CMBS/Europe
Presale Report

Castanea One PLC

Expected Ratings*

EUR423,973,670 Credit Default Swaps (CDS)
EUR528,750,000 Floating Rate Notes (FRN)

Class	Amount (EURm)	Type	Rating	CE (%)
CDS	423.97	CDS	AAA	55.5
A+	0.25	FRN	AAA	55.5
A1	71.5	FRN	AAA	48.0
A2	47.0	FRN	AAA	43.0
B	72.0	FRN	AA	35.5
C	119.0	FRN	A	23.0
Funding Notes	5.0	FRN	AAA	-

Analysts

Uta Gardewischke
+44 207 862 4052
uta.gardewischke@fitchratings.com

Katie Moretti
+44 20 7417 3471
katie.moretti@fitchratings.com

Andrew Currie
+44 20 7417 4374
andrew.currie@fitchratings.com

Performance Analytics

Mario Schmidt
+44 20 7417 4232
mario.schmidt@fitchratings.com

* Expected ratings do not reflect final ratings and are based on information provided by issuers as of 27 May 2004.

■ Summary

This transaction is a synthetic securitisation of portions of mainly commercial mortgages originated by Allgemeine HypothekenBank Rheinboden AG (the "Originator" or "AHBR" rated 'BBB+/F2' by Fitch). Fitch Ratings has assigned expected ratings to the floating-rate notes and senior credit default swap ("senior CDS") to be issued by Castanea One PLC ("the Issuer" or "Castanea") as indicated at left. The expected ratings reflect the credit enhancement provided to each class by subordination of the classes junior to it, the underwriting and servicing expertise of the mortgage originator, the positive and negative features of the reference pool, and the integrity of the legal and financial structure. The expected ratings for the floating-rate notes address the likelihood that investors will receive timely payment of interest and ultimate repayment of principal by final legal maturity.

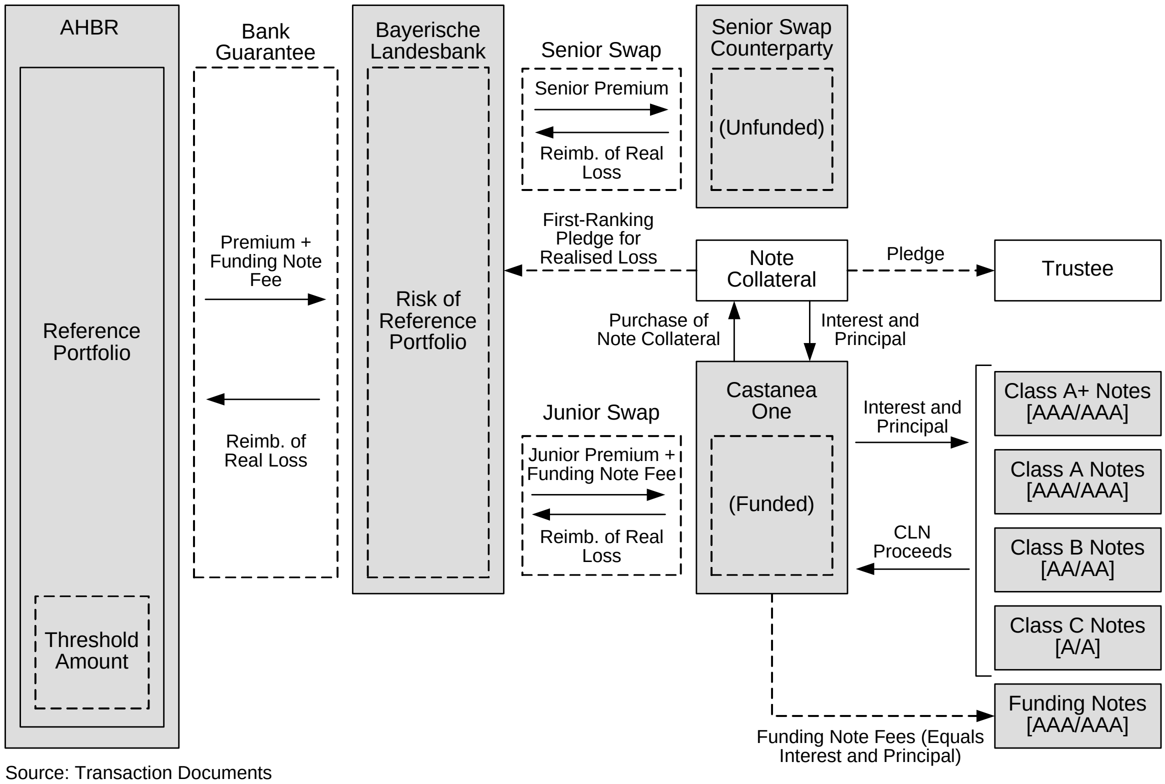
The transaction uses a partially funded credit-linked note synthetic structure in which losses are synthetically allocated to the notes and unfunded senior CDS according to the performance of a reference pool of portions of mortgages, which remain on the Originator's balance sheet. The structure uses an intermediate public sector bank ("Landesbank"), Bayerische Landesbank ("BayernLB"), to provide a public sector guarantee to AHBR to reimburse losses incurred in the reference pool. Such losses will first be allocated to the threshold amount of EUR219 million, then to the rated notes via the Junior Credit Default Swap ("junior CDS") in reverse sequential order, beginning with the class C notes, and finally to the senior CDS.

Under the senior CDS, the Landesbank can claim such losses from the senior CDS counterparty. In exchange for the loss protection provided, BayernLB will pay the protection seller a fixed-rate premium on the notional amount of the junior and the senior CDS outstanding on each payment date. The expected ratings address the likelihood of a claim arising under the credit protection, but do not address the timely or eventual payment of the premium by BayernLB.

The reference pool comprises both entire, and portions of 115 commercial (and to a limited extent residential) mortgage loans originated by AHBR, the aggregate principal balance of AHBR's securitised interest being EUR952.7m. The loan book out of which these securitised interests have been created is EUR9.0 billion, of which AHBR's portion represents EUR2.9 billion. The securitised interests in respect of 55.7% of the securitisation pool are synthetically created second lien portions, while 44.3% (eight loans) are whole loan exposures. The loans are secured on 551 properties located in Austria, Belgium, Denmark, France, Germany, The Netherlands, Spain, the UK and the US, with over 2,800 leases.

The structure includes replenishment provisions for a period up to July 2005, during which new loans can be added to the reference pool to replace amounts prepaid and repaid under original mortgages up to the initial outstanding amount. These new loans must conform to certain criteria. At closing the Class A+, A1, A2, B and C notes will be collateralised with Landesbank Note Collateral.

Structure Diagram



Source: Transaction Documents

Credit Committee Highlights

- The securitised interests in respect of 55.7% (107 loans) of the securitisation pool are synthetically created second lien portions, while 44.3% (eight loans) are whole loan exposures. Second lien portions are subordinated to the first lien for the purposes of allocating foreclosure proceeds.
- Geographic diversification across eight western European countries and the US, the largest exposure in the UK representing 35.1% of the securitised pool balance.
- Large number of loans although there is some concentration as 10 largest loans by securitisation exposure account for 51.4% of securitised current balance.
- Office properties secure 47.1% of the securitised balance.
- Diversification by tenant income, as there are more than 2,800 leases; however, the weighted average tenant quality is low. Some reference claims have single tenant exposure.
- High current and balloon loan to value ratio (“LTV”) (>90%) on certain loans. Overall the current LTV ratio, weighted by securitisation exposure, is 71.9%.
- AHBR originated 65.4% of the reference pool as participants in syndicated loans. AHBR was not the agent bank for these loans.
- Exposure to short lease terms on some central European properties.

