

Primer on European CMBS Servicing

More independent third-party servicers needed?

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Overview

- This report offers an overview of European CMBS servicing. Servicing is central to the functioning of a securitisation and high quality servicers can be assumed to provide lower default and higher recovery levels for CMBS bondholders.
- The key servicing functions are collateral management, surveillance, cash management and information distribution. There are different types of servicer roles and different levels of servicing. Primary servicing deals with borrowers and reports to the master servicer. Master servicing deals with investors and manages the primary servicer(s). Special servicing deals with non-performing and/or defaulted loans. The back-up servicer is the named replacement of the primary and/or special servicer, in case of an insolvency of the original servicer.
- There are 15 European CMBS servicers that are rated by one or more rating agency, significantly less than in the US market. Each rating agency has a slightly different methodology and Fitch and S&P have the largest number of servicer ratings outstanding. The share of CMBS with rated servicers has increased from 11% in 2000 to 34% in 2005 and is expected to increase further in the future.
- The servicer is supposed to act in the best interest of the bondholders as per the servicing standard. However, there is no uniform standard definition and there are a number of potential conflicts of interest. These include:
 - ▶ Potential conflicts between servicing standard and other transaction documents as far as the exact level of servicing is concerned;
 - ▶ Potential conflicts between servicer and original lenders with regards to borrower contact relating to the existing loan;
 - ▶ Potential conflicts between special servicers and B-note investors when they are the same party or owned by the same parent.
- Some of the conflicts can be avoided by better coordination in drafting and communication. Possible conflicts between special servicers and B-note investors are easier to avoid when the special servicer is independent. But there are currently only three independent third-party servicers. We believe that more servicers are due to enter the market to fill the demand from a growing number of CMBS conduits.
- Servicer fees could come under further pressure as a result of increased competition. In our opinion, caution is needed since too much fee pressure might endanger the quality of servicing, which, given the complexity of the current deals, is not desirable.
- Based on our analysis of available data, servicer rating does not seem to be a dominant factor in current CMBS pricing in the primary market.

Introduction

Investors are now starting to focus more on servicing

At most European CMBS conferences, there is typically a servicer panel. The topics discussed at these various servicer panels are technical and complex. However, investors and arrangers are typically focused on primary issuance trends, such as collateral quality, structuring and pricing. But as the number of outstanding deals and secondary trading increase, CMBS investors increasingly recognise that servicing is a key function. Servicers essentially ensure that investors receive what they were promised, in terms of both interest and principal on their bonds, as well as periodic reporting.

This article offers an overview of European CMBS servicing

The objective of this article is to provide an overview of the CMBS servicing market and discuss any outstanding issues. In order to provide the overview, we describe the role of the various types of servicers, discuss the servicer ratings, identify a number of possible conflicts of interests, consider various market trends and finally evaluate the possible pricing impact. We believe it is better for investors to focus on these issues now, rather than wait for a major crisis, like say a note default, which we have been able to avoid to this point.

The role of servicer

Servicing is central to the functioning of a securitisation

The servicer administers and monitors the loans in a securitisation on behalf of the issuer. Since the issuer is a special purpose vehicle, only issuing bonds and holding the collateral, the servicer acts ultimately in the best interest of the CMBS bondholders. The servicing role is central to the functioning of a securitisation and becomes more critical when the collateral performance is deteriorating.

High quality servicers assumed to provide lower default and higher recovery levels

The servicer's management of both performing and non-performing loans is likely to have a direct impact on the default frequency and recovery levels on both the underlying loans and consequently the CMBS notes. High quality servicers are assumed to be more effective managers and provide investors with lower default and higher recovery levels. This can be expected, especially in countries with more complicated work-out and enforcement procedures.

Levels include primary, master, special and back-up servicing

There are different types of servicer roles and different levels of servicing, including primary, master, special and back-up servicing, which are defined and highlighted below.

Primary deals with borrower and reports to master servicer

The primary servicer performs the following services: day-to-day payment collection from borrowers (and/or tenants), loan administration, management of borrower relations for performing loans to minimise defaults and provide periodic reporting to the Master Servicer (or to the investors directly).

Master deals with investors and manages the primary servicer(s)

The master servicer provides the payment remittance to investors (in most cases, these are effected via the cash manager involving the calculation and paying agent), monitoring of the loan portfolio and the primary/special servicers' performance and periodic investor reporting (if not done by the primary servicer).

In many European deals the primary and master, servicer are the same

Please note that these roles are not standardised in all European CMBS transactions. In most cases in Europe, the primary servicer is the same as the master servicer. Therefore, the primary servicer performs the tasks of both types of servicers. However, this is less likely to be the case if the loan pool contains any A/B note structures, any partial or syndicated loans or has loans from more than one contributor. In these cases, it is more likely that there are separate primary servicers and master servicers, which is a more appropriate structure for dealing with the above-mentioned collateral complications.

Special servicer deals with non-performing and/or defaulted loans

The special servicer is responsible for the payment collection from non-performing and/or defaulted borrowers. It also needs to evaluate, determine and execute loan work-out strategies with non-performing/defaulted borrowers to maximise recoveries (possibly including borrower negotiations, formal foreclosure, asset disposition, bankruptcy of the borrower and litigation) and report to the master servicer. In certain transactions, such as those involving non-performing loan (NPL) portfolios, there might only be a special servicer, given that most assets already have a non-performing and/or default status. This is difficult to verify due to the lack of NPL deals in the public markets.

