Date: April 28, 1997

To: John Westerfield

From: Spencer Young

Having observed the small loan conduit operations over the past month, I have compiled a summary of the related business practices in place today ("Status Quo") and suggestions that we may wish to consider ("Recommendations"). The recommendations are segregated into six business areas: Underwriting; Pricing; Deal Management; Relationship Management; Marketing; and Documentation. Subject to your thoughts, the target dates for implementation would be assigned after conferring with Liz and George, who have not seen this list yet, but whose input has obviously been instrumental in its compilation.

I would appreciate your input on how best to introduce these recommendations in the most constructive manner, so that I am not perceived as moving in on anyone's turf, but rather as a contributing team member.

(Please note that I use the description "client" in lieu of "correspondent" throughout this memo, as well as "originator" to connote the in-house loan originators, who report to George.)

Recommendations

I. Underwriting

	Status Quo	Recommendation	Target Date
1	Underwriting standards are loosely defined and therefore there is an increased incidence of phone calls. This situation also provides a fertile ground for misunderstandings with clients as well as inconsistent underwriting.	Draft and distribute clear, simple underwriting guidelines for distribution to all clients. Implement up-front training sessions, distributing guidelines in advance, followed by group kickoff training sessions.	
2	Although Morgan Stanley has a reputation for getting some of the best subordination levels on its conduit deals and has a high quality / low leverage program, there appear to be no underwriting parameters that clearly define the deals that qualify for this decidedly preferential pricing.	Establish precise high quality underwriting guidelines, with input from each of the rating agencies so as to capitalize on Morgan Stanley's current competitive advantage. Additionally, financial institutions, particularly Life Companies, would likely be very interested in pursuing such a program as a participant to a high-quality program or for private label execution. Accordingly, this could be a separate marketing initiative.	This is the basis for the IQ Brand
3	Guidelines and due diligence procedures associated with borrowers as a credit risk do not currently exist.	Incorporate this increasingly important (to rating agencies and investors) component of credit risk in the underwriting guidelines.	

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4	In a rising interest rate environment, thin first mortgage DSCR deals may no longer be effectively monetized.	Set up parameters to extend amortization perhaps coupled with an extended term to mitigate the refi risk, and increased spread to address bond liquidity premiums. In addition, a mezzanine debt program should be rolled out and offered as a new product with specific parameters. The basis for structuring reserves for debt service coverage should also be articulated.	
5	Guidelines for SPE's and Bankruptcy remoteness are unclear and therefore can be inconsistently applied – generally for smaller balance loans, we ask for it, and if pressed, we will cave to get the deal. This opens MSMC up to criticism of providing preferential treatment to certain clients.	Establish dollar cutoffs for borrower entity requirements with buy in from the respective rating agencies – they have done this in the past. Pricing adjustments for waiving the requirement may also be considered.	
6	The time taken to input information to AMOS for the prelim and final stages of approval appear to be quite time consuming (ranging from 4 to 10 hours per deal)	Investigate making certain modifications to AMOS, such as scaling back certain information requirements, setting up an "electronic bridge" to populate required fields from clients, or revise the process of collecting information to reduce this time requirement.	
7	"Carve out" requirements appear to be unclear and therefore could be inconsistently applied.	Establish standard recourse carve out provisions and pricing parameters for negotiated revisions to preserve Morgan Stanley's reputation for flexibility and putting some of this decision-making in the hands of client underwriters.	
8	Final Committee Meetings tend to take up much of senior management time and the formality of it can hinder timely closings and smooth deal flow.	Eliminate this requirement for all loans under a specific dollar threshold (say $10mm), otherwise delegating to two people (the in-house originator and chief underwriter or his designee). The chief underwriter (GKok, or his designee) should be responsible to apprise the Sell-side (e.g. RRahbany) of unique underwriting issues on smaller deals as they arise. In addition, having the sell-side information completed pre-closing can also contribute to an unnecessary backlog -- therefore post-closing information gathering and preparation should be identified..	
9	Preliminary review meetings can utilize significant resources on deals with low hit ratios.	Hold Prelim meetings only for larger loans (say $10mm or more) and loans which materially deviate from underwriting guidelines; are priced below minimum pricing parameters; are "high leverage" transactions; or contemplate unique deal structures. Decision making on smaller deals should rest with GKok, chief credit officer, or his designee, again with informal input from the Sell-side.	

