

# DXSCORE<sup>®</sup>

The Definitive Credit Rating for CRE Loans From DEBTX

by

DebtX

THE DEBT EXCHANGE

## Managing Commercial Real Estate Lending Risk from Loan Origination through Maturity: The Potential for Pain

- Regulators have strongly signaled their unease with growing CRE concentrations
- Smaller banks have to deal with the trickle-down effects of CCAR and DFAST
- Rising portfolio valuations have potentially been masking growing risk
- Originators and risk managers need to find common ground in this new paradigm

“What we’ve got here... is failure to communicate.” – *Cool Hand Luke*

## How the Regulators View Our World

- In December of 2015 and again in July of 2016, the FDIC, OCC and the Fed all signaled their concerns in regards to the growing risk to the banking system posed by growing CRE portfolios and loosening underwriting standards.
- “Credit risk is increasing because of strong loan growth combined with easing in underwriting standards. More specifically, indirect auto lending and leveraged lending remain concerns, with CRE concentration risk management moving from a monitoring status to an area of additional emphasis.”
- “In light of rapid CRE growth, supervisory reviews completed in 2015 raised concerns over the quality of CRE underwriting, portfolio-level stress testing and sufficiency of concentration risk management practices at banks. The OCC has observed an easing of CRE underwriting standards, including less-restrictive loan covenants, extended maturities, longer interest-only payment periods, and limited guarantor requirements as examples of risk layering. Banks are placing greater reliance on loan-to-value ratios to mitigate other structural concessions.”
- “Multifamily might be approaching the supply/demand equilibrium point in some areas — suggesting that prices may weaken and vacancy rates might rise.”

# “My name is Will...and I was an enabler.”

William S. Mercer, CFA- Head of Analytics for DebtX

- Immediately before the Great Recession, and by no means due to spectacular market prescience, I joined DebtX on the loan sale advisory side of the house and ultimately transitioned to my current Analytics role.
- Prior to the move, I was managing fixed income portfolios including CMBS, CRE CDO's, REIT's and Homebuilders. Like everyone else at the time, I thought my risk was well managed.
- In my previous role as a commercial real estate lender, I made loans that went into CMBS deals, loans that were sliced and diced into CDO's, and loans on buildings owned by REITs. Little did I know that I would be using my own supply down the road.

## About DebtX

- In 2000, DebtX launched the first Internet marketplace for loans, and in 2005 we opened the platform to direct loan sellers and loan syndicators.
- Over the last 16 years, we have captured precise trade data on whole loan and participation sales executed via our platform as well as the over US \$10 trillion of UPB we value each year. DebtX leverages this data to provide an independent estimated market price for our clients' loans and loan portfolios.
- DebtX leverages valuation and analytics and its extensive market data to provide clients with realistic scenario analysis and credit default modeling.
- DebtX also offers a variety of innovative information services, including Market Data, historical statistics, and analytical research. DXScore® is our credit rating system for commercial real estate loans.

# Why did we create DXScore?

- The extended bull run in real estate finance has led to a blurring of lines between price and risk.
- Currently, having a third party risk rate a loan is expensive, time consuming and generally a “one and done” process.
- On a more philosophical note, part of our core mission is to improve asset liquidity and transparency in the CRE loan market, hopefully resulting in a reduction of required reserves over time.
  - I. Risk Ratings
  - II. Pricing
  - III. Market Liquidity
  - IV. Document Management

# DXScore Synopsis

- DXScore is a granular, numerical credit rating system for commercial and multifamily loans
- Measures a loan's bundle of risks (LTV, DSC, Pay History, Tenant Rollover Risk, etc.)
- Calibrated based on relationship of risk measures with events of default and losses over time
- Enables easy comparison of heterogeneous assets
- Consistent, objective & unbiased
- Transparent, auditable and repeatable methodology

- Scale from 1 (highest risk) to 120 (least risk)
- Most NPLs Score 0 to 60
- Most Performing Loans Score 60 to 120
  - Below 69 are considered **High Risk**
  - 70-79 are considered **Moderate Risk**
  - 80-99 are considered **Normal Risk**
  - 100+ are considered **Low Risk**
- New Loans at Minimum DSCs/LTVs score in the low 80s