Structure

The transaction is structured as a partially funded synthetic, which means that losses allocated to the notes and credit protection are linked to the performance of a reference pool of loans that will remain on the balance sheet of AHBR. AHBR will enter into a contractual Bank Guarantee agreement with BayernLB, a public sector bank, to protect itself from losses incurred in the reference pool above the threshold amount of EUR219m in exchange for a premium payment from AHBR. The public sector bank will then enter into a junior CDS with the Issuer and a senior CDS with the senior swap counterparty to protect itself from the losses claimed by AHBR under the Bank Guarantee.

Castanea One PLC, a Dublin, Ireland, registered public company limited by shares, is the Issuer of the rated notes.

Key Information

Reference Pool Characteristics at Cut-Off Date

Reference Pool: 115 fixed- or floating-rate commercial mortgage loans and synthetic participations in commercial mortgage loans

Mortgage Security: 551 commercial properties in Austria, Belgium, Denmark, France, Germany, The Netherlands, Spain, the UK and the US

Loan Originator: AHBR AG ('BBB/F2')

Outstanding Pool Balance: EUR952.72m

Weighted Average DSCR (Fitch): 2.27 times

Weighted Average ICR (Fitch): 1.53 times

Weighted Average Interest Rate: 4.5 %

Weighted Average LTV: 71.9%

Weighted Average Balloon LTV: 54.4%

Weighted Average Seasoning: 2.7 years

Securitised Outstanding Loan Balance Range: EUR0.2m to EUR133.6m

Average Securitised Loan Balance: EUR8.3m

Three Largest Securitised Loan Portions: EUR309.9m, 32.5% of pool (cut-off date)

Five Largest Loans: EUR370.8m, 38.9% of pool (cut-off date)

Ten Largest Loans: EUR489.7m, 51.4% of pool (cut-off date)

Cut-Off Date: December 2003 (for one reference claim cut-off was January 2004)

Final Loan Maturity Date: December 2015

Weighted Average Remaining Loan Term:
8.8 yrs

Closing Date: June 2004

Property Characteristics at Cut-Off Date

Market Value ("MV"): EUR12.4bn not syndicated and not weighted by securitised exposure

Weighted Average Property Quality (Fitch): 'B-' (on a scale of A to D)

Transaction Parties

Originator: AHBR AG.

Issuer: Castanea One PLC (Dublin, Ireland)

Servicer: AHBR AG.

Arranger: Commerzbank Securities ('A-/F2')

Trustee: Deloitte & Touche GmbH

Principal Paying Agent: BNP Paribas Securities Services, Luxembourg

Public Sector Bank: Bayerische Landesbank AG ('AAA/F1+')

Should losses be realised in relation to the reference pool, and the trustee agrees that the determination and allocation of such losses is justified, these losses will first be allocated to the threshold amount, then to the rated notes via the junior CDS in reverse sequential order, beginning with the Class C notes, and finally to the senior CDS.

Note Tranches and Collateral

The class A+, A1, A2, B and C notes will be collateralised at closing with note collateral provided by BayernLB. The note collateral will be available until October 2015, at which point it will be substituted by other note collateral subject to certain tests. The spread on the class A+, A1, A2, B and C notes will be paid by BayernLB pursuant to the junior CDS. The note collateral will be pledged to the trustee and will be held on behalf of the noteholders by a custodian in a segregated account of an entity rated at least 'F1' by Fitch Ratings. On each date, on which a principal payment is to be made under the notes, BayernLB shall repurchase from the Issuer an equivalent portion of the Note Collateral at par.

The note collateral issued by BayernLB is rated 'AAA'. The structure does not provide for any substitute collateral should any of the note collateral be downgraded during the term of the transaction.

Funding Notes

The notes provide the Issuer with the funds necessary to pay any fees, costs and expenses payable in connection with the sale of the notes and certain additional costs. The notes are not subject to loss allocation and do not provide any credit enhancement to other classes of notes. The funding notes rank at least *pari passu* with all other unsubordinated obligations of the Issuer. However, payments under the notes are limited to the funding note fee that is payable by BayernLB to the Issuer under the junior swap agreement for the purpose of paying interest and principal on the funding notes.

Credit Protection Tranches

Bank Guarantee

AHBR AG, as protection buyer, will enter into a loss guarantee (the "Bank Guarantee") with BayernLB. Pursuant to the Bank Guarantee, BayernLB will pay AHBR amounts equal to the Realised Losses incurred on the reference pool.

Credit Default Swaps

The structure provides for BayernLB to enter into a senior CDS agreement at the closing date. Under the CDS BayernLB will buy credit protection from the senior swap counterparty to which it will pay a quarterly fee. In return, losses will be allocated to the credit protection. The rating of the senior CDS is not dependent on the credit quality of either AHBR or BayernLB. Fitch's ratings address the likelihood of a claim arising under the credit protection and not the timely or eventual payment of the premium by BayernLB.

With respect to Class A+, A1, A2, B and C, BayernLB will enter into a swap agreement with the Issuer. The Issuer will pay BayernLB amounts equal to the Realised Losses allocated to the notes in exchange for a premium representing the difference between interest received from the collateral and interest payable on the rated notes.

Interest Payments on Notes

Noteholders will receive quarterly interest payments in arrears based on three-month EURIBOR plus the applicable margin. Payments will be made on the 25th day of October, January, April and July, commencing in October 2004. Interest on the notes will be paid using the interest from the collateral plus the class spread amount (premium) paid by BayernLB.

Principal Payments on Tranches

Principal payments will be allocated to the credit protection and note tranches sequentially, starting with both the senior CDS and class A+ in line with scheduled principal paid under the reference pool, until each class is redeemed. The senior CDS and class A+ will rank *pari passu* in terms of principal payments. When redeeming the classes, an amount equal to prepayment and foreclosure proceeds on the reference pool will also be allocated sequentially, starting with the most senior class outstanding at that time.

The calculation of the amount to be redeemed may be distorted by late recoveries on previously realised loans, or as a result of an unjustified loss procedure where the trustee has determined that a loss was not realised appropriately in accordance with the documentation and an adjustment is needed. Amounts may also be distorted by loan replenishment over the first year of the transaction. During the replenishment period, as described below, prepaid and repaid loan amounts may be replenished, postponing the principal repayments due to the notes and credit protection.

The senior CDS will amortise on a *pro rata* basis with the class A+ notes. The notional amount will fall as the loan amortises, but the senior CDS will not receive any actual principal receipts.

Realised Losses

A realised loss will only be determined after AHBR has completed its full recovery process. For the purposes of this transaction, the loss calculation will include reasonable fees, disbursements, litigation, foreclosure, valuation and sales expenses. The loss calculation excludes prepayment penalties, internal costs and servicer and bank expenses. Rolled-up interest arrears are included in the loss calculation subject to a cap of 8.1% per annum. Credit events under the loans are borrower bankruptcy and failure to pay.

Any excess spread generated by the reference pool is not (synthetically) credited against realised losses and therefore any realised losses on individual loans and above the threshold amount will reduce the principal balance on the notes. Any realised losses in respect of the reference pool qualifying for the loss allocation will be allocated first to reduce the outstanding threshold amount of EUR219m, then to reduce the class C, B, A2, A1 and A+ notes. Losses will be allocated to the class A+ notes using a reduction factor that is the ratio of the note amount to the credit protection size. At scheduled maturity realised losses exceeding the threshold amount will be allocated to the relevant classes of notes. Furthermore, losses for which eligibility is not determined will be deferred and settled at the actual resolution date, or final maturity, whichever comes first.