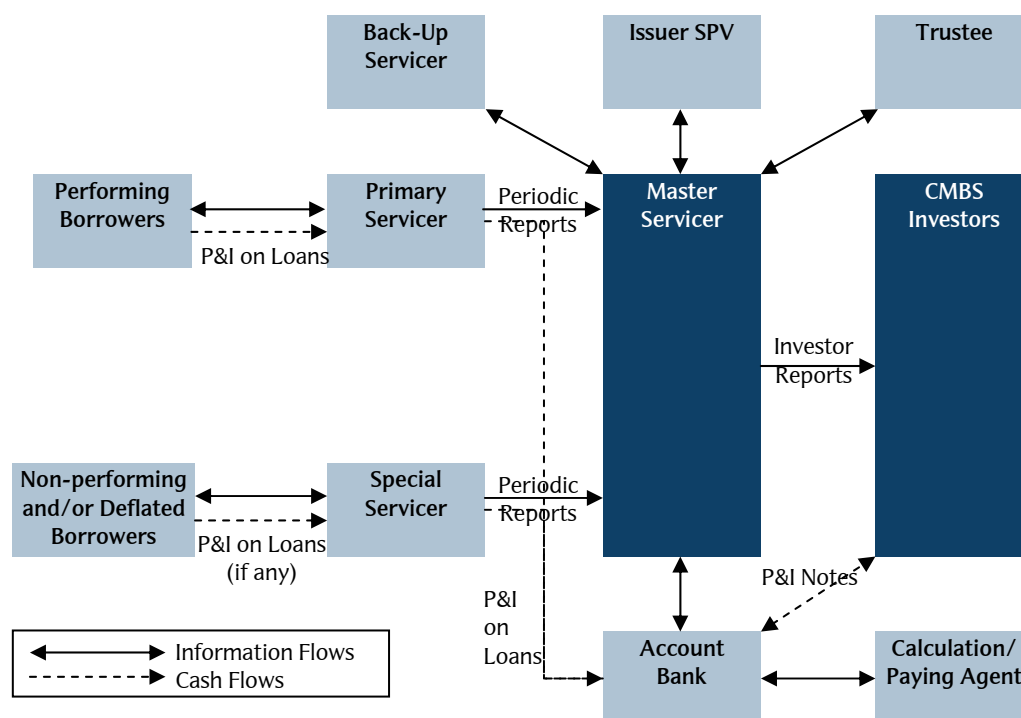
Back-up servicer needs to have up-to-date info to take over active role in case of insolvency

The back-up servicer is the named replacement of the primary and/or special servicer, in case of an insolvency of the original servicer. The back-up servicer will find it difficult to take over the servicer's active role, unless it has up-to-date information about both the collateral pool and the CMBS bonds. Fitch highlights the need for the back-up servicer to be involved with the transaction on an ongoing basis. It views back-ups more favourably if the arrangement is warm or hot (ie, involved in the deal on an ongoing basis). This implies that the back-up servicer needs to be provided on a regular basis with portfolio data dumps in order to reduce the time needed to transfer the portfolio. In European CMBS, the back-up servicer is not always named, but certain replacement criteria are set out.

The importance of a back-up servicer was illustrated by the case of a Swedish RMBS transaction named EuropeLoan, which as a result of "the prompt and seamless replacement"¹ of its servicer by its back-up servicer, maintained a good operating record. This was after a series of negative events, which included three months after closing, both its servicer and originator (which was also special servicer) filed for bankruptcy and the second servicer guarantor was downgraded. These negative events resulted in increased transaction fees and costs and reduced excess spread in the transaction. However, these were counteracted by the handling of the situation by the back-up servicer, which was crucial to maintaining the transaction's track record. Despite the limited number of these types of occurrences in European ABS, we believe it would be a mistake for deals to be structured without a back-up servicer in a misguided effort to create more cost efficiencies.

¹ *Moody's Investors Service Special Report; A Case Study on RMBS Servicer Bankruptcy: The EuropeLoan Transaction – Weathering a Perfect Storm; 24 May 2004, by Lisa Macedo and Yaron Ernst.*

Figure 1: CMBS servicing process diagram



Source: Barclays Capital.

Figure 1 illustrates the servicing role and various information and cash flows between the relevant parties.

Servicing key functions are cash management and information distribution

In summary, the key functions of servicing focus on collateral management, surveillance, the management of cash as it is received from the underlying commercial mortgage loan assets and needs to be paid on the CMBS bond liabilities, as well as the creation, processing and distribution of information on the loans to certain transaction parties and information on the bonds to the investors.

Servicer ratings and rankings

Fitch servicer ratings range from 1 to 4 and are function and country specific

Servicers are increasingly rated and ranked by recognised rating agencies. This section attempts to summarise their methodologies.

Fitch's servicer ratings are assigned by function (primary, master and special) and are issued on a country-specific basis (as based on the location of the assets securing the loans) on a scale from one to four². One is the highest rating, which is defined as fully acceptable, with overall superior performance. Four is the lowest rating and is defined as acceptable. Fitch gives benefit in RMBS transactions for rated servicers, rated two or better. To determine its servicer ratings, Fitch uses a scoring matrix with approximately 140 sub-components. Each servicer function is reviewed based on a select set of weighted criteria resulting in a composite score. The criteria are categorised into seven groups; (1) company history and management experience; (2) stability of financial position; (3) staff experience and training; (4) adequate procedures and internal controls; (5) loan administration; (6) servicing of defaulted loans; and (7) technological platform and data management.

