

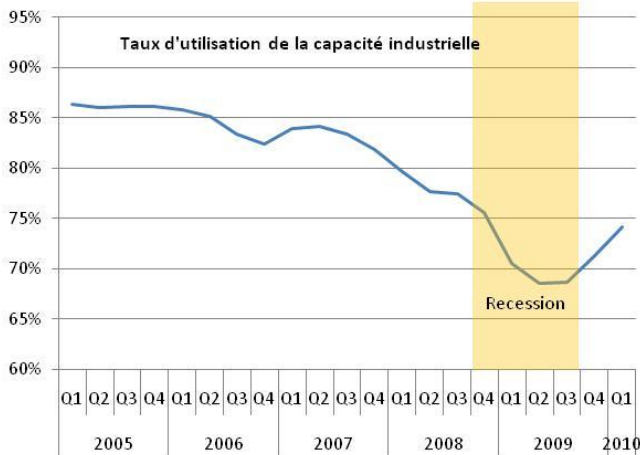
éc Otéra

Weekly
Review



Financial news

According to Statistics Canada figures issued last week, Canadian industrial capacity utilization rate increased 2.9% in Q1, ending the quarter at 74.2%. This was the strongest quarterly showing since Q1 2007. Industrial capacity utilization increased in 20 industrial sectors out of 21, notably computers & electronics: 96%, paper: 89%, and metals: 86%. The sole exception was printing, which slid two basis points to 64%. These increased rates of utilization indicate that the excess supply built up during the recession is melting away like snow. The Canadian economy will soon be working at full capacity, which is sure to bring some inflationary pressure to bear in the next few quarters. As mentioned in our previous edition, this leaves no doubt as to the necessity for the Bank of Canada to increase its key interest rate to a less accommodating level in the coming months.



Source: Statistique Canada

Against all forecasts, retail sales in the U.S. dropped in May by 1.2% after 7 consecutive months of increases (+0.6% in April). Despite this unexpected setback, however, retail sales were up 6.9% year over year. This was disappointing news nevertheless, which combined with the weakened job market brings back some of the apprehensions about the solidity and viability of the economic recovery in the U.S.

In light of the unprecedented confidence crisis with respect to the sovereign debt of certain members of the euro zone and the uncertainty surrounding the economic outlook there, (+0.2% GDP in Q1 2010), no one was surprised on June 10th when the European Central Bank (ECB) opted for the status quo and kept its key interest rate at 1%. ECB president Claude Trichet has pledged to stabilize the

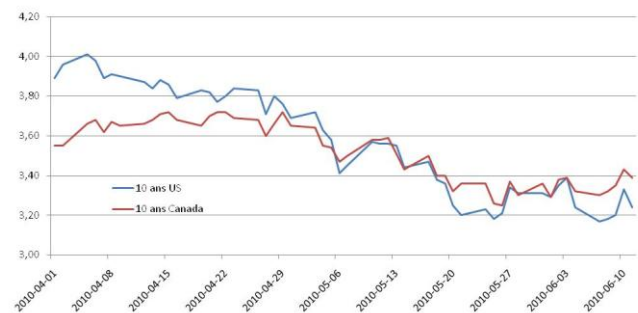
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euro, which has been hard pressed by the economic crisis in Greece and the fear that the malaise will spread to Spain, Ireland and Portugal, three severely indebted countries. The euro dropped 30 cents against the greenback so far this year, and a large majority of economists are actually predicting that the buck will close that last 20-cent gap when the Federal Reserve finally increases its key interest rate in late 2010 or early 2011 in response to the consolidation of economic growth, especially since the euro zone's key interest rate will need to be kept low due to the weakness of its economy.

Also no surprise, the Bank of England kept its key interest rate at 0.50%, opting to continue endorsing its quantitative easing program of £200 B (US\$290 B). Although there are signs of some economic stabilization, the resurgence of financial tensions precludes any sudden increase of the key interest rate in the U.K.

The bond market

On the bond market, consistently low inflationary pressures and the fact that Bank of England and European Central Bank directors have resolved to keep their key interest rates low have somewhat allayed investor concerns. The result was that The Canadian long-term bond rate decreased 7 basis points to 3.39% last week. In the U.S., the long-term bond rate showed no variation at all and remained at 3.24% last week.



The debt market

The primary market for American CMBS seems to be picking up. Two new CMBS issues are afoot in the U.S. (one of which was priced late last week), and a third issue of some US\$800 M led by Goldman Sachs is apparently imminent.

First, as we revealed in this space of the last issue, JP Morgan priced a new CMBS issue totalling US\$716.3 M last Thursday (JP Morgan Chase Commercial Mortgage Securities Trust 2010-C1). This was the second CMBS issue since 2008 to include multi-borrower loans. The fact that two main contributors (JP Morgan for 78% of the loans and Ladder Capital Finance for the rest) joined forces is an interesting development. It shows the beginnings of a trend whereby several loan originators get together for securitization purposes. See the comment below on the upcoming Goldman Sachs issue.