The Trustee

Due to the synthetic nature of this transaction, the trustee will assume a number of vital responsibilities on behalf of the noteholders that include, *inter alia*:

- Holding a pledge on the Landesbank note collateral for the noteholders and instructing the transfer of collateral to the Issuer or to the noteholders, as required.
- Verifying the determination and allocation of all realised losses, including the relevant loan's eligibility and the servicing standards applied.
- Checking the acceptability of all reports and documents supplied to it by the Issuer, including pool performance reports.
- Appointing third-party experts when required (eg valuers).
- Co-operating with the applicable parties involved in insolvency, bankruptcy or other similar proceedings against the Issuer.

Replenishment

The structure includes a replenishment period up to July 2005 during which AHBR can reinvest prepaid and repaid principal amounts as well as the balance amount of loans removed from the pool because of non-eligibility. The replenishment is subject to a number of tests, including affirmation of the credit protection and note ratings. The replenishment of all new reference claims taken together cannot exceed EUR300m.

Fitch expects the reference pool to change during the life of the transaction, although the replenishment criteria restrict the types of loans that can be included. The replenishment period is relatively short.

Exchange Rate Reset

The structure includes a provision whereby, on any replenishment date, the Issuer may reset the currency exchange rate of non-EUR reference claims, thereby changing the euro-equivalent amount. The initial balances of the outstanding non-EUR-denominated loans were defined at the exchange rate prevailing in December 2003. The Issuer may only reset the exchange rate subject to certain conditions, which include the following:

- the re-set may not be carried out if it causes the outstanding EUR-equivalent amount to rise above the initial outstanding EUR-equivalent amount of the Non-EUR reference claim; and
- the reset must be applied to all loans denominated in the reset currency.

After the replenishment period, re-set may not be carried out if it results in an increase, but may occur if it causes a decrease in the outstanding EUR-equivalent amount of the non-EUR reference claim on the previous day.

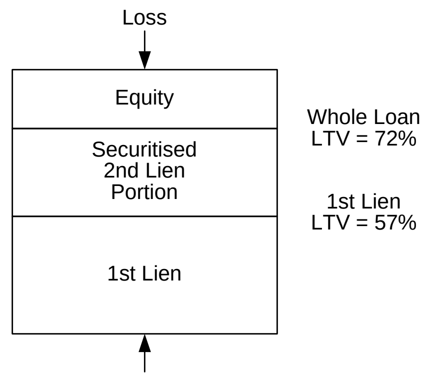
Credit Enhancement

Credit enhancement and credit protection for each class of notes will be provided by subordination. Credit enhancement for the CDS and A+ notes will total [55.5%] and be provided by Class A1 (7.5%), Class A2 (4.9%), class B (7.6%) and class C (12.5%) [of outstanding balance] and the threshold amount (23%). Credit enhancement will be 35.5% for the class B notes, and 23.0% for the class C notes.

■ Second Lien Portions of Reference Loans

The reference pool comprises 115 claims made up of both whole loans and portions of loans. The majority of the reference pool by number of loans (107) and securitised balance (55.7%) comprises portions of loans that are subordinated for the purposes of allocating foreclosure proceeds to other claims of AHBR arising under the same reference loans. Such portions of loans are effectively synthetically created second lien positions; an example is illustrated in the chart below. The remainder of the reference pool (eight loans) comprises entire loans, which represent 44.3% by securitised balance.

Reference Loan with Second Lien Portion



Source: Transaction documents

Second lien positions have been synthetically created in respect of certain reference loans to enable these loans to serve as collateral for separate refinancing instruments. The synthetically created first lien portions of the reference loans constitute collateral for *Pfandbrief* and have been refinanced via *Pfandbrief* issuance, while the synthetically created second lien portions of the loans comprise the reference pool for this transaction.

The main determinant of the performance of second lien positions is the performance of the underlying collateral of the reference loan. However, an additional factor is the size of the second lien relative to the entire loan. One indicator of the relative risk of each second lien position is the loan to value ("LTV") of its related first lien, since foreclosure proceeds are allocated to first lien positions prior to second lien positions. Second lien positions of reference loans for which the first lien LTVs are high are exposed to a greater risk that residual foreclosure proceeds will not be available following full redemption of the first lien. A full loss on a second lien position will be incurred if foreclosure proceeds are insufficient to cover amounts payable under the first lien.

Furthermore, there is a certain amount of gearing of credit enhancement for second lien loans, which is driven by the size of the second lien relative to the size of the entire loan. For example, a loss incurred on a second lien position that is small relative to the entire loan will result in higher credit enhancement than the same loss incurred on a second lien position that is larger relative to the entire loan. The relative size of a second lien position can be determined by comparing the first lien LTV to the LTV of the entire loan; the larger the difference, the larger the second lien.

The amount of each reference loan assigned as a second lien portion has been determined on a loan-by-loan basis. The weighted average first lien LTV of the reference loans (excluding first lien only loans) is 57%; however, the lowest first lien LTV is 14.0% and the highest is 74.9%.

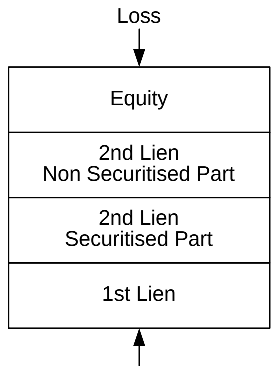
Amortisation

The allocation of amortisation payments between first and second lien portions has been determined on a loan-by-loan basis. For certain reference loans, amortisation will be allocated in full to the second lien portion. In other cases, however, amortisation amounts will be allocated on a full or modified *pro rata* basis. The allocation of all amortisation payments to second lien positions is beneficial and potentially reduces the expected losses on such claims.

Split Second Liens

Following the determination of the size of the second lien portions of reference loans, certain of these portions were split into senior and subordinate positions. The senior positions only are included in the reference pool and represent 10.1% of the securitised balance; an example is illustrated in the figure below.

Reference Loan with Split Second Lien Portion



Source: Transaction documents

The second lien portions of loans that have been split are those relating to reference loans with a maturity date beyond 2015. Senior positions have been structured such that they will fully amortise by 2015. The reason for the split is that the state guarantee of the Landesbank providing the Bank guarantee will expire in 2015.

The senior positions of split second lien portions of reference loans benefit from a number of features. All amortisation payments allocated to the second lien portion will be allocated to the senior position, which is beneficial and potentially reduces expected losses on such claims. In addition, foreclosure proceeds will be allocated sequentially between the senior and subordinate position, starting with the senior position, until fully redeemed. As the senior positions benefit from the subordination of the subordinate positions, the split second lien reference loans will potentially benefit from reduced credit enhancement when compared to second lien positions described above. However, the magnitude of this benefit is dependent, to a certain extent, on the size of the senior position relative to the second lien position.

■ Reference Pool

The reference pool consists of 115 loans the aggregate principal balance of AHBR's securitised interest being EUR952.7m. The total loan book from which these securitised interests were created has a value of EUR9.0bn, EUR2.9bn of which corresponds to AHBR's syndicate portion. These loans are secured by first priority mortgages (except for three second lien mortgages) over 551 freehold and leasehold commercial (and to a limited extent residentially used) properties with a total market value of EUR12.4bn. The properties are located in Austria, Belgium, Denmark, France, Germany, the Netherlands, Spain, the UK and the US

The table below shows the diversification of the reference pool by securitised balance by country. The inclusion of loans from nine countries makes this a diversified reference pool, although European property markets are highly correlated in terms of the cyclicality of their rental and capital value.