² Fitch Ratings; "Rating European Residential and Commercial Mortgage Loan Servicers – 2005", by Edward Register and Jeremy Deacon, 14 March 2005.

<p>S&P servicer rankings have five categories from strong to weak and are linked to an outlook as well as a specific financial position assessment</p>	<p>Standard & Poor’s servicer rankings intend to assess a servicer’s strengths, weaknesses, opportunities and limitations.³ This is done by examining three areas; (1) management and organisation; (2) loan/asset administration; and (3) financial position. The rankings are aligned across collateral types for CMBS, RMBS and ABS by servicer function (primary, master or special). The ranking can be strong, above average, average, below average and weak. Outlooks are also assigned to the near-term servicing duration (approximately 12 to 18 months) and may be stable, positive, developing and negative. Standard & Poor’s evaluation is a three-step process: (1) wide range of material on servicer’s organisational structure, personnel, systems, procedures and financial history is reviewed; (2) on-site meetings with senior management to discuss operations; and (3) the ranking committee assigns ranking, which is forwarded to servicer. There is a detailed list of criteria for servicers to obtain an average ranking per servicer function as well as per collateral type. Servicers ranked average with a stable outlook and a sufficient financial position have achieved an acceptable level of competence. Note that S&P states the financial position separate from the ranking.</p>
<p>DBRS servicer ratings have four categories from superior to weak</p>	<p>Furthermore, we note that Dominion Bond Ratings Service (DBRS) rates GMAC as Superior in master and primary servicing. DBRS published a report on its approach in 2004.⁴ DBRS’ servicer ratings range among four different classes from Superior, Good, Adequate to Weak.</p>
<p>Moody’s servicer ratings have five categories from SQ1 to SQ5</p>	<p>Lastly, Moody’s does not rate CMBS servicers, but does rate RMBS servicers. Two of these RMBS servicers, Crown Mortgage Management Ltd and Hudson Advisors Germany GmbH, are also CMBS Servicers. As these servicers also service commercial mortgages, we take into account these Moody’s ratings. Moody’s has published its methodology for assigning residential mortgage servicer quality ratings, which range from SQ1 (strong) to SQ5 (weak).⁵ Given the limited number of servicer ratings by Moody’s and DBRS, we do not provide a detailed outline of their servicer rating methodology. Figure 2 provides an overview of the ratings of all servicers that are involved in servicing European CMBS transactions.</p>

³ Standard & Poor’s; “Servicer Evaluations Ranking Criteria”, by Michael Gutierrez, Michael Merriam, Richard Koch and Mark Goldberg, 21 September 2004.

⁴ Dominion Bond Rating Service; “Servicer Rating Approach”, by Kevin Chiang and Huston Loke, July 2004.

⁵ Moody’s Investors Service; “Residential Mortgage Servicer Quality (“SQ”) Ratings in EMEA: Moody’s Methodology, by Yaron Ernst and Jodi van Breda, 14 October 2003.

Figure 2: European CMBS servicer ratings and rankings

	Servicer Name	Country	Role(s)	Fitch Rating	S&P Ranking	Moody's Rating	DBRS Rating	Average Rating
1	Capmark Financial (formerly GMAC Commercial Mortgage)	UK	PS & SS	2+/2	Strong/Above Average		PS/MS - Superior	1-/2
2	Morgan Stanley Mortgage Servicing Ltd	UK	PS & SS	1-/2-	PS - Above Average			2+/2-
3	Hatfield Philips International Ltd	UK	PS & SS	2/2	Above Average/Above Average			3+/3+
4	Crown Mortgage Management Ltd	UK	PS & SS	2-/2-	PS - Average	PS/MS - 3+/3+		3+/3+
5	Home Loan Management	UK	PS&SPS	2+/2+				2+/2+
6	FBS Gestioni SpA	Italy	SS	3+				3+
7	Italfondario SpA	Italy	PS/SS	3+/2+	SS – Above Average			3+/2+
8	UGC Banca	Italy	SS	2	Above Average			2
9	SGC/Archon Group Italia	Italy	SS	2+	Above Average			2+
10	Credit Servicing SpA (result of merger between Pirelli and SIB)	Italy	SS	2	Above Average			2
11	Credito Fondiario e Industriale SpA	Italy	PS	2-	Above Average			2-
12	Capitalia Service jv srl	Italy	SS	2-				2-
13	Zenith Service srl	Italy	MS		Average			
14	Hudson Advisors Germany GmbH	Germany	SS	2-		1-		2
15	Servicing Advisors Deutschland GmbH	Germany	SS	3+				3+

Note: PS means Primary Servicer, SS signifies Special Servicer and MS indicates Master Servicer.

Source: Rating agencies, Barclays Capital.

Servicer independence and possible conflicts of interest

Servicers act in the best interest of the bondholders as per the servicing standard, but there is no uniform standard definition

As discussed before, the servicer is meant to act in the best interest of the bondholders as a prudent lender, which is typically documented in the servicing standard contained in the offering circular and the servicing agreement. However, in the current European CMBS market, there is no uniform definition of the servicing standard. The complications that the servicer has to deal with regarding the collateral might make it difficult for a servicer, especially if it is involved in many different transactions, each of which might have different servicing standard definitions, to ensure it abides by the servicing standard at all times.