II. Pricing

	Status Quo	Recommendation	Target Date
10	Pricing decisions are imprecise given the current wide bands in the current pricing grid. This can result in inconsistent pricing and increased calls from clients; this also unnecessarily takes up a lot of time of Trading Desk	Issue detailed pricing grid, which places the decision making in the hands of the clients and delegates pricing decisions to our originators. The pricing grid should address: loan term, call provisions, loan size, amortization, DSCR and LTV. Given the time required to produce the glossy pricing grid containing pictures of those on the conduit team, consideration should be given to having two pricing grids; the glossy one for general marketing use that provides reasonably wide bands; and a more detailed one that can be updated and issued at a moment's notice.	
11	The pricing grid tends be issued infrequently, often months at a time.	Designate a person in REDCM responsible for producing the pricing grid on a regular (at least monthly) basis. This person would be responsible for reverse engineering to agreed-upon targeted arbitrage and will liaison with Trading and the Originators to be sure the pricing is sufficiently competitive and compensates MSMC for the principal risk undertaken, as determined by the Trading Desk.	
12	There are frequent times when there is no Trader on the desk, therefore responsiveness to clients can be compromised. The notion of "beeping" someone out of an important meeting does not address this need.	There should be a dedicated Trader on the desk at all times, with designated backup, and a tag team approach.	
13	There is uncertainty over how to negotiate changes in call provisions. This can contribute to inconsistent negotiations, mispricing, or an unnecessary additional time burden on the Trading Desk.	Create a call provision tradeoff matrix outlining the cost of modifying the standard call provision features. This provides consistent pricing and puts some of the decision making in the hands of clients, thereby reducing phone calls and negotiations at the MSMC level.	
14	There are divergent views and concerns over the use and extent of break-even pricing.	Get closure on how this will be used, addressing the programmatic and economic implications.	
15	Pricing is delegated to the Chief Underwriter with cursory guidance; therefore creating risk of mispricing or re-trading in the later stages of the deal.	A revised pricing matrix with more specific pricing guidance should be developed.	Expected to be issued week of 4/28

III. Deal Management / Process

	Status Quo	Recommendation	Target Date
16	It is difficult to track deals through negotiations, resulting in a risk of inconsistent pricing, ineffective negotiations and clumsy deal structuring.	Create in-house "black box" capability, as a separate component of AMOS that allows anyone, including the trading deck to "call up" a deal from his/her computer and understand all the issues and chronology of negotiations. They can then intelligently pick up where the last person left off.	
17	Hit ratios and deal production trends are not monitored and reported by client.	A pipeline regularly reporting this information should be developed.	
18	The reasons why deals are lost are not always understood, communicated and utilized for Program modifications.	Identify a person responsible for maintaining a database of lost deals and preparing a meaningful summary of why deals are lost. Program changes should then be developed to address this.	
19	There are numerous meetings for finals, prelims, pipeline, group sessions etc.	Consideration should be given to cut back the number of meetings, so that more emphasis can be placed on deal production.	
20	Deals are tracked and evaluated principally via paper and the production of detailed books, which requires a great deal of in-house resources.	Maintain central database that will print out all required information, as necessary – again investigate leveraging off of AMOS.	
21	The number of consultants supporting the Program have grown to the point that MSMC office space cannot accommodate.	Relocate consultants to a less expensive (but local to 1585 Broadway) office space. Give consideration to setting up out-sourced, yet captive, regional underwriting shops.	GKok and KPighi have identified 5,600 sq. ft of local space - occupancy to occur in May.
22	Clients have indicated that AMOS is difficult to set up and there are no instructions. Additionally, the logistics of updating the software to the full complement of clients in the network is cumbersome, and could introduce confusion and frustration at the client-level.	It is apparent that some form of installation and user manual for AMOS is needed. Investigate the feasibility of rolling out a front end to AMOS via the Morgan Stanley intranet (security clearance procedures would need to be set up). Updates could then be instantaneously made. In addition, deal submissions, along with subject collateral pictures could be scanned in and simultaneously transmitted same day and used to populate required data fields.	
	Relationship managers and chief underwriter are involved in detailed underwriting as backup to originators	Have secondary origination backup be an originator while chief underwriter oversees the consistent application of credit decision-making, and relationship managers focus on marketing, advocating deals and developing new products and programs.	