Diversification by Country

Countries	Securitised Loan Balances (EUR)	% of the Reference Pool
United Kingdom	334,758,728	35.1
France	185,665,280	19.5
Germany	140,558,275	14.8
Spain	114,021,729	12.0
United States	112,035,854	11.8
The Netherlands	30,700,404	3.2
Denmark	28,974,032	3.0
Belgium	3,163,096	0.3
Austria	2,846,271	0.3
Total	**952,723,670**	**100**

Source: AHBR/Fitch Ratings Ltd

Fitch has inspected 53 properties in the reference pool with a total market value of EUR5.1bn, which represent 41.0% of the total property assets by market value. These properties secure loans representing 44.2% of the securitised outstanding balance of the reference pool. Valuations for a significant number of properties were reviewed by the agency to assess initial and equivalent yields. This has enabled Fitch to gain a good understanding of the markets for these properties and to underwrite these loans on an individual basis.

At the cut-off date, the weighted average current LTV of the loans in the reference pool was 71.9%. The highest and lowest current LTV ratio in the pool will be 96.2% and 43.6%, respectively, at closing. The loan with the highest current LTV is wholly owned by AHBR and has a current outstanding balance of EUR8.24m, of which only EUR1.57m, or 0.2% of the pool, will be securitised. The loan is secured on a grade C retail warehouse property located in a small town (21,000 inhabitants) in Baden-Wuerttenberg, Southern Germany, and is let to a non-rated retailer until June 2014.

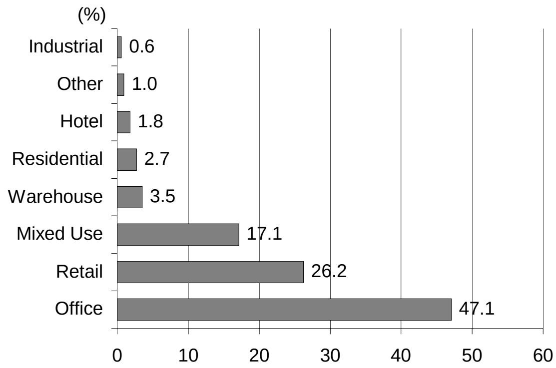
As the pool comprises a large number of loans it is relatively diversified. However, there is some concentration, as the largest 10 loans by securitisation exposure represent 51.4% of the pool by securitised balance. The largest and the second-largest loan by securitisation exposure represent 14.0% and 11.1%, respectively, of the securitised balance. The largest loan is secured by a sale and leaseback portfolio of 351 properties in France, of which 85.0% are office properties and 70.3% by value are located in Paris, the remainder being spread across regional France.

Property Type Concentration

The exposure to collateral located in many different submarkets of each country should make the reference pool more resilient to a downturn in any single market. As can be seen in the chart in the next column, the pool provides some diversification by property type. There is a concentration in the office sector, which is considered to be a more volatile submarket in terms of rental and capital value movements. However, the agency's analysis specifically addresses the risks of this concentration. Moreover, in European CMBS an office concentration of 47.0% is comparable to other transactions.

In addition to the largest loan, other office concentrations in the securitised pool correspond to a loan representing 7.4% of the pool by securitisation exposure that was originated in Spain. This loan is secured by 22 properties, of which 12 are prime to secondary offices, many located in inner-city Madrid.

Asset Distribution Weighted by Securitised Balance



Source: AHBR/Fitch Ratings Ltd

The second-largest asset type by securitised balance is retail. The majority of this, corresponding to 14.0% of total securitised pool, consists of one regional and three super-regional shopping centres in the UK. These types of centre tend to have lower than retail average volatility because of their good tenant diversification.

Loan to Value Ratios

The LTV distribution chart on the next page shows that the current LTV ratios of the loans in the reference pool weighted by securitisation exposure are fairly well distributed. However, there is a concentration of loans with current LTV ratios in the 50%-55%, 70%-75% and 75-80% ranges. There is also a high concentration of very high current LTV loans (greater than or equal to 90%) making up more than 13.0% of the securitised pool. These exposures represent 80.0% of securitised balance from one UK loan that is secured on two UK super regional shopping centres and 20.0% by securitised balance from German loans. However, the current LTV ratio on the loan secured by the two UK shopping centres

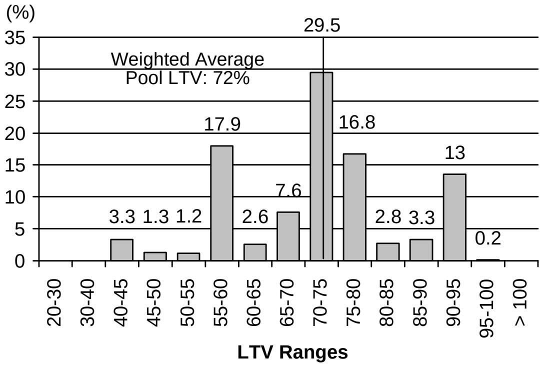
Use Type Distribution by Country Weighted by Reference Pool

(%)	Hotel	Residential	Industrial	Mixed	Office	Other	Retail	Warehouse	Total
Austria	-	-	-	0.3	-	-	-	-	0.3
Belgium	-	-	-	-	0.3	-	-	-	0.3
Denmark	-	-	-	1.9	1.2	-	-	-	3.0
France	-	0.2	0.5	0.1	17.1	1.0	0.3	0.3	19.5
Germany	-		0.1	3.1	4.6	-	4.6	2.5	14.8
Great Britain	-	-	-	4.8	14.1	-	16.2	-	35.1
Spain	1.8	-	-	0.6	4.3	-	4.6	0.7	12.0
The Netherlands	-	-	-	0.5	2.2	-	0.5	-	3.2
USA	-	2.5	-	5.9	3.3	-	-	-	11.8
Total	**1.8**	**2.7**	**0.6**	**17.1**	**47.1**	**1.0**	**26.2**	**3.5**	**100.0**

Source: Transaction Documents

is much lower, at approximately 70.0%, when undrawn commitments are excluded.

Current LTV Distribution Weighted by Securitised Balance

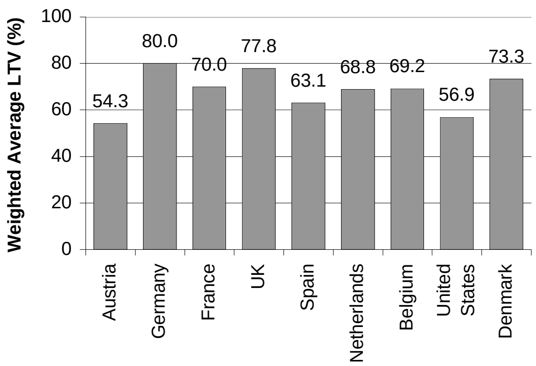


Source: AHBR/Fitch Ratings Ltd

These very high LTV loans could entail a greater risk that proceeds from a refinancing or sale of the properties at maturity would be insufficient to repay the outstanding balance. This is explicitly reflected in Fitch's analysis.

By country, Germany and the UK exhibit the highest current LTV ratios, as illustrated in the chart below.

Weighted Average Current LTV per Country



Source: AHBR/Fitch Ratings Ltd

Other Characteristics

The properties securing the reference loans are, on average, approximately 3.0% over-rented, as passing rents are higher than prevailing market levels.

The weighted average unexpired lease term of the pool is 11.4 years, which is greater than the weighted average loan maturity of the pool at closing of 8.8 years.

Fitch considers the collateral quality of the pool on a weighted average basis to be in the 'B-' category on its scale from 'A' to 'D'. This means good quality property which is relatively well located and which the agency believes would benefit from good occupational and investor demand. Fitch has not been made aware of any material environmental issues relating to the properties.