Possible conflicts between servicing standard and other transaction documents

There could be a possible conflict between the servicing standard and other transaction documents, including the loan document, inter-creditor agreement and servicing agreement. If this is the case, then it will be difficult for the servicer to determine which document prevails. Discussions around having a uniform servicing standard for all European CMBS transactions might represent an opportunity for industry organisations, such as CMSA, to come up with a uniform servicing standard. Incorporation of one servicing standard definition in all transaction-related agreements would be one potential way in which to avoid possible conflicts.

Possible conflicts between servicer and original lender

A recent Fitch article⁶ also highlights the possible problems involved if the original lender (loan originator) is actively trying to maintain its long-term borrower relationship, by interfering with the servicer's responsibilities. This could perhaps include the lender accommodating borrower's requests for minor changes to the loan agreement or waiving certain rights the lender might have in exceptional circumstances. Such activities could easily interfere with the servicer's obligation to serve the best interests of the bondholders. They are also contrary to the "true sale" spirit of securitisation.

The appropriate adoption of Chinese walls between origination and servicing departments is essential in addressing this potential conflict. Given the true-sale nature of most European CMBS transactions, there is really no reason for the original lender to stay actively involved. It is important for the borrowers to be informed regarding the sale of the loan at the time of the CMBS issuance, so that further borrower contact is shifted from the lender to the servicer.

Possible conflicts between special servicer and B-note investor when they are the same party or owned by the same parent

Another, more widely discussed, possible conflict of interest could occur when one or a number of the B-notes are held by the same party as the Special Servicer. In that instance, the special servicer could be tempted to not serve the best interests of the rated notes first. Similar issues might arise, where the independent special servicer is owned by a parent that has an active B-note investment programme. Chinese walls between special servicer and owner might then have to be created.

Possible conflicts are easier to avoid when servicer is independent

In any event, it is likely to be easier for the servicer to withstand any interference from the original lender, if the servicer is independent from the original lender. Of course, if an independent servicer is financially dependent on a small number of clients, independence may be difficult to achieve. Although, as servicers increase the number of clients, we would expect this issue to be less of a concern.

Based on this, we can identify three categories of servicers:

- 1) Fully independent, third-party servicer, which is owned by a party that is completely unaffiliated with the original lender.
- 2) Independent servicer subsidiary, which is still owned by and affiliated to the original lender.
- 3) In-house servicing, closely affiliated with the lending department to ensure continuity in the borrower relationship.

Currently there are only three independent third-party servicers, but more on their way to fill demand from growing number of conduits

The increase in the number of CMBS conduits in Europe has triggered growth in the market for third-party servicers, as not all conduit lenders have the capability or desire to service their own programme loans. Currently, three servicers (Capmark/GMAC, Hatfield Philips and Crown) are actively pursuing this type of business. However, it seems that two more servicers will be entering this market, as well. Morgan Stanley, which has been a long-standing captive servicer for the ELoC programme, and Wachovia, which is new to the European market, have both announced that they want to expand their business in this area.

The following table lays out some of the match-ups between servicers and CMBS conduit programmes.

⁶ *Fitch European CMBS Quarterly*; "I could tell you, But...confidentiality and disclosure in European CMBS servicing", by Edward Register, March 2006.

Figure 3: Third-party servicing and CMBS conduit programmes

Servicer	Sponsor	Conduit Name
Capmark/GMAC	CS/GMAC	Cornerstone Titan
	JP Morgan	European Property Capital 3
	Goldman Sachs	Fleet Street Finance One
	Citibank	Victoria Funding (EMC-III)
	Merrill Lynch	Taurus No.1
Hatfield Philips	RBS	Epic (Caspar)
	ABN Amro	Talisman-1 & 2
	Credit Suisse	Titan Europe 2004-1&2, 2005-1
	Societe Generale	White Tower 2004-1, 2005-1
	Lehman Brothers	Windermere III, IV, V and VI

Source: Barclays Capital.

Growth in multi-contributor deals likely to further stimulate this demand

Finally, the increase in multi-contributor deals has increased the need for independent third-party servicers. As a loan contributor to another bank's CMBS transaction, one might want to ensure that certain loan details remain confidential and are not shared with a servicer, which is affiliated with a co-contributing, but also competing lender.

