

Morgan Stanley Commercial Mortgage Conduit 1998 Business Plan

February 27, 1998

Morgan Stanley began its fiscal year with aggressive, yet achievable goals . . .

- ◆ Fiscal 1998 Originations = \$2.5 billion
- ◆ Revenue = \$40 million
- ◆ One of top five Wall Street firms in originated conduit securitizations

... particularly in the context of the size of the Commercial Mortgage Debt Market ...

- ◆ Total Commercial Mortgages Outstanding = \$1.3 trillion
- ◆ 10% (\$130 billion) rolls over each year
- ◆ CMBS volume increased by 48% to \$44.3 billion in 1997
- ◆ Consensus expectations anticipate the CMBS market to grow 15%, to \$50 billion+ in 1998

... and conduits now account for roughly 50% of the CMBS market.

(1997)

	\$mm	# deals	Mkt shr %
Conduit	21.9	24	49.5
Private Label	10.4	38	23.5
Large-Loan	4.5	5	10.3
Non-U.S.	3.6	13	8.0
Fannie/Freddie	2.7	9	6.0
Leased-Backed	1.2	17	2.7
Total	\$44.3	106	100.0

Morgan Stanley plans to capitalize on this strong and profitable market . . .

- ◆ Establish strong strategic alliances with clients capable of originating the most profitable conduit product
- ◆ Become large enough to benefit from economies of scale as the market matures
- ◆ Focus on developing a conduit franchise that capitalizes on its competitive advantages

... however, there are certain constraints that are unique to Morgan Stanley

- ◆ Staffing -- headcount constraints have negatively impacted client service
- ◆ Office Space -- have had to maintain production premises off-site
- ◆ Systems -- have multiple redundant systems that do not communicate with one another
- ◆ Balance Sheet -- the \$5.0 billion limit has been reached
- ◆ Firm Relationships -- pursuit and maintenance of unprofitable “firm” relationships

The channels of Morgan Stanley's conduit have enabled it to become a market leader within a short period of time . . .

- ◆ REFA
- ◆ QuestCap
- ◆ Financial Institutions
- ◆ Direct
- ◆ Other Sources

... however, there are noteworthy issues associated with each channel.

- ◆ REFA -- hit rates have been low; have required substantial training
- ◆ QuestCap -- organization is vast and splintered, requiring significant resources to maintain
- ◆ Financial Institutions -- risk of pulling away and going it alone after learning the business
- ◆ Direct -- can require significant resources to pre-screen deals
- ◆ Other -- difficult to plan for this due to the dynamic nature of this component of business

Based on closings to date and current pipeline, 1998 production from these channels could be significant . . .

(\$Millions)	Annualized YTD Closings	Annualized Current Pipeline
REFA	482	743
QuestCap	662	1,242
Financial Institutions	1,023	3,067
Direct Originations	671	1,047
Other Sources	1,262	1,021
Totals	4,100	7,120

Based on the above, and given the current channels conduit business, \$6.0 billion can be originated in 1998

... and fiscal 1998 revenue could surpass expectations ...

		\$mm
1997 Originations (slated for securitization in 1998)		825
Weighted Average Spread	170 bp	
Projected Net Execution	130 bp	
Revenue from FY 97 originations		22
Revenue from FY 98 originations		<u>29</u>
Projected FY 98 revenue		51
Upside to FY 98 revenue (assuming favorable capital structure and status quo spreads)		<u>19</u>
Upside FY 98 revenue		70

... based on projected 1998 conduit securitizations ...

Projected 1998 Conduit Securitizations:

- ◆ From FY 97 Originations
- ◆ From FY 98 Originations

\$mm

825

2,375

3,200

... thereby setting the stage for continued strong revenue in 1999.

	\$mm
Projected FY 98 Originations	6,000
Less: FY 98 Originations securitized in FY 98	<u>2,375</u>
Available for Securitization in FY 99	3,625
1999 Revenue from FY 98 Originations	73

NOTE: Excludes Revenue from FY 99 Originations

Based on the current pipeline, the Morgan Stanley conduit origination channels are relatively profitable . . .