Property Markets

The following section provides a brief description of AHBR's reference pool in each country (except for Austria and Belgium, where exposures are small) and some background on the property markets within which the collateral is located.

UK

The portfolio consists of 36 UK loans that are secured by 64 properties. The UK portfolio contains three super-regional shopping centres (two of which secure a single loan) and a regional shopping centre. These represent 39.5% of the UK portfolio by securitisation exposure. The remainder of the UK pool is mainly secured by office properties, Central London offices comprising 45.6% of all UK assets by market value. These offices are considered to be prime and secondary grade.

The UK commercial property market has fared relatively well throughout times of adverse economic development and market participants now expect it to fully recover over the next two years.

The Central London office market was the most affected by economic slowdown, which pushed vacancy rates up to 10.6% in Central London, 14.4% in the City and 8.5% in West End. Prime rents fell by 33.0% and average rents by 29.0%. By contrast with the occupational market, the investment market was buoyant. Yields remained stable and even came under downward pressure in some sub-sectors in response to strong investor demand. The outlook now is positive and economic indicators point towards a recovery. For further information, see "*Central London* Offices: A Storm *in a Tea Cup?*", published on 5 March 2004 and available at www.fitchratings.com.

Over the same period, regional office markets remained relatively strong, with many experiencing only small rental declines while some saw continued rental growth.

The retail shopping centre market has been the strongest performing sub-sector in the UK property market, as consumer expenditure has remained high, fuelled by a strong housing market and the availability of inexpensive consumer debt.

France
The portfolio consists of seven loans originated in France. The largest loan in the pool by securitisation exposure represents 71.3% of all French loans by securitised balance. Some 70.4% of the assets in this loan are located in Paris and 29.6% in regional France. The remaining six loans are mainly secured by 18 properties located in Paris. Three more properties secure these loans: one in Brussels, one in Madrid and one in Lille. The majority of these are prime to secondary offices.

Despite some decline in rental and capital values, Central Paris has been among the stronger-performing European office markets in recent years. The main reason for this is that supply was limited at the beginning of the economic slowdown, which caused a comparatively low oversupply at this time. Rents have remained relatively stable and prime rents in the central business district have fallen only 17.0% over the last three years. Vacancy rates are relatively low by comparison with other European cities, at 5.0% in central Paris and 6.8% in the Paris region as of December 2003. As a result of the relatively strong occupational market, foreign investment into the Paris office market has been high, leading to aggressive investment yields. The outlook for the Paris office investment market is good, as it looks set to benefit from the expected economic recovery.

Germany
The portfolio consists of 54 loans secured by 65 properties. The average loan size is much smaller than those originated in other countries in the reference pool. Similarly, the properties that secure these loans tend to be of lower value and tend to be located in smaller cities. The portfolio consists of a mix of mainly office and retail properties, as well as some warehouse and industrial properties. A small proportion (14.7% by securitisation exposure) of all the German loans is located in eastern Germany (including Berlin). A number of loans in this portfolio were originated as a finance lease on sale and leaseback portfolios. These benefit from long lease contracts, but tend to have long loan maturities and, in many instances, passing rent is above market levels. On average the loans in Germany were originated at a much earlier time than those in other countries.

The German commercial property market is relatively dispersed due to the country's federal rather than centralised system. In line with other European markets, the performance of the German property market is currently determined by the country's sluggish economy. However, the performance of individual markets is determined by the strength of their respective local economies and type of businesses.

Frankfurt has probably been the worst hit office market due to its high exposure to financial markets, and has experienced a vacancy rate of over 14.0%. By comparison, the office market in Munich has benefited from a stronger occupational market, which has kept vacancy rates low, at 7.0%. Other office markets in cities such as Hamburg and Cologne have remained relatively stable. However, an expected slow recovery will probably affect the pace of recovery in the commercial property markets.

Spain
Five loans in the reference pool were originated in Spain. The largest of these represents 62.6% by Spanish securitisation exposure. This loan is secured by 22 properties and is discussed in more detail in the loan section below. The next largest loan by securitisation exposure is secured by a portfolio of out-of-town retail malls anchored by a large Spanish retailer. Overall, there is a large exposure to properties located in Madrid.

The Madrid office market experienced oversupply of new space which has resulted in a vacancy rate of 9.3%. Vacancy rates are higher in the more peripheral areas and especially in some out-of-town business parks. Rental levels have started to fall. There are still a large number of developments that are expected to be completed this year and in the next years, which will further impact the market. The level of development activity is higher in out of - town locations than in inner city Madrid.

US
The five loans in the portfolio originated in the US are characterised by being secured on single properties. The weighted average current LTV ratio for these loans is much lower than the pool average, at 54.4%. The properties are located in Arlington, Virginia, Boston, Massachusetts, Silver Spring, Maryland, and in Washington DC. There is one multi-family asset and the others are mixed retail and offices. All assets are multi-occupied.

The Netherlands
Five loans in the portfolio were originated in the Netherlands. The loans are secured by nine properties, of which six are offices, one a shopping centre and one a mixed-use property. The largest loan represents 57.4% of all Dutch loans by securitisation exposure. The loan is secured by one office property located in an out-of-town office area of Amsterdam.

The Amsterdam office market is currently experiencing a strong oversupply of office space. This is following a 12 year period of continuous economic growth, which resulted in the strong performance of office markets. Overall vacancy rates now stand at 12.7%, but are much higher in some sub-markets, especially in out-of-town office locations. Prime office rents in some sub-markets have decreased sharply.

Denmark

One loan was originated in Denmark and is described in more detail in the loan section below. This loan is secured by four properties located in Copenhagen.

As in other European office markets, the economic downturn has caused vacancy rates in Copenhagen to rise in recent years, although only to relatively modest levels. Overall vacancy rates are currently reported at 9.1% – 7.6% in the city centre and 11.1% for the suburbs. Although new developments in the pipeline are expected to be completed by the end of 2004, tenants have already been secured for most of these properties. Prime office rents started to decrease in 2003 and further, though modest, declines are expected in the next year.

■ Loan Characteristics

Outlined below is a brief description of the five largest loans by securitisation exposure. This section also offers an example of a loan that illustrates the nature of a synthetically created split second lien loan that accounts for 39.5% of the pool.

Loan 1: Sale and Leaseback Portfolio, Mainly Offices

14.0% of Securitisation Pool, France: Regional and Paris

This loan is secured on a sale and leaseback portfolio of 351 properties that are leased to a ‘BBB+’ rated French telecoms operator. AHBR is a member of a syndicate of banks and owns 8.7% of the loan. No second lien tranche has been created for this loan, and the whole AHBR-owned portion is included in the securitisation.

The portfolio is concentrated in the Paris region: 40.5% by market value is in Central Paris, 29.9% is in Ile-de-France and the remaining 29.6% is spread throughout the regions. By market value, the portfolio is split as follows: 86.0% offices; 6.6% other; 3.7% technical; 2.4% warehouse; and 1.3% residential.

The portfolio can also be broken down into the following two categories.

- A 45.1% segment of the portfolio by market value is intended to be sold (at least in part). This sub-portfolio comprises mixed office properties and areas of facilities where telecoms networking equipment is located;
- A 54.9% segment of the portfolio by market value is of strategic importance to the tenant, which had no intention to sell at the cut-off date; these assets, which are still owned by the telecoms operator; house network cabling and other technical equipment that is vital to the tenant’s operation and cannot be displaced.

The tenant has been granted a lease on each property, most of these leases expire in March 2011. Approximately 2.0% of the property by income is occupied by other tenants.

The current LTV ratio is 70.8%, while the balloon LTV is expected to be approximately 37.1% in March 2011.

