Dominion Bond Rating Service

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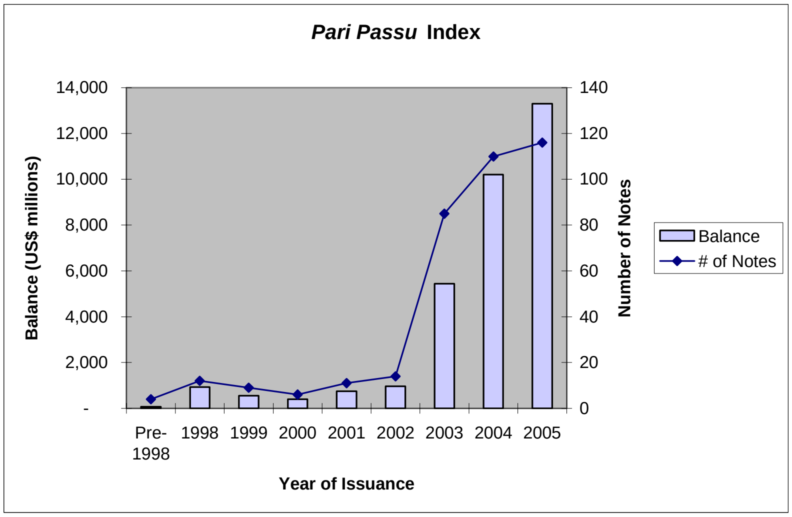
Pari Passu Index

The *pari passu* contribution in 2005 into U.S. commercial mortgage-backed securities (CMBS) transactions was higher than the record previously set in 2004, as shown on the chart below.



DBRS has updated its *Pari Passu* Index. In 2005, 52 newly originated loans were split into *pari passu* notes and 116 *pari passu* notes were contributed to CMBS transactions. Considering the 82%[1] increase in total U.S. CMBS volume in 2005 from 2004, the 30% increase by balance in *pari passu* notes over the same time period is less significant. The smaller growth of *pari passu* notes is because transactions in 2005 were substantially larger reducing the need to diversify large loans by splitting them into *pari passu* notes.

The majority of loans split into *pari passu* notes are secured by high quality institutional real estate assets, which retain their ability to attract capital during a period of relative illiquidity. However, with the complicated *pari passu* loan structure, multitude of participants and governing documents, regardless of the availability of capital, the resolution time in an event of default will likely increase resulting in a higher loss severity.

As DBRS has addressed in previous updates, the financial reporting of these loans remains an on-going issue. While it seems only logical that a property should have one cash flow, in practice a property's cash flow can differ based on the master servicer. In most instances the cash flow difference is minimal and has to do with minor adjustment to normalized real estate taxes or capital improvements. However, DBRS has seen cash flow differences up to 20%. While major cash flow discrepancies are not commonplace, disparities exist for nearly all master servicers.

A structural feature found in most *pari passu* loans to mitigate losses is a cash management agreement, but loans could potentially miss triggers based on inaccurate financial reporting. DBRS expects financial reporting issues on pari passu notes in 2006 to persist and hopes to help clarify these problems.

While the DBRS *Pari Passu* Index only includes U.S. CMBS, the *pari passu* structure has also been used in the Canadian market. The universe of *pari passu* notes in the Canadian market is substantially smaller with five *pari passu* notes in Canadian CMBS transactions.

DBRS will continue to update the *Pari Passu* Index semi-annually. To request a copy of the *Pari Passu* Index, please contact us at: cmbs.surveillance@dbrs.com.

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[1] Source: Commercial Mortgage Alert.