	<u>Avg. Spread</u>	<u>Range of Profits</u>	
		<u>Pts.</u>	<u>\$mm</u>
REFA	157	0.93-1.75	2.2 - 4.4
QuestCap	161	1.17-1.87	4.9 - 7.9
Financial Institutions	181	1.45-2.20	14.8 - 23.7
Direct Originations	141	0.98-1.40	1.3 - 4.1
Other Sources	163	1.76-2.25	5.8 - 7.4
Totals	167	1.22-2.00	29.0 - 47.5

... and provide a diversified mix of collateral types.

	<u>Avg.</u> <u>Spread</u>	<u>Collateral Type Mix%</u>		
		<u>Comm</u>	<u>Multi</u>	<u>Hotel</u>
REFA	157	55%	23%	22%
QuestCap	161	46%	30%	24%
Financial Institutions	181	53%	40%	8%
Direct Originations	141	27%	71%	2%
Other Sources	163	25%	61%	14%
Totals	167	45%	44%	11%

... there are some channels which are notably more efficient to work with

- ◆ Clients who are able to originate flow product with limited input from Morgan Stanley
 - ◆ Belgravia (Finova)
 - ◆ Conning (GAL)
 - ◆ Mellon (Servicing Refinancing Program)
 - ◆ Home Savings of America
- ◆ Clients who are able to aggregate product for sale
 - ◆ Union Bank / Norwest / KeyCorp
- ◆ Direct deals where there is a strong real estate relationship with Morgan Stanley

In summarizing our current origination channels, it is appropriate to rank them.

	REFA	Quest	Fin.Inst.	Direct	Other
◆ Volume	5	2	1	3	4
◆ Profitability	4	2	1	5	3
◆ Firm Relationship	5	4	1	2	3
◆ Ease of Use	4	5	1	3	2
◆ L/T Potential	5	2	3	1	4
Overall	5	3	1	2	4

Morgan Stanley is competitive in Conduit CMBS for many reasons . . .

- ◆ Packaged solutions (e.g., debt, equity, advisory)
- ◆ Strong relationships with Financial Institutions
- ◆ Diversified channels to source conduit product
- ◆ Efficient CMBS executions
- ◆ Ability to be in the market frequently

... however, there are many products
Morgan Stanley generally does not offer ...

- ◆ Small Loan (<\$1mm) Financing
- ◆ ARMs
- ◆ 3 to 5 year interim financing
- ◆ Credit Tenant Lease program
- ◆ Construction Financing
- ◆ Earnout Financing

... And there are a good number of other potential sources not yet developed ...

- ◆ Dean Witter
- ◆ Novus
- ◆ Holliday Fenoglio
- ◆ Bank United
- ◆ Michigan National
- ◆ Laureate Realty
- ◆ Mass Mutual
- ◆ AMI Capital

Who are Morgan Stanley's primary competitors and how are their businesses structured?

	<u>Nomura</u>	<u>Lehman</u>	<u>CSFB</u>
Staffing	150	90	75
Channels	Direct & Brokers	Direct Brokers & Fin. Instit.	Direct & Brokers
'98 Volume Goals	\$6.0B	\$6.0B	\$5.0B
Products offered	Fixed, ARMs Construction Interim Fin.	Fixed, ARMs Interim Fin.	Fixed, ARMs Interim Fin.
Orientation	Principal	New Issue	Principal

Despite the outlook for Morgan Stanley's conduit business, it will deteriorate if resources are not significantly increased . . .

- ◆ Office Space -- establish use of office space at 1585 Broadway, contiguous to MSR
- ◆ Systems -- establish budget for \$1.0mm to develop fully integrated information systems
- ◆ Balance Sheet -- increase balance sheet limit by \$2.0 billion

... And most importantly, professional staffing needs to be expanded.

	<u>Current</u>	<u>Request</u>	<u>Total</u>
◆ Program Managers	3	0	3
◆ Bankers	8	7	15
◆ Analysts	5	15	20
◆ Underwriters	9	9	18
◆ Contract Finance	5	5	10
◆ MIS/Trading Support	3	3	6
◆ Whole loan trading	1	1	2
Totals	34	40	74

In summary . . .

- ◆ Our current volume goals are unrealistically low, given the potential of our current origination channels
- ◆ We are unable to sufficiently service our current client base, expand our product line, or develop other promising sources of business
- ◆ To manage this business, additional resources are required (staffing / space / systems / balance sheet)
- ◆ With the additional resources, we can do \$6.0B with our current origination channels
- ◆ The channels are well oiled, but they will blow up if we don't allocate sufficient resources to manage this business the right way