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23	There is a large number of phone calls from clients who ask the same questions, taking up in-house originator time and causing a certain degree of frustration from the monotony.	As part of the new client kickoff, arrange for a full day training session at a central client location, after providing sufficient time to review MSMC's Underwriting Guidelines.	
24	The pipeline is administered first hand via spreadsheet by the chief underwriter.	The pipeline should be administered by a dedicated administrative person in a relational database format, with systems support provided by consultants and Morgan Stanley systems support.	
25	The ability to process direct business is currently limited and MSMC doesn't appear to be equipped to handle large deal volumes that are of poor information quality.	Set up a defensive strategy to be able to competitively price deals by having an integrated low cost structure. This should be managed by seasoned commercial real estate lenders/mortgage bankers, independent of MSMC.	
26	The pipeline can at times be stale, and is difficult to keep current. The reasons why MSMC has lost deals are not always understood and disseminated to all interested parties.	Clear out deals that have not been signed up in 30 days. Arrange for each client to issue a weekly pipeline report, and incorporate the requirement in the purchase agreement, along with a form of exhibit. An analyst or administrative assistant should compile this information weekly and summarize why we lost deals to spot trends early on and react to market changes.	
27	There is a tendency for new clients to send deals that deviate substantially from traditional conduit deals (e.g., hospitals, parking lots, big box forward construction) and in the interest of being flexible and creative, MSMC tries to find a way to get the deal done. This generally results in finding out that the deal does not work, an expenditure of valuable time and frustration on the client's end due to a misleading initial response.	Emphasis should be placed on traditional conduit deals that do not deviate significantly from the underwriting guidelines. The person charged with new product development should be the one to work on the "fringe" deals.	
28	Inbound deals get delivered directly to the originator, often via overnight delivery. Sometimes these packages are not looked at for days.	Have all deals go to an administrative assistant, responsible for receiving, confirming receipt with the client, logging in and assigning to an originator, with guidance from GKok. This person should also have a backup and prepare a response time report by originator to monitor client service and balance workloads if they become too great on any one person at any stage in time.	
29	Some clients have indicated that they periodically have difficulty reaching their assigned originator on the phone.	Set up secondary back-up on deals with an in-house originator, and tertiary back up, if necessary. In addition, all should have beepers so that they can be quickly reached, if necessary.	

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30	It is difficult for people to serve as backup on deals because the documentation cannot be readily located.	Modify AMOS to capture all underwriting issues and negotiation points on each deal that can be called up by anyone, so they can come up to speed right away.	
31	Larger loans (typically greater than $15m) structured as a small loan conduit are lumpy for a standard conduit execution and not appropriately structured for a large loan execution; therefore there are missed deal opportunities.	Design a mechanism to put such large loans in a trust and issue participations from this trust to a series of CMBS deals	
32	Quick quotes are verbally given and are open for miscommunication.	Consider revising quick quotes to conditional commitments, which also enable deals to be swept off the street. In the event a quick quote is the most appropriate to get the deal, a fax memorializing the quote should shortly follow the discussion.	

IV. Relationship Management

	Status Quo	Recommendation	Target Date
33	Clients are not exclusive to Morgan Stanley and many have no demonstrated track record in the origination of conduit product; accordingly, limiting entry by other institutions due to market overlap may be imprudent.	Develop conflict resolution procedures that properly addresses the concerns of all participants to the MSMC Conduit Program, but open the Program up and let Darwinism take its course. If MSMC has the best mousetrap, deals will still make there way to us.	
34	We seem to encourage financial institutions to push Wall St. out of the principal lending business.	If a financial institution wishes to provide business on a flow basis only, or start their program with table funding and evolve over time to taking a principal position, we should accommodate. The concept of "sharing" all profits, and virtually delegating all of the underwriting to designated "partners" should be considered.	
35	Rate lock procedures are unclear and therefore there is risk of not meeting a client's needs in a volatile interest rate environment.	Establish clear rate lock procedures that anyone can carry out on behalf of a client, that also address open credit issues on the deal being rate locked.	Program term sheet has been developed – roll out expected in the next few weeks.