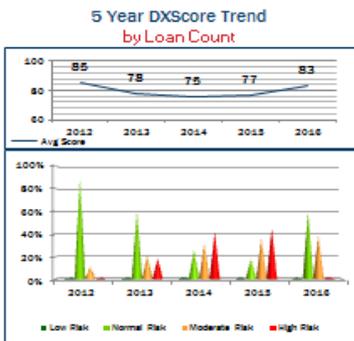
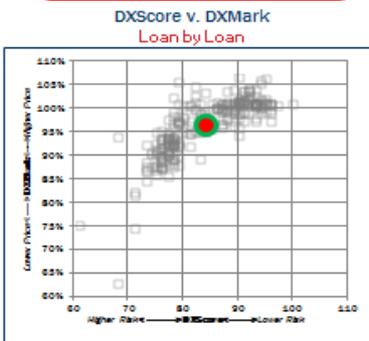
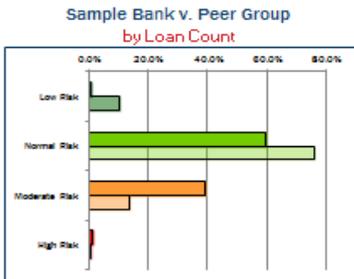
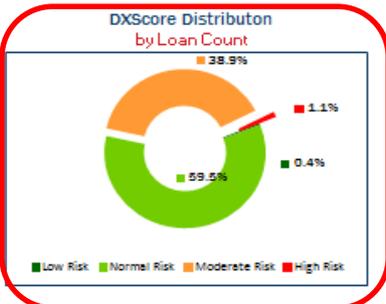
### Sample Bank

**DXScore Snapshot**  
Analysis As Of 10/31/2016

**\$225,875,656**  
250 Loans



Ranking of 100 Four Group Banks



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### Sample Bank

#### DXScore Distribution by Cohort

DXScore	Sample Bank				Peer Group			
	Loan Count	Loan Count%	Loan Balance	Loan Balance%	Loan Count	Loan Count%	Loan Balance	Loan Balance%
105-120	0	0.0%	\$0	0.0%	68	0.6%	\$30,588,747	0.2%
100-104	1	0.4%	110,841	0.0%	463	4.4%	\$407,422,527	2.5%
98-99	0	0.0%	0	0.0%	533	5.1%	\$531,882,798	3.2%
96-97	8	3.1%	7,853,285	3.5%	914	8.7%	\$1,232,344,860	7.4%
94-95	17	6.9%	11,226,734	5.0%	1,238	11.7%	\$1,816,432,335	11.0%
92-93	29	11.5%	20,310,583	9.0%	1,449	13.7%	\$2,621,680,765	15.8%
90-91	28	11.1%	29,430,258	13.0%	1,243	11.8%	\$2,448,561,004	14.8%
85-89	38	15.3%	33,058,918	14.6%	2,079	19.7%	\$3,224,231,459	19.4%
80-84	30	11.8%	21,231,072	9.4%	1,102	10.4%	\$1,900,723,431	11.5%
75-79	86	34.4%	83,265,876	36.9%	1,104	10.5%	\$1,747,564,705	10.5%
70-74	11	4.6%	10,055,156	4.5%	328	3.1%	\$547,072,054	3.3%
60-69	3	1.1%	9,332,934	4.1%	19	0.2%	\$53,547,926	0.3%
40-59	0	0.0%	0	0.0%	8	0.1%	\$22,650,934	0.1%
20-39	0	0.0%	0	0.0%	0	0.0%	\$0	0.0%
1-19	0	0.0%	0	0.0%	0	0.0%	\$0	0.0%
<b>Totals</b>	<b>250</b>		<b>\$225,875,656</b>		<b>10,548</b>		<b>\$16,584,683,545</b>	

