CAPITAL LeaseFunding

The *Source* for Credit Tenant Lease Solutions

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Terrorism Insurance Provisions in Credit Tenant Leases

On November 26, the President signed the Terrorism Insurance Act of 2002, which provides a federal backstop to insurance companies suffering losses as a result of a terrorist attack. In return, insurance companies are required to make terrorism insurance available to policy holders on the same terms as they would other types of casualty insurance. Though they can charge an additional fee.

Many credit tenant leases require the tenant to maintain insurance policies satisfactory to the landlord and its lender and in some cases to rebuild after any type of casualty. These provisions help to mitigate the risk associated with terrorism. Leases that fail to contain such protections, can be a problem. In such cases, borrowers would be required to provide evidence in the insurance certificate that terrorism coverage is not being excluded from the all risk policy.

The requirement that terrorism insurance be included in "all risk" policy is important because the new legislation is a short term measure it expires in December, 2005. Because CTL loans are 10 years or longer, the lender cannot waive the requirement of continuous terrorism coverage in the loan documents. If possible, owners of net leased properties should negotiate explicitly into their leases the requirement that the tenant's all risk policy include coverage for terrorism insurance. If this is not possible, borrowers will be required to maintain such coverage for the duration of the loan at an unpredictable expense.

Crowded Nov. - Dec. CMBS Calendar Helps Volume, Widens Spreads

The US CMBS market has been in the doldrums for most of '02, with volume through October lagging '01 by $15.4 billion. November and December saw a sharp pickup in activity with thirteen issues being planned totalling $12 billion. Overall, CMBS volume worldwide in '02 lagged '01 by $8.7 billion while '02 non-US CMBS volume continues to set records with YTD volume at $26.3 billion versus $19.6 billion last year.

After an extended period of relative stability, 10 year AAA bond spreads widened from the mid to low 40's to about 50-51 bps over swaps between November and December. Mezzanine bonds widened anywhere from 10-30 bps. The primary driver of this spread widening has been the sharp tightening in 10 year swaps which dropped from 56 bps to 45 bps. The year end volume blitz has also put pressure on spreads.

Despite recent spread widening, market fundamentals remain strong, buoyed by the strong performance of CMBS relative to equities and the fact that many life companies are flush with cash and need to invest. Life companies which normally invest 10-15% in AAA CMBS have taken down 30-40% of the AAA classes in recent months. Much of this investment is seeking a temporary "safe haven" and it is likely that some of these bonds will be re-marketed in '03.

Against this backdrop, conduit origination has picked up in November and December as borrowers seek to lock in long term financing at today's low rates. The recent Fed action which lowered short term rates another 1/2 point to 1.25% from 1.75% makes further reductions unlikely. If recent trends continue, '03 should prove to be a good year for CMBS -- and borrowers seeking to lock in low rates.

Schedule CREF Conference Plans Early

'03 is shaping up to be an interesting and challenging year for the CTL market. How the current strong demand for net leased properties will fare in the face of continued economic weakness, credit downgrades, market volatility and pending FASB accounting changes is an open question.

We will discuss our outlook for the net lease market as well as new CTL financing programs at our annual MBA "early bird" correspondent briefing, scheduled for 7:15 a.m., Monday February 3rd at the San Diego Conference Center room 7A upper level. A breakfast buffet will be served starting at 6:30 a.m. Our senior management and originators will be available for one on one meetings. Please call Chris Crovatto, Bill Paylor or your originator early to schedule a meeting.

Credit Update

Auto Zone Inc. **(BBB+)** was placed on **positive outlook** based on the company's strong operating results.

Tyco **(BBB-)** was placed on **negative watch** as earnings have continued to be depressed and liquidity remains a problem.

Perkin Elmer **(BBB-)** was placed on **negative watch** because of concerns about the company's ability to meet debt coming due in '03.

CVS Corp. (**A** by S&P and **A2** by Moody's**)** was put on **negative outlook** by Moody's due to concerns that the company's aggressive store expansion program in the face of strong competition will put further pressure on leverage. S&P lowered its A rating on the series A-2 CVS Credit Lease Backed Pass through certificates to BBB+. These certificates have a large balloon which is insured by Royal Indemnity Co. Separately Royal's ratings were downgraded to BBB+.

McDonald's Corp. **(A)** was placed on **negative watch** as the company struggles with increased competition and eroding margins.

CLF Website Expanded

CLF's comprehensive website draws close to 800 visitors per week. To make the site even more user-friendly we have redesigned and expanded it. One of the new features is a loan request form which will enable you to request a loan online. A CLF originator will get back to you in 24 hours to discuss your transaction in detail. Visit our "new look" website beginning in late December at w w w .caplease.com.

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