When analysing the level of debt that this transaction can support, Fitch assessed the likely timing of defaults and loss severity on the reference loan. As the majority of the rental income from the portfolio is due from the telecoms operator, the agency considered scenarios in which the tenant was in default and performing. Under its ‘AAA’, ‘AA’ and ‘A’ scenarios, Fitch assumed that the telecoms operator and all other tenants defaulted on day one, thereby triggering a credit event under the reference loan.

The agency therefore sized the balloon repayment risk associated with the different classes of note by calculating stressed vacant possession values for the assets following a credit event on day one. Valuations were calculated by stressing future income, first through the assumption of void periods from the date of valuation until the properties became income producing, and second, by applying discounts to market rents. The stressed future income was then capitalised using appropriate yields on a property-by-property basis.

In Fitch’s analysis this loan contributes above-average losses to the overall securitisation pool at the ratings above that of the telecoms operator, since the assumed early default of the tenant is a particularly stressful test. Although lease expiries coincide with loan maturity, the high level of amortisation, involving an expected 37.1% balloon balance, means that refinancing risk at that point is relatively low. Fitch applied conservative valuation yields to reflect the unusual nature of these assets.

Loan 2: Shopping Centre

11.1% of Securitisation Pool, UK: North East & Scotland

This loan is a participation in a larger facility syndicated among eight banks. AHBR's participation represents 10.3% of the loan. The whole AHBR-owned portion of the loan is included in the securitisation and no second lien tranche has been created for this loan. The loan is secured by two super-regional shopping centres – one near Glasgow city centre, Scotland, and the other near Newcastle city centre, England. These super-regional shopping centres are well established and are located on major routeways close to motorway junctions, and benefit from good access to large catchment populations.

The centres are leased to approximately 300 tenants (circa 475 leases) and provide over 212,000m^2 (2.3m ft^2) of enclosed retail accommodation. The majority of the units in the centres are let under long leases and make provision for the payment of a base rent and an additional turnover rent. The centres are anchored by two large UK retailers, and a number of large national multiples also have a presence. The current LTV ratio, is 69.4% excluding, and 92.4% including, the undrawn commitment, while the balloon LTV is expected to be 61.2% excluding, and 84.6% including, the undrawn commitment in December 2015. The valuation on which the LTV level is based is conservative by comparison with other valuations on similar assets. The loan, which is hedged for the unexpired term of the loan and has a current ICR of 1.68 times, matures in just over 11 years, while the weighted average lease expiry is in 10 years.

The tenant diversification and the predominantly long-term leases mean that this loan performs well in Fitch's analysis. Although the LTV ratio is relatively high, it is based on a comparatively conservative valuation. The agency considers this loan to be secure, as the income is well diversified on a tenant basis, reducing exposure to the default of any single tenant. Furthermore, the agency expects the value of these properties to be supported by the current planning regime, which restricts the construction of further out-of-town super-regional shopping centres. The properties require ongoing active management and Fitch considers that the sponsor of this loan has the required management skills and experience to maximise the value of these assets.

Loan 3: Portfolio of Mainly Offices, 2 Shopping Centre and 4 Hotels

7.4% of Securitisation Pool, Spain

This loan is secured by 22 properties leased to 226 tenants. The portfolio consists of mainly prime to secondary office properties. The majority of the properties by market value (74.2%) are located in Madrid – all in the centre, with the exception of two properties located in an out-of-town business park. There are two shopping centres in the portfolio, one in a suburb of Madrid and another in a regional town. In addition, the portfolio contains three warehouse/distribution assets as well as four hotels, which are leased to a Spanish hotel operator on long leases. The largest hotel by market value is a business hotel located in a prime office location in inner-city Madrid. Two hotels are located in the Andalucia region and one in Barcelona. The leases in this loan have a weighted average unexpired life of 5.5 years.

The hotels in the portfolio are let to an experienced hotel operator on lease terms that do not include any turnover rent element. To reflect the specific risks associated with hotel assets, rents have been stressed accordingly and conservative yields have been applied to reflect the investment characteristics of these assets.

The loan has a current LTV ratio of 56.4% and an ICR of 2.2 times. No second lien portion has been created for this loan, but it has been split as the loan maturity extended beyond 2015. The low LTV level, high ICR, high-quality asset pool and diversification of tenants mean that this loan performs well in Fitch's analysis. The average unexpired lease term is relatively short, but this is somewhat mitigated by the large number of tenants, which creates a smoother cash flow.

Loan 4: Shopping Mall

3.4% of Securitisation Pool, US

The loan is secured by a mixed office and retail property located in New York, US. The property comprises an 11-storey building, with retail on two lower levels, the ground and one upper floor. The property, originally built in 1912, was renovated in 1989 and 2002. It is located south of Midtown Manhattan, near Penn Station in a secondary office and secondary retail location. The property was fully used as a shopping mall until 2002, when a large amount of space was converted into offices. The property is now let to 103 tenants and has a 12.5% vacancy rate, which mainly affects the retail space. The rent on this property is approximately 9.0% reversionary, as market rent is higher than current rent payable. Approximately 49.2% of the income is payable by investment grade tenants: 19.8% by a tenant rated 'AA-' and 29.4% by a tenant rated 'BBB'.

No subordinated tranche has been created for this loan, and the whole AHBR-owned loan is included in the securitisation. The current LTV is 43.6% and the loan is expected to amortise to 41.9% at maturity in December 2006. Although the LTV level is low, the current valuation of the asset appears relatively ambitious. The DSCR is 2.9 times and ICR is at 3.4 times. The low current LTV, high cover ratios and diversity of tenants mean that this loan contributes below-average losses to the securitisation pool.

Loan 5: Offices and Mixed Properties

3.0% of Securitisation Pool, Denmark

The loan is secured by four properties located in Copenhagen, close to the main airport on the isle of Amager. A new underground station is currently being built within walking distance of the properties, which will provide access to the city centre and the airport. All four properties in this portfolio are part of a sale and leaseback transaction to a large European airline operator rated 'BBB+'. The four properties are within 2km of each other in an area that is developing into an established office location.

The largest property by market value consists of five separate buildings, of which 85.5% by income are being used as offices. The remaining space comprises workshops and conference facilities. The second-largest asset consists of two buildings that are both mainly used as offices, one of which was built in 1973 and refurbished in 1990, while the other was built in 1990. The third-largest property consists of four buildings that were built in 1960 and accommodate offices, technical space and data rooms. The property could easily be converted to office use only. The smallest property by market value is an old industrial building that has been converted to modern offices.

Overall, the property portfolio is 7.0% over-rented. The average unexpired lease term is 11.7 years, which compares to an unexpired loan term of over nine years, with loan maturity in October 2013. The balloon LTV is expected to be 60.1%.

AHBR owns the whole loan, but for the purposes of the securitisation, a subordinated portion of the loan will be included in the pool and has been structured such that the LTV on the first lien portion is 47.7%. The whole loan's current LTV is 73.3%, which implies a second lien portion of 25.6%. In a default situation, foreclosure proceeds will first be used to redeem the first lien portion of the loan. As the first lien LTV of this loan is relatively low, a higher amount of foreclosure proceeds is expected to remain as surplus for distribution to the second lien tranche. Since the second lien portion of the loan is relatively large on a pool comparison, losses that are received on this tranche may represent only a small proportion of total claim amount.

The loan is binary in nature, as it is secured by properties that are all let to the same tenant. In a tenant default situation, the probability that the loan will default is high. However, the low first lien LTV, the long unexpired term of the lease compared with loan maturity, the investment grade tenant and conservative valuation yields mean that this loan performs marginally better than the pool in Fitch's analysis.