Market trends

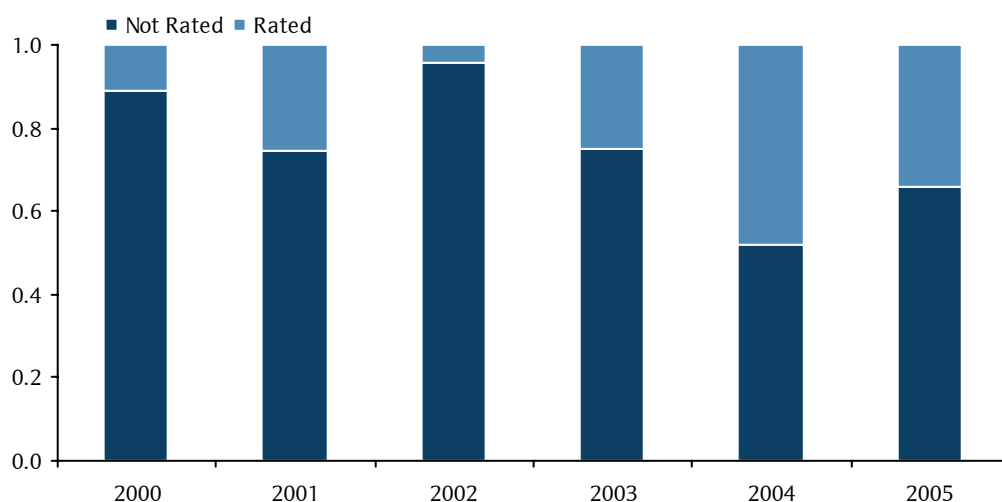
Share of CMBS with rated servicers has increased from 11% in 2000 to 34% in 2005

With the emergence of servicer ratings, some interesting market share analyses can be undertaken. The first issue to consider is the percentage of total European CMBS issuance that has a rated servicer. This figure has increased from only 11% in 2000 to 48% in 2004. In 2005, the percentage dropped to 34%, which might be partly due to the near-doubling of issuance in that year and the large number of single borrower transactions. Please refer to Figure 4.

Share of CMBS with rated servicers expected to further increase in the future

Despite this percentage drop, there was good absolute growth of transactions with rated servicers in 2005. During the 2000-05 period, 29% of European primary CMBS issuance did have a rated servicer. Fitch claims that 44% of multi-borrower CMBS have a Fitch-rated servicer. S&P report that they rank servicers who service 35% of total outstanding multi-borrower European CMBS by volume (excludes single borrower deals). We expect these percentages to increase as more servicers get a rating, more third-party servicers are expected to enter the market from the US (such as Wachovia) and more captive servicers are expected to open for third-party business (like MSMS).

Figure 4: Percentage of annual CMBS issuance with and without a rated service (%)



Source: Barclays Capital and rating agencies.

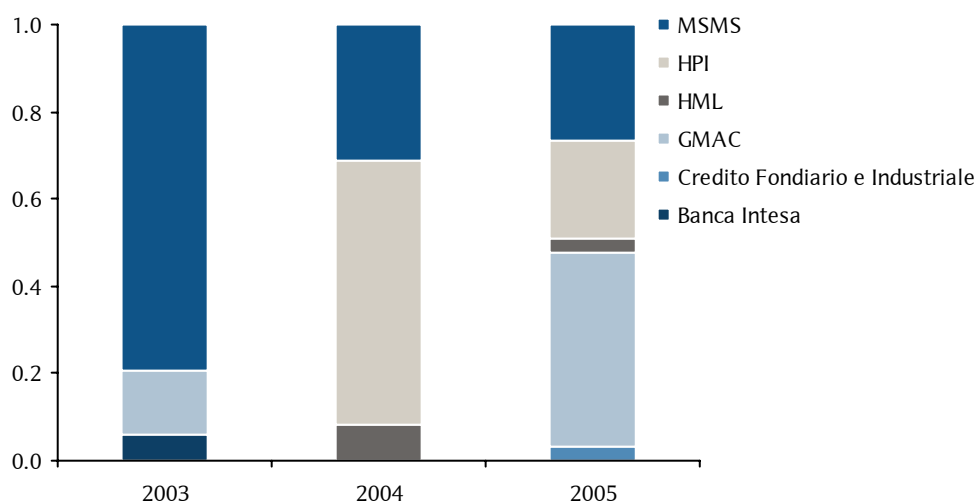
Secondly, we can also consider the market share of individual rated servicers among all rated servicers. In order not to confuse their different roles, the primary servicers and special servicers need to be considered separately.

In primary servicing, MSMS has lost market share, but is still the largest party at 34%

Figure 5 illustrates the market share development over the last three years. It shows that MSMS was very dominant in 2003, on the back of the success of its ELoC-programme. However, as other CMBS conduit issuers ramped up their issuance and the market matured, MSMS' share of new issuance servicing has come down, while others such as Capmark/GMAC and Hatfield have increased. We would expect a further diversification of servicer market shares, where more players take their fair share in the future. It is noted that the data presented excludes any deals that are no longer outstanding, which might distort some of the individual historical servicer's market shares, especially in the earlier years.

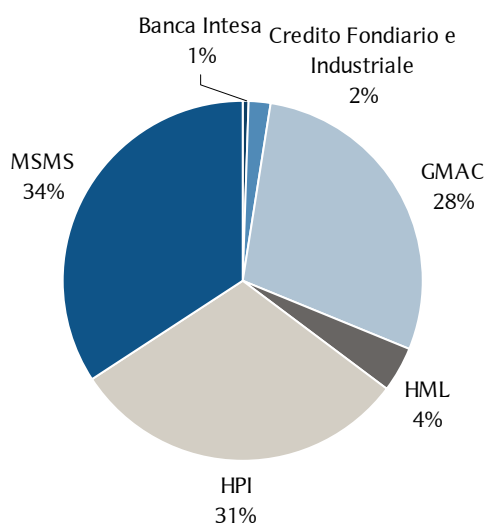
As can be deduced from Figure 6, MSMS' market share of primary issuance over the 2003-05 period is still the largest among all European primary/master servicers, at 34%. Hatfield and Capmark/GMAC come a close second and third at 31% and 28%.

