usual suspects. Because the market is so inefficient, the loans sold aren't the ones they want sold. But because of the difficulty in reaching a wide array of buyers, a lot of banks take the easy way out, instead of doing the right thing.

What's the state of online due diligence in Asia?

Unlike the U.S., the process is still very paper intensive. Virtual data rooms are not common. The Korean market is more sophisticated and pumps out more sales as a result. Market inefficiency leads to lower pricing, which leads to more loan workouts. You also get more regulatory forbearance, which only delays the market recovery. What many don't realize is that you can improve recovery rates if loans that go through workout are also sold in the secondary market. Workouts will improve a loan sale. After the workout, you can sell an NPL as an improved sub-performing loan or even turn it into a performing loan.

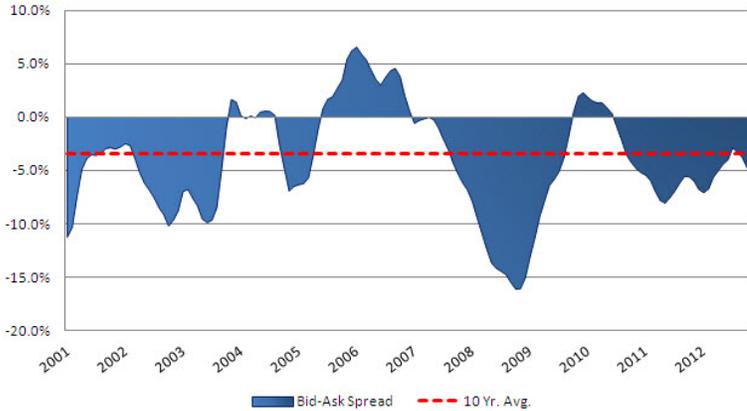
Who is DebtX working with in Asia?

We're talking to many sellers throughout Asia. We expect to see an increasing amount of interest as regulatory forbearance comes to an end in China and Japan. In Korea, banking consolidation will accelerate, and that will result in more sales as banks clean up their consolidated balance sheets. To date, DebtX has turned away a bunch of deals because pricing has been way out of line. But we expect that to change as transparency improves, buyer and seller expectations narrow and the banking cycles continue to turn.

For questions about the loan sale market in Asia, contact Mark Bourgeois at 571.377.8377, mbourgeois@debtX.com.

Market Strengthens for Loan Sellers

DebtX Bid-Ask Index



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For loans traded at DebtX's marketplace, the price gain has been even stronger.

Impaired performing loan prices are up 12.2% year-over-year at the end of October. The weighted average monthly price of impaired performing loans traded at DebtX's marketplace was 79.4% in October 2012, compared to 70.8% in October 2011.

Non-performing loan prices climbed 28.8% year-over-year at the end of October. The weighted average monthly price of non-performing CRE loans traded at DebtX's marketplace was 51.9% in October 2012, up from 40.3% in October 2011.

Meanwhile, marketplace liquidity increased and the bid-ask spread between buyers and sellers was narrowing.

DebtX's Bid-Ask Index in November narrowed by 45 basis points, indicating that the gap between seller and buyer expectations was shrinking, a trend that began in mid-2011. While buyer and seller expectations are coming closer in line, they have not yet returned to equilibrium, where they were in 2010.

Liquidity Index, a monthly barometer of liquidity for pools of loans sold at DebtX, was up 15.8% in October 2012 from a year ago.

"2012 was a good time to sell loans," Kelley said. "Based on DebtX's most current metrics, the end of the year is also looking like a good time to come to market."

For questions about current pools in market, contact DebtX's trading desk, 617.531.3433. To subscribe to DebtXData, call 617.531.3477.

Upcoming Conferences

CRE Finance Council January 2013 Conference
January 14-16, 2013
Loews Miami Beach Hotel
South Beach Miami, FL

MBA's CREF / Multifamily Housing Convention & Expo
February 3-6, 2013
Manchester Grand Hyatt
San Diego, California

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Industry First: DXSyndicate Offers Mobile Access

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"DXSyndicate enables Agency Services to automatically send alerts to external parties, ensuring timely delivery of critical reports," Ricks said. "This frees up Agency staff from the burden of chasing documentation via one-off telephone or email reminders. Our clients love the efficiency of this new functionality."

Show Date	Status	Deal	Report	Internal Contact	Source Contact	Source Phone
2012-06-01	Received/Posted	Air India	Monthly Financials	Lalit Sagar	Sankumar Vignesh	
2012-06-02	Received/Posted	Air India	Year end Financials	Daniel Garcia	Sankumar Vignesh	
2012-06-05	Received/Posted	Air India	Monthly Financials	Lalit Sagar	Sankumar Vignesh	
2012-07-01	Requested	Air India	Monthly Financials	Lalit Sagar	Sankumar Vignesh	
2012-07-02	Requested	Air India	Year end Financials	Daniel Garcia	Sankumar Vignesh	
2012-07-05	Time to Call	Air India	Monthly Financials	Lalit Sagar	Sankumar Vignesh	
2012-07-06	Time to Call	Air India	Yearly Financials	Lalit Sagar	Sankumar Vignesh	
2012-08-01	Not Started	Air India	Monthly Financials	Lalit Sagar	Sankumar Vignesh	
2012-08-05	Requested	Air India	Monthly Financials	Lalit Sagar	Sankumar Vignesh	
2012-09-05	Not Started	Air India	Monthly Financials	Lalit Sagar	Sankumar Vignesh	
2012-10-05	Not Started	Air India	Monthly Financials	Lalit Sagar	Sankumar Vignesh	
2012-11-04	Not Started	Air India	Monthly Financials	Lalit Sagar	Sankumar Vignesh	
2012-12-05	Not Started	Air India	Monthly Financials	Lalit Sagar	Sankumar Vignesh	
2012-12-05	Not Started	Air India	Fiscal Year end Tax	Daniel Garcia	Geoff Ricks	617-555-1212

DebtX has created a streamlined interface to quickly generate reporting schedules per deal. From a single dashboard, a team is able to monitor all reporting tasks, due dates, status, and who the source contact is for each deliverable. This improves covenant reporting timeliness for each deal and across the entire portfolio.

For more information about DXSyndicate, contact Geoff Ricks at gricks@debtX.com, 617.531.3421.

DebtX Study: Sealed Bids Yield Higher Proceeds

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proceeds because of a variety of factors, including shill bids, insider bidding and the assessment of a 5% sales fee to successful bidders in an English forward auction.

The study noted that loan sale proceeds for English forward auctions can exceed the results of sealed bids, but only when a bidding war occurs. The research showed, however, that bidding wars for non-performing CRE loans are atypical and are difficult to predict in advance.

With a sealed bid format, the bids of other investors are not disclosed. However, in an English forward auction, bids are revealed. Sealed bids benefit sellers because buyers have only one opportunity to make a best offer. That dynamic leads to outlier bids, which results in higher prices for sellers.

To view the sealed bid white paper or request other DebtX white papers, go to <https://www.debtX.com/Contact/WhitePaper.asp>.