Due to the volatility of the capital markets (including the bond market) and certain particularities of the underlying loans, securities were issued for a slightly lower price than those initially sought by the promoter, as indicated by the two columns on the right:

Cl	Size	M/F	C/E	WAL	DbtYld	LTV	Prg Guidance	Fl Pricing
A-1	\$416.10	AAA/Aaa	15.00%	4.53	15.90%	51.20%	Sw +140a	140
A-2	\$131.30	AAA/Aaa	15.00%	6.76	15.90%	51.20%	Sw +160a	160
A-3	\$61.50	AAA/Aaa	15.00%	9.53	15.90%	51.20%	Sw +160a	165
B	\$16.10	AA/Aa2	12.75%	9.98	15.50%	52.60%	Sw +225-240	250
C	\$26.90	A-/A3	9.00%	9.98	14.80%	54.80%	Sw +325-340	345
D	\$14.30	BBB/Baa	27.00%	9.98	14.50%	56.00%	Sw +425-440	440

Investors of the fixed-income variety did not appreciate the fact that the loans are mostly backed by retail trade properties (US\$508 M, or 71%), US\$300 M of which was extended to finance shopping centres held by the borrower, Inland Western Retail REIT. The B-piece attached seems to have been sold privately to a real estate debt fund managed by Blackrock Realty Advisors.

Apparently, one of the interesting features of this issue's structure is the fact that holders of AAA securities are entitled to replace the special servicer as of the moment that 75% of the investment-grade subordinated first-class capital (class E, rated BBB- by Moody's and Fitch, with 4.54% subordination) is eroded by real or anticipated losses (the Appraisal Reduction Amount principle). The aim of this strategy is to give holders of senior bonds more rights.

Credit Suisse is currently marketing a re-securitization (Re-Remic CMSC 2010-RR5) of US\$168.1 M in investment-grade U.S. CMBS bonds belonging to CS and originated by two previous issues (US\$92 M in A5 bonds rated BBB by S&P from the Wachovia Bank Commercial Mortgage Trust 2007-C30 issue, and US\$76.1 M in A3 bonds rated AAA from the Credit Suisse Mortgage Capital 2006-C4 issue). The capital structure of the re-securitization is not available yet, but it seems that the senior notes associated with this vehicle will get a 30% credit bump courtesy of the notes in the subordinated class (e.g. senior tranche 70% deep and junior tranche 30% deep). As we indicated in the February 16th issue of *Écotéra*, the main characteristic of re-securitizations backed by underlying investment-grade bonds is that they automatically form two new bond classes: a new class AAA (sold at a higher price) and a subordinated class. The advantage of proceeding in this manner is that the AAA securities are highly prized by banks and insurance companies, notably for purposes of amassing regulatory capital. In other words, having AAA securities reduces the reserve capital they are required to hold. This issue should close on June 16, and preliminary discussions indicate pricing of about S+300 basis points for the AAA-rated senior securities from this issue.

As mentioned previously, Goldman Sachs (GS) is apparently set to market a relatively sizeable issue (~US\$800 M), including a

contribution by Citigroup, Starwood Property and GS. Citigroup's US\$100-M portion would have a 10-year term and an LTV ratio of less than 65% secured by 9 lower storeys of the 25-storey Barney's Building, which houses that company's flagship store, at 660 Madison Ave. This new issue is interesting for two reasons. On the one hand, in the case of the JPMCC 2010-C1 issue (see above), the fact that there are several loan originators indicates that they can basically accumulate small loan portfolios while minimizing the associated warehousing risks in the event of the capital market closing. On the other hand, the collaboration among several contributors means the volume of the issue can be increased in order to amortize the issuance costs on a larger portfolio.

The volume of transactions in the secondary cash market for American CMBS was once again weak last week (30% of a typical week in the spring of 2010) due to the relative volatility of the capital market. Investors have been concentrating their purchases on short-term AAA securities, pre-2005 cohorts of bonds, and senior re-securitization securities such as the upcoming CMSC 2010-RR5 issue discussed above. This weak transaction volume translated into a 5-basis-point tightening of the spreads for short-term AAA Super Seniors.

Fixed Rate (Conduit)	Avg. Life	Spread (bp)		
		6/9	Week Earlier	52-wk Avg.
AAA	5.0	S+199	S+194	+270
	10.0	S+384	S+412	+494
AA	10.0	S+2,615	S+2,535	+3,024
A	10.0	S+3,136	S+3,061	+3,711
BBB	10.0	T+4,414	T+4,429	+5,335

ASKING SPREADS OVER TREASURYS

10-year loans with 50-59% LTV

	6/4	Month Earlier
Office	233	257
Retail	225	244
Multi-family	211	230
Industrial	223	243

Source: Trepp

Source: CMA, June 11, 2010