Figure 5: Market share of European CMBS issuance with rated primary/master servicer per year



Source: Fitch and Barclays Capital.

Figure 6: Market share of European CMBS issuance with rated primary/master servicer for 2003-05 period



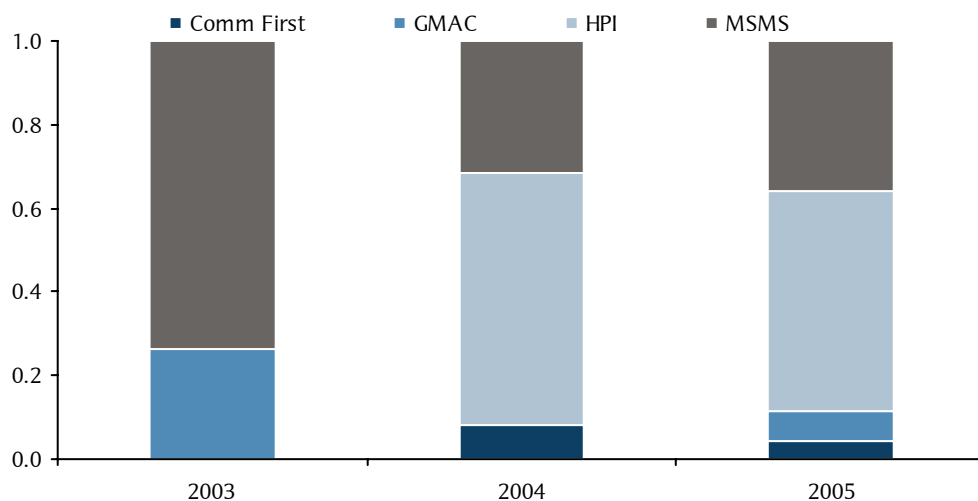
Source: Barclays Capital.

In special servicing, Hatfield Philips has the largest market share at 52%

In the case of special servicing, the picture is similar to that for primary servicing. Again, MSMS' market share of annual new issuance has declined from 2003 to 2005, with others, especially Hatfield Philips, picking up a larger share. Please refer to Figure 7.

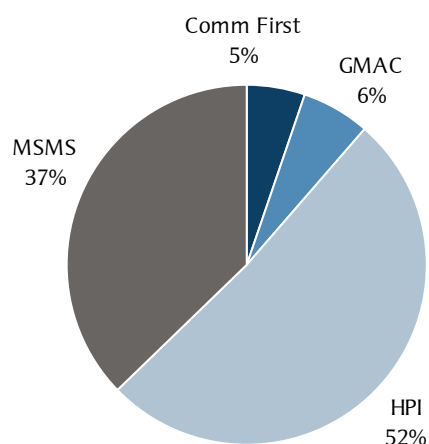
In fact, over the entire period between 2003 and 2005, Hatfield has realised a 52% market share in special servicing, whereas MSMS has 37%, as illustrated in Figure 8.

Figure 7: Market share of European CMBS issuance with rated special servicer per year



Source: Barclays Capital.

Figure 8: Market share of European CMBS issuance with rated special servicer for 2003-05 period



Source: Barclays Capital.

Growth in issuance and current concentration is likely to attract more competition

As the data indicate, there currently seems to be a lack of third-party servicers in the market, with Capmark/GMAC and Hatfield being the dominant players. Both the growth in the overall CMBS market as well as the current concentration in the servicing market, will in our opinion likely trigger a reaction from competitors that are either currently captive to their own originated deals (such as MSMS) or not currently active in Europe (Wachovia). In our view, investors will welcome more competition in servicing, but we feel some caution should be exercised. CDO and SIV investors in European CMBS, in particular, might welcome more third-party servicers, since they could have exposure restrictions to dominant CMBS servicers tied to rating agency requirements.

Servicer fees could come under further pressure as a result of more competition

Indeed, an increase in competition in the CMBS servicing market can already be seen in terms of growing pressure on servicing fees. However, price competition can have an undesired impact on the quality of servicing. In a recent Fitch report⁷, the agency noted that some third-party servicers now have a weighted average servicing fee of 4 bp for securitised transactions, well below the average of 7 bp for all rated servicers. This reduction in fees is most likely due to the increased level of competition from third-party servicers. Any decline in fees might need to be offset by cost reductions and increased operational efficiency. This would be fine in a commoditised and highly standardised market, but this is not the case in the European CMBS market at this juncture.

Caution needed since too much fee pressure might endanger quality of servicing, which given the complexity of the deals, is not desirable