Loan 6: Office Property

0.6% of Securitisation Pool, Germany

The loan is secured on one office property located in a town (240,000 inhabitants) in Lower Saxony in the North West of Germany. The property is let to a single tenant, rated 'AA-' by Fitch, until May 2013. The property is approximately 4.0% over-rented, which means that passing rent is above market levels. The current LTV is 91.2% and the loan is expected to fully amortise by maturity in August 2029.

A second lien portion of the loan will be included in the securitisation and has been structured such that the LTV of the first lien portion of the loan is 55.0%.

In addition, the second lien portion of the loan has been split into a securitised and non-securitised slice. The portion of the loan to be included in the securitisation pool has been sized such that it will fully amortise by December 2015. All amortisation payments collected for the second lien portion will be allocated to the securitised portion of the second lien in priority to the non-securitised portion.

In a default situation, foreclosure proceeds will first be used to redeem the first lien portion of the loan. One implication of this is that foreclosure proceeds must comprise at least 55.0% of the current value of the property securing the loan less amortisation; otherwise a full loss will be incurred by the second lien portion. Before losses occur on the securitised second lien portion, they will be allocated to the non-securitised second lien portion, as it is junior in terms of loss allocation. This is a beneficial feature of reference loans for which the securitised portion is a split second lien.

However, any loss on the second lien portion of the loan will be allocated to the non securitised second lien portion first. The non-securitised part of the second lien portion of the loan is relatively small, it only representing only 17.1% of the AHBR-owned second lien. The loss absorption can therefore only be modest.

■ Origination and Servicing

At a corporate level, Fitch has assigned a long-term rating of 'BBB+' to AHBR AG and its unsecured bonds. These ratings reflect the bank's increasing integration into the BHW Group, which Fitch believes would provide financial support, if required. A report on AHBR's corporate rating is available on Fitch's website.

Background

AHBR is recognised as Germany's largest "pure" mortgage bank. As such it also undertakes Public Sector Finance, which in 2003 was still the greater part of its balance sheet. A few other mortgage banks in Germany have "mixed bank" status, enabling them to carry out activities additional to those specified in the Mortgage Bank Act.

AHBR was formed through the 2001 merger of Allgemeine Hypotheken Bank and Rheinboden, prompted by consolidation activities in the German mortgage bank sector. At that time, size was considered a crucial factor in minimising refinancing costs and maximising synergies.

AHBR, a member of BHW Group, had total assets of EUR79bn in December 2003. BHW specialises in residential mortgage lending and, as of end-2002, had total assets of EUR113bn. AHBR's main shareholders are trade union association BGAG (50.0%), BHW (39.5%) and DBV Winterthur (10.4%). As of December 2003, its outstanding portfolio of real estate finance business totalled EUR24bn while total public sector finance business represented EUR43bn.

AHBR's future objectives are to concentrate on and increase its mortgage lending business. As of December 2003, 55.0% of its loan portfolio corresponded to public sector finance and 30% to mortgage lending. The company aims to build up a balanced mortgage lending portfolio, comprising 50% residential and 50% commercial lending. The current levels are 36.0% commercial and 64.0% residential assets. Similarly, AHBR aims to achieve an equal split between domestic and international assets, which represented 85.0% and 15.0%, respectively, of the portfolio as of December 2003.

AHBR has substantially increased its mortgage lending activities outside Germany since 1999, through new mortgage commitments of EUR1.03bn (or 25.5%) in 2000 and EUR1.5bn or (25.9%) in 2003. This trend is likely to continue, as AHBR seeks to balance the domestic and international components of its mortgage portfolio. The international exposure brings diversity to the portfolio.

AHBR has decided to outsource the processing its residential lending business to BHW. With regard to development exposure, the company controls potential risks by restricting domestic developer business to key accounts only.

Outside Germany, AHBR operates from representative offices. The first of these was opened in 1999 in London and others were later established in Amsterdam, Paris, Madrid and London. In 2002 a representative office was opened in New York, US.

Within Germany, the headquarter office is in Frankfurt and there are also regional offices in Munich, Berlin, Hamburg, Stuttgart and Cologne.

Origination

The majority of loans originated by AHBR (45.0% by securitisation exposure) comprise bilateral agreements with borrowers, while the remainder are participations in syndicated loans, many with German mortgage banks. For the US loans, AHBR has only originated as a syndicate partner.

The collateral pool consists of mortgages originated between 1985 and 2004, and secured on commercial properties in Austria, Belgium, Denmark, France, Germany, Spain, the Netherlands, the UK and the US. The vast majority were originated between 2000 and pool cut-off-date. Until 1998, loans were only originated in Germany.

AHBR had a total commercial mortgage loan book of around EUR8.8bn as of Dec 2003, 41% of which was secured outside Germany. More than 62.8% of AHBR's new commercial mortgage commitments in 2003 were advanced against non-domestic assets. For this transaction, the total loan book from which the securitised interests were created is worth approximately EUR9.3bn; only certain portions of AHBR's syndicated participation, which represents EUR3.0bn, are included in the securitisation.

Fitch conducted a management review of AHBR's origination and servicing teams at the head office in Frankfurt. The agency also reviewed samples of the documentation produced at loan origination and thereafter on a number of the loans. These reviews enabled Fitch to appraise the company's origination and monitoring procedures to ensure that acceptable servicing systems and personnel were in place.

AHBR's commercial lending operation is divided into domestic and international marketing units and credit departments. For each country where AHBR has representative offices, there is a desk in Frankfurt. The staff are experienced in loan origination in the countries for which they are responsible and have the relevant language skills.

For all countries, strategic controls over origination targets and lending criteria are determined by

AHBR's head office in Frankfurt. The lending criteria are regularly communicated to the representative offices so that the loan originators fully understand the types of loans that AHBR aims to originate. The lending targets vary between the countries according to market conditions.

Both regional and international offices are marketing units only. The credit, servicing and valuation departments are based in Frankfurt and are responsible for domestic and international business. For the domestic business, the credit department is split into subdivisions by property type, while for international business, it has a desk for each country. The servicing and real estate valuation divisions are separate to credit but report to the same board member.

In the case of representative offices, the origination process and credit report is completed in Frankfurt and the departments involved in the process are supported by market expertise from the representative office.

The loan underwriting methodology is based on the cash flow generating potential of the properties securing the loans. It also takes into consideration mortgage lending value (*Beleihungswert*) and market value (*Verkehrswert*). These are ascertained by internal valuers for domestic business and internal and external valuers internationally. The origination process and the credit approval procedure are centralised at AHBR's head office in Frankfurt.

Both the representative office and the credit department provide their credit recommendations in a first and second vote. The outcome of the credit analysis is summarised in a credit report, which must then be approved by individuals at department head and board level before the loan is granted.

Structural and environmental surveys are commissioned only when considered necessary. Property inspections and background checks are carried out internally on new borrowers and loan sponsors to establish their credit and property management histories.

Servicing and Credit Risk Monitoring

The servicing team is centralised in Frankfurt and employs a total of approximately 48 staff. There are also two work-out teams, one located in Frankfurt and one located in Berlin consisting of 8 to 10 people. All the servicing work is carried out in Frankfurt.

The servicing division is split into five units. There are three processing units in Frankfurt, including one for specialised, leisure and operating assets. A second unit of 12 people in Frankfurt also deals with corporate loans above EUR1m, while a third unit handles retail clients and residential mortgages. For cost efficiency reasons, the company intends to move the last of these areas to the BHW group, which specialises in the field. All three of these units are supported by a fourth, the marketing group, which helps achieve the best sales results. The marketing unit keeps a comprehensive database of comparable investment and letting transactions as well as lists of potential investors or tenants. The fifth unit is a workout team located in Berlin.

