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EOP FLIPS OR FLOPS? WHERE HAVE THEY LANDED?

In the first half of 2007, Blackstone's \$39.2 billion purchase of Equity Office Properties (EOP) was the industry's hot topic. At the same time, many real estate professionals were balking at the high price it paid. Then, in Blackstone-fashion, it turned around and immediately sold many of these properties for a profit. The subsequent sales generally implied cap rates below 5% and mind-boggling prices per square foot. Today, these buyers are saddled with loads of debt, depressed real estate values and rising vacancies. If one bought a CMBS transaction in 2007, you likely have exposure to at least one loan secured by a Blackstone-EOP flipped property and you too may soon feel the consequences of these inflated prices and over-leveraged loans.

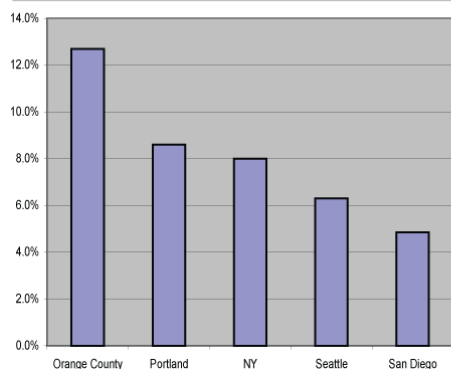
Now, nearly three years following the closing, DBRS is interested in reporting the updated performance of some of the securitized EOP-Blackstone flips. The results are simply not good. The losers are prominent real estate investors across major markets. The loans were made assuming cash flow growth and in most instances, just the opposite has occurred. It does appear that some loans will make it to maturity but all will face tremendous refinance risk.

Some highlights of the study are below:

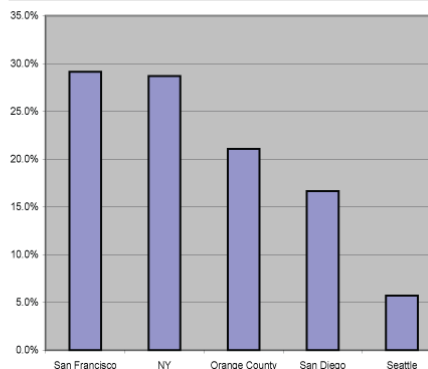
- Assuming an 8% cap rate, no loans have sponsor equity remaining.
- Two loans have experienced mezzanine loan defaults.
- Five loans are in special servicing.
- 12 loans are on the servicer's watchlist.
- No loan has achieved the underwritten pro forma net cash flow (NCF). In fact, those underwritten to projections have experienced a 37.6% NCF decline compared to the pro forma.
- For the 19 loans that reported both the borrower's NCF at issuance and a YE2008 NCF, 14 have experienced a NCF decline.
- Of the 26 fixed rate loans, 15 are below 1.0x, based on mortgage debt and YE2008 reported NCF.
- For the 27 loans that reported a YE2008 NCF, 17 have debt yields that are below 6.5%. The average debt yield for the 27 loans is 5.3%, less than half of what is required in today's lending environment.
- Every loan is structured as interest-only and lacks amortization making the exit debt yield no better than the current measure.

Since Q2 2007, the approximate time of many of these bulk sales, availability rates and rental rates have taken a turn for the worse in nearly all of the markets. While some markets have deteriorated only moderately, some have gotten quite bad. The graphs below display the worst performing markets in terms of both availability rate increases and rental rate decreases.

Largest Increase in Availability Rate



Largest Declines in Rental Rate



If it was up in the air in 2007, where has it landed starting in 2010? DBRS will attempt to answer this in a follow-up industry commentary detailing the results of 29 securitized CMBS loans secured by 80 EOP flipped properties, in 11 MSAs, representing \$8.4 billion in outstanding first mortgage debt.

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