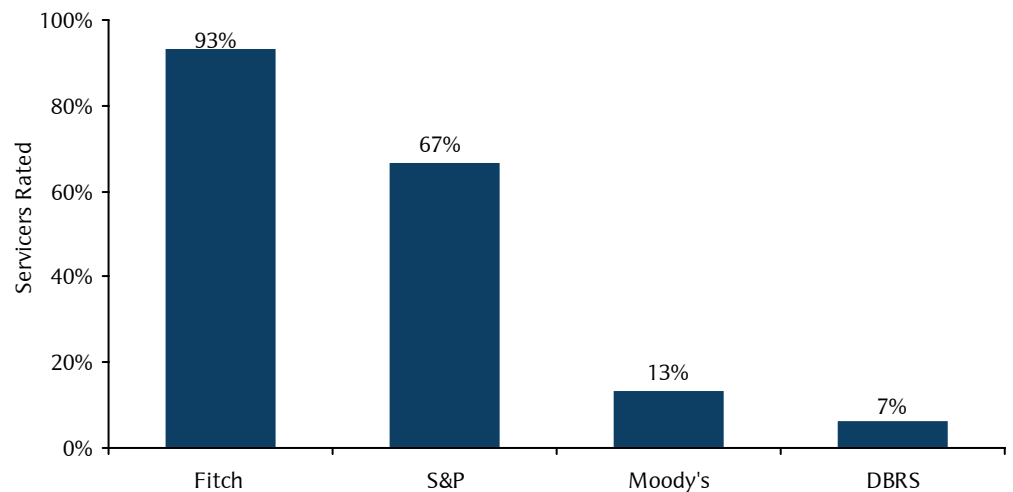
Therefore, we would caution structurers and investors that they should allow sufficient commercial room for servicers to deal with the still increasing level of complexity of European CMBS deals. On the other hand, servicers do need to find creative and efficient ways of dealing with this complexity as well as the expected increase in competitive pressures in their market. However, given the current status of the European CMBS market, it does seem unlikely that the European servicing market will become as standardised as the US market. In the US, servicing rights are booked as an asset when originated or bought and amortised accordingly. This turns servicing into a commodity and not the tailored customer service that borrowers might prefer and investors require in the more complex and non-standardised European CMBS market. This will also likely prevent any large-scale outsourcing by European CMBS servicers to more specialist service providers in the short term.

⁷ Fitch Ratings: Hatfield Philips International Limited Servicer Report, by Edward Register, Heather Collins and Robbie Sargent, 20 March 2006.

Fitch rate 93% and S&P 67% of European-rated CMBS servicers, with the other agencies following some distance behind

Finally, we analyse the market shares of the rating agencies in terms of coverage. In this regard, Fitch and S&P are far ahead of the other agencies, with 93% and 67% coverage, respectively. Moody's, in particular, does not officially rate CMBS servicers, but gains market share through the backdoor by rating two servicers that service both commercial and residential mortgages. We are encouraged by the rating coverage by DBRS, which might prompt some of the more dominant rating agencies to step up their coverage in a more competitive environment. Please refer to Figure 9.

Figure 9: Percentage of rated servicers by individual rating agencies



Source: Barclays Capital and Rating Agencies.

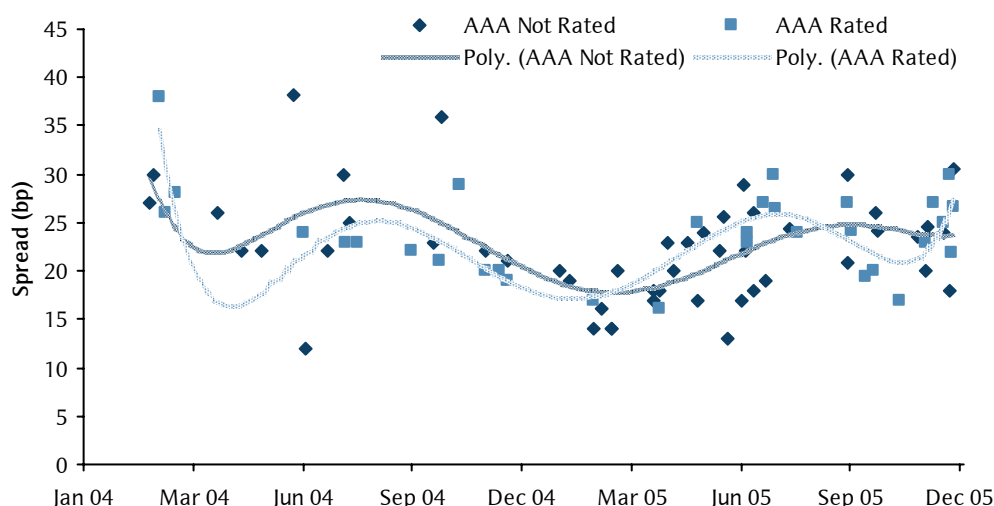
Pricing impact

Do investors take the rating of the servicer into account in pricing CMBS?

After considering the different servicer ratings and market shares, we should consider whether investors take the servicer rating into account in pricing. Anecdotal evidence indicates that a limited number of experienced CMBS investors have strong preferences for certain servicers. However, these preferences (probably more related to the user-friendliness of their reporting) do not seem to correspond and sometimes are contrary to the current servicer ratings. This is interesting and could raise the question whether the ratings give sufficient weight to this aspect of servicing that is important to investors.

To determine whether investors in general have any preferences, we considered the pricing at issuance on European CMBS deals with rated servicer compared to deals without a rated servicer during 2004 and 2005. We considered both AAA and BBB pricing, bearing in mind that the quality of the servicer might be more important to investors in lower rated bonds.

