

# FINANCIAL POST

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# CMBS issuance enjoying boom

Last of three offerings this month closes tomorrow



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*Off The Record*

The past month has been a busy period for the country's commercial mortgage-backed securities industry.

Tomorrow, Real Estate Asset Liquidity Trust — known as REAL Trust — closes its \$381.4-million initial public offering.

This issue, the first by the entity associated with Royal Bank of Canada, is the third completed in the past month.

Earlier, Schooner Trust, an entity associated with TD Bank, closed a \$332.445-million offering. And Merrill Lynch Financial Assets Inc., the leader of the pack and the pioneer of the commercial mortgage-backed securities (CMBS) market almost six years back, raised \$456-million. That deal was Merrill's 13th.

According to DBRS, during the past six years 36 issuers have raised \$11.4-billion.

And there has been lots of talk in the industry about securitizing commercial mortgages. In fact, the Commercial Mortgage Securities Association, a U.S. industry group, holds its first branded conference outside the United States in Toronto today.

All up, RFA has anted up \$110-million, having crossed the \$100-million threshold thanks to its investment in Real Trust.

"It's a nice number," said Pyle, whose investor base has also expanded over the past few years. Initially, RFA had one investor, a wealthy individual. Since then it has added a money management firm and has received lots of offers from well-heeled individuals looking for yield in a low-interest rate world. "We have the capital availability to go to at least \$200-million over the next four to five years," said Pyle, whose main competition for his part of the business is Chicago's BancOne.

RFA operates in a defined market niche: it limits itself to purchasing the non-publicly offered securities, those parts of the CMBS offering that are sold by way of offering memorandum. Those securities, also known as the non-offered securities, are at the bottom of the food chain. The rest of the offering, the higher-quality pieces that mostly come with a AAA-rating, are sold to investors by prospectus.

On REAL's deal, RFA bought seven classes of certificates (the Class Fs to the Class Ms) plus the Class Xs — the so called interest-only pieces. The face value of those seven is about \$15.3-million and a face interest rate of 5.45%.

On Schooner's deal, RFA operated in a similar way: it bought the certificates (from Class F to Class M) plus the interest-only pieces. The face value of those seven was about \$18.62-million and a face interest rate of 5.533%.

"We paid between \$13-million to \$14-million for the Fs to Ms," said Pyle, which means it paid a discount to own a security that is at the bottom of the pile in terms of monthly distributions. "We buy at a discount which translates into higher yields. And [the

At least one investor, RFA Capital Management, is pleased with the boom in CMBS issuance. It has given Alan Pyle and his partner, Don Rodney, a business. And what's more, the two, who have been around for three years, have given their investors returns in the 13% to 14% range.

And what's more, the returns seem nearly risk free: so far only one of its mortgages has had to be liquidated and none has gone into default. "It was one mortgage for about \$3-million on one property. We have an interest in over \$3-billion in mortgages so it's a great record," said Pyle, who cautions the situation is better than otherwise "because we haven't been through a recession in the real estate industry."

Pyle said one of the "real attractions of this business is that you make an investment this month and you get your first payment next month. Each month it comes in on the 12th and up to now it has been working like clockwork," said Pyle, whose firm recently added Ben Rodney, his partner's MBA-equipped son whose specialty is in financial modeling. "The concept of CMBS is very simple. The technicalities are very very complex."

RFA invested in the Schooner and REAL deal. And it has invested in four other CMBS issues. (It has also bought five offerings in the secondary market.)

lates into higher yields. And [the discount] is all subject to negotiation," said Pyle, adding the discount increases as the buyer acquires higher lettered certificates.

"The yield on the Class M certificates will be a lot higher than the Class Fs. But there is a lot more risk with the Class Ms," said Pyle, whose firm, as a condition of investing, has the ability to throw out a certain percentage of mortgages that are in the CMBS pool.

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Pyle restricts his investing activities to commercial real estate and isn't interested in being an investor in other securitizations, such as credit cards.

But he sees some dangers in the commercial real estate world. "The market is getting somewhat overheated. Values are getting driven up. The mortgage market is becoming more competitive and institutions are more aggressive in providing funds to borrowers than they were," he said. "It's gone from a lender's market to a borrowers market, which means there's more risk for the lenders."

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