Credit

All credit exposures are subject to supervision by the credit department. Monitoring reports are produced on a monthly basis, while a more comprehensive report is produced quarterly and reviewed by the respective head of departments. For loans with an inherent increased risk, this may be done more frequently.

Loan managers are obliged to check their loans once a week for payments in arrears. Payment in arrears are followed up by way of a reminder to the borrower. If problems persist, the loan manager can recommend a restructuring programme.

The servicing approach adopted by AHBR, and the regular monitoring of its credit exposure, enables the bank to recognise potential risks associated with any particular loans. A loan showing a persistent deterioration in the credit-standing of the borrower, operators and/or tenants is serviced by AHBR's workout department.

Servicing and Workout

At the time of the review, approximately 1,400 cases were being processed the workout department, of which 800 related to residential mortgages and approximately 600 to commercial mortgages. So far there have been no foreclosures on loans originated outside Germany. The Berlin team deals with cases in eastern Germany, many of which correspond to mortgages made on large residential blocks.

The workout department aims to resolve issues in the most time-efficient manner, although It can take between six months and three years (on average approximately two years) to process commercial assets. The aim is to achieve a free rather than forced sale, as the sale proceeds from an auction usually involve a larger discount than those achieved through free sale.

Overall Fitch is satisfied that AHBR maintains effective credit control.

■ Credit Analysis

Fitch analysed the transaction using its European CMBS multi-borrower model, which simulates tenant defaults to assess stressed DSCRs on a loan-by-loan basis. This approach is well established for the analysis of CMBS transactions.

Amortisation schedules and loss calculation were adjusted to reflect subordination and other features of the second lien portion of loans in the pool. Amortisation schedules for allocation between the first, second and securitised second lien portions were provided by the originator and applied. Losses were calculated on a whole loan basis, as described below, and were then split and allocated as determined by the synthetic structure described in the structural section above.

Fitch's methodology is described below.

- The collateral is broken down by lease and cash flows projected over a period of up to 30 years.

- At lease rollovers, void periods are assumed based on the quality of the property (principally determined by location). Certain percentages of tenants are assumed to remain at lease rollover, again depending on the stress run being carried out as well as the characteristics of the commercial property markets in which the property is domiciled.

- At rollover, rents are reduced based upon the type of property, the property market and the stress run being carried out. The Fitch assessment of rental value declines ("RVD") uses information from previous property market recessions experienced in all countries included in the reference pool. In Europe, the office market has generally been the most volatile market and therefore RVDs applied to office properties are higher than for other types of properties. Retail properties and residential properties, on the other hand, have typically proven more resilient. The applicable level of stress is expected to change over time as some loans prepay or reach their maturity dates, and as the weighting of the collateral properties and leases changes.

- Furthermore, at the end of a lease, refurbishment costs are assumed, which vary depending on the type of property. Letting commissions of 10% of first year's rent are also netted off.

- In addition to tenant rollover, tenants are randomly defaulted according to the Fitch corporate default matrix. The probability of default is dictated by the public or shadow rating of the tenant and the stress run being carried out. Again, void periods and re-letting costs and fees are assumed for each defaulting lease.

- This produces underwritten cash flows on a loan-by-loan basis, which are then compared to projected interest and scheduled principal payments on each loan. Under each stress scenario, it is assumed that, where the DSCR drops below a certain level (usually 1.0x) for an extended period, the loan will default. It is also assumed that scheduled principal payments take place where there is sufficient stressed excess cash flow to do so, otherwise the loan defaults. The DSCR default test is adjusted where there is recourse to an investment-grade borrower or guarantor.

- When a loan defaults, the model calculates the loss severity by taking the amount of principal outstanding at the date of default (ie the initial amount less scheduled principal repayments up to the date of default) less a stressed recovery value for the properties. The recovery values reflect Fitch's property underwriting requirements adjusted for sale costs and delays in refinancing or sale. For the purpose of this transaction, foreclosure costs and accrued interest capped at 8.1% are included in the realised loss calculation.

- In this transaction, foreclosure proceeds are used to repay the first lien portion of loans first. Any remaining proceeds are allocated to the second lien portion loans.

- For split second lien loans, losses are allocated to the non-securitised part of the second lien first. If the non-securitised parts of second liens are not large enough to absorb all losses, they are subsequently allocated to the securitised part of the second lien. The size of the parts of second lien portions at the time of default also reflects the level of amortisation at that point.

- Many hundreds of runs are carried out for each stress level and the results are then analysed to calculate the average credit enhancement sought and the standard deviation, both at a pool level and for individual loans. Credit enhancement on individual loans is weighted by its securitisation exposure.

- Credit enhancement on split second liens is calculated on the basis of loss as a percentage of the securitised second lien.

- Following this, an adjustment is made for factors that cannot be reflected in the model including loan, borrower and property concentration, loan servicing, loan origination, environmental and disaster issues, and excess spread, if applicable.

- The maturity profile of the pool is also considered, particularly in relation to the tail period when, for example, a single loan may remain outstanding, which can concentrate the risk in relation to notes still outstanding.

■ Results

The analysis allowed Fitch to assess default probability and loss severity on a loan–by-loan basis. Both the likely timing of default and whether losses are expected at loan maturity or during the term of the loan were considered. The resulting credit enhancement requirements are as shown at the start of this report.

The agency's analysis reflects the characteristics of the transaction structure. In this transaction, foreclosure costs were included and accrued interest capped at 8.1% was applied to calculate realised loss.

The reference pool is geographically well diversified and also presents reasonably good diversification by asset type, despite concentrations in office properties. The diversification by property type and by geographic location reduces the pool's exposure to a downturn in any one sector or region. The pool has a reasonably high average lease term of 11.4 years. There are, however, several regions in which average lease terms are well below the pool average.

The second lien portions of loans in the securitisation pool achieved different results than the whole loan securitisation exposures. The subordinate nature of the second lien portion of loans means that the proceeds from foreclosure must be at least sufficient to repay the first lien portions of loans as the second lien tranche will otherwise incur a full loss. The second lien portion of loans is therefore more severely affected by a decline in the value of real estate. Where loans in the reference pool have a high first lien LTV ratio, the credit enhancement levels on the corresponding second lien portions included in the securitisation pool are high. Loans with high first lien LTV also tend to exhibit high required credit enhancement in more than one rating scenario, which leads to small discrepancies between the results for different rating levels. In addition, the amount of credit enhancement sought is exacerbated if the second lien portion is small, since loss is expressed as a percentage of a small tranche.

The securitised portions of split second lien loans receive amortisation in priority to the non-securitised part of the second lien and are also prioritised in that losses are allocated to the non-securitised part of the second lien first.

At the cut-off date, the pool exhibits good ICRs and DSCRs, which help the performance of the portfolio. However, some of the loans included in the pool have hedging arrangements that are scheduled to terminate, or reset dates that fall within the next four to six years. This could create additional stress on the loans if interest rates rise.

Finally, Fitch considers AHBR's policies and expertise to be adequate for the servicing of this large and diversified portfolio.

■ Performance Analytics

Fitch will monitor the transaction on a regular basis and as warranted by events. Its structured finance Performance Analytics ensures that the assigned ratings remain, in the agency's view, an appropriate reflection of the issued notes' credit risk.

Details of the transaction's performance are available to subscribers at www.fitchresearch.com. Further information on this service is available at www.fitchratings.com.

Please call the Fitch analysts listed on the first page of this report for any queries regarding the initial analysis or the ongoing performance.