Figure 10: AAA issuance spreads for European CMBS transactions with and without a rated servicer for 2004 and 2005

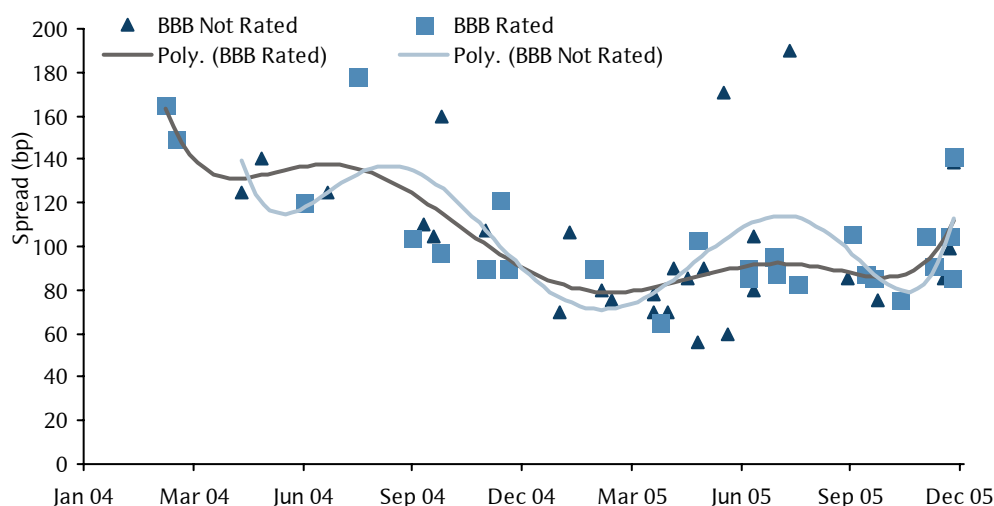


Source: Barclays Capital, Rating Agencies and Bloomberg.

Servicer rating does not seem a dominant factor in current CMBS pricing

The comparison on both levels does not seem to support the hypothesis that investors price European CMBS transactions with a rated servicer tighter than transactions without a rated servicer. The spreads are not consistently above or below each other, which leads us to conclude that other factors (other than the rating of the servicer) are more important to investors. Please refer to Figure 10 and Figure 11. Therefore, based on our limited analyses, we conclude that it does not seem that servicer ratings are a dominant factor in pricing CMBS in the current market.

Figure 11: BBB issuance spreads for European CMBS transactions with and without a rated servicer for 2004 and 2005

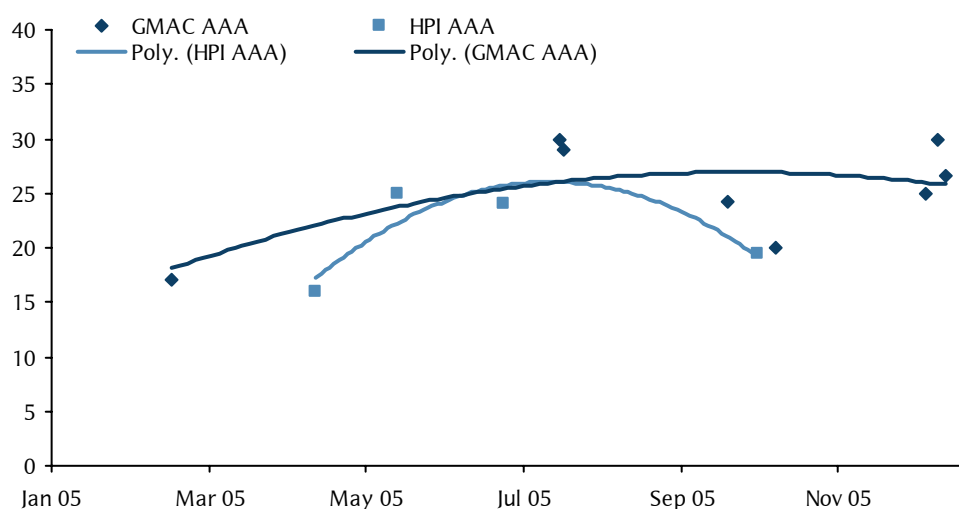


Source: Barclays Capital, Rating Agencies and Bloomberg.

Deals with highly rated servicers do not seem to price tighter than deals with more lowly rated servicer

As a safety check, we also considered the pricing at issuance on deals with a highly rated servicer compared to deals with a lowly rated servicer. We selected Capmark/GMAC as the highly rated servicer and Hatfield Philips as an average rated servicer. Unfortunately, the data are limited and do not seem to support our hypothesis that deals with a more highly rated servicer would price tighter than deals with a more average rated servicer. This is illustrated in Figure 12. Again, it seems that other factors (apart than the rating of the servicer) are more important to investors in pricing European CMBS transactions.

Figure 12: AAA pricing for CMBS transaction with highly rated servicer (Capmark/GMAC) and average rated servicer (Hatfield)



Source: Barclays Capital.

Other issues

Disclosure requirements impact servicers as well

Other issues that affect servicers include the current discussion in the sector regarding disclosure requirements. These requirements should be properly documented in the servicing agreement and comply with all relevant legal requirements (in part determined by the Market Abuse Directive) and potentially meet reporting standards, as defined by industry groups such as CMSA.

Finally, it has been suggested that it would be wise to get the servicer involved in the final stages of loan negotiations (before closing) to ensure the loan document reflects a realistic and workable servicing standard and that the reporting and servicing processes agreed in the loan agreement are properly defined. This would avoid potential technical issues that result from incomplete or inaccurate document drafting, with which the servicer and investors might otherwise have to live for the duration of the transaction.

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