	Status Quo	Recommendation	Target Date
36	How new clients are assimilated into the Program could be better systematized to be sure nothing slips through the cracks, because first impressions are lasting impressions.	Develop a checklist of things to do when kicking off a new client relationship.	
37	Outside of Warren Friend's Transaction Status Report, there is no summary of issues and status of each of the conduit relationships.	Relationship Managers should each prepare a similar report weekly to communicate regularly where things stand with each conduit client, and distribute to all on the conduit team and designated other people on a need-to-know basis.	

V. Marketing

	Status Quo	Recommendation	Target Date
38	The existing product line appears to be missing certain property types and does not possess features that competitor programs offer	Expand the product line to include such items as: • Congregate Care • Nursing Homes • Rate locks at various stages • Buydowns • Convertibles • Mezz debt • CTL Program • HUD 236 takeout program	
39	Increasingly, financial institutions are requesting forward construction / rehab /re-tenanting takeouts on their deals, and the response to date has been that MSMC cannot accommodate this market need.	Consider teaming up with certain financial institutions with a strong credit culture and excellent construction lending experience through a joint venture. MSMC would fund 20% - 25% of qualifying construction deals (on a Libor basis), with MSMC's position senior to the financial institution. MSMC would provide a takeout commitment for the full amount, subject to satisfactory project completion and stabilization. MSMC would receive a construction fee, takeout fee and carry during the development phase.	
40	Market information on what the competition is doing is captured and communicated on an informal basis	Designate a person to be the central repository of buy-side market information who will summarize and distribute to all on the conduit team	
41	New product innovations can be more systematically developed	Designate a person to be primarily responsible for the development of new product innovations, who will maintain a database of competitor information updated regularly with input from Research (HEsaki).	
42	Product recognition has begun to be realized	Leverage off of Liz's newsletter approach to REFA and QuestNet for an overall newsletter for partners to the MSMC conduit franchise.	

Status Quo	Recommendation	Target Date
The MSMC small loan conduit is structured to offer fixed rate product only.	In the event of future rate spikes, develop a defensive strategy to roll-out an ARM program, working closely with the rating agencies on the underwriting parameters and desirable structural features and be prepared to issue a separate pricing matrix.	
The competition for early rate lock has increased, threatening the competitiveness of current MSMC procedures	Once deal flow and the pipeline has reached a certain critical mass (e.g. $80mm - $100 mm per month) give consideration to hedging the pipeline.	
Current rate lock procedures are subject to margin calls which are unacceptable to some borrowers.	Offer a variety of rate lock options which shift the risk between parties, and at different stages in the origination process.	

VI. Documentation / Closing

Status Quo	Recommendation	Target Date
There appears to be inconsistent use of mortgage documents and a cumbersome closing process across originators through the use of many law firms.	Reduce number of law firms to two and engage a dedicated loan closer with at least one backup. Since John Grinch is a part time resource, two strong loan closer paralegals should be engaged. Assign someone to design a thorough, yet effective closing process checklist.	
A part-time loan closer not on MSMC's payroll is used to administer closings, along with one contract paralegal and a second to be hired.	Although not generally viewed as a glamorous area of the business, its importance to a smooth business operation cannot be over-emphasized. Consideration should be given to hire a strong full-time commercial mortgage loan closing expert, who can manage contract paralegals, as necessary.	
There appear to be a series of different program documents	One set of standard docs should be used, except to the extent client docs reviewed by MSMC counsel can be effectively modified for securitization, with riders.	
Standard mortgage documents call for interest measured on a 30/360 basis.	Standard mortgage documents should calculate interest on an actual / 360 basis. This should be communicated upfront to each client. In the event the borrower balks, this provision should be used as a bargaining chip that we trade for something else.	In process of implemen-tation