#### 10 Highest Risk Loans

Rank	Asset Reference	Loan Balance	Collateral Type	LTV	Zip	DXMark	DXScore
253	xxxxxxx	\$831,177	Retail	51.1%	02903	87.6%	73
254	xxxxxxx	\$496,714	Lodging	71.0%	01966	88.6%	73
255	xxxxxxx	\$482,585	Retail	56.8%	02903	86.6%	73
256	xxxxxxx	\$287,872	Retail	72.0%	04258	92.4%	73
257	xxxxxxx	\$2,860,369	Other	71.5%	01915	74.6%	71
258	xxxxxxx	\$534,980	Other	70.0%	02910	81.6%	71
259	xxxxxxx	\$523,612	Other	69.8%	02891	82.2%	71
260	xxxxxxx	\$3,300,830	Lodging	88.3%	02790	62.7%	68
261	xxxxxxx	\$119,980	Lodging	60.0%	04240	83.3%	68
262	xxxxxxx	\$804,009	Industrial	82.3%	02740	75.2%	61

#### Historical Default Statistics

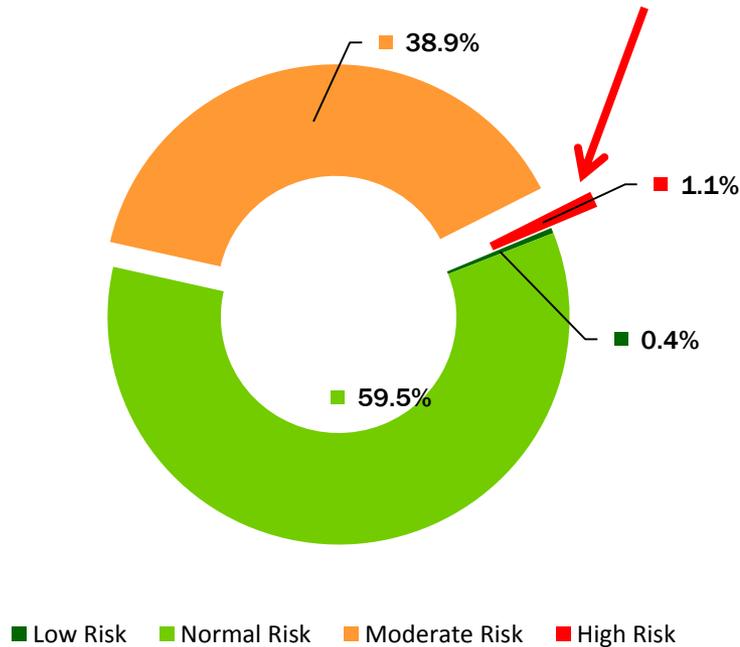
Validation Data

Low Risk	Historical Incidence of Default				
	1-Year	2-Year	3-Year	4-Year	5-Year
2012	0.1%	0.1%	0.1%	0.1%	0.1%
2013	0.0%	0.0%	0.0%	0.0%	
2014	0.0%	0.0%			
2015	0.1%				
<b>Long Term Loss Given Default</b>					37.6%

Normal Risk	Historical Incidence of Default			
	1-Year	2-Year	3-Year	4-Year
2012	0.7%	1.5%	2.2%	3.3%
2013	0.4%	1.0%	2.1%	
2014	0.3%	1.3%		
2015	0.7%			
<b>Long Term Loss Given Default</b>				18.1%

Moderate Risk	Historical Incidence of Default			
	1-Year	2-Year	3-Year	4-Year
2012	2.3%	4.4%	5.7%	7.3%
2013	2.3%	4.2%	6.3%	
2014	2.8%	5.5%		
2015	3.4%			
<b>Long Term Loss Given Default</b>				22.3%

High Risk	Historical Incidence of Default			
	1-Year	2-Year	3-Year	4-Year
2012	3.5%	11.7%	13.7%	15.4%
2013	7.3%	10.6%	12.9%	
2014	7.7%	10.3%		
2015	6.4%			
<b>Long Term Loss Given Default</b>				31.8%



## Segments the Portfolio by Risk

- 0.4% of Portfolio is Considered **Low Risk**
- 58.5% of Portfolio is Considered **Normal Risk**
- 38.9% of Portfolio is Considered **Moderate Risk**
- 1.1% of Portfolio is Considered **High Risk**
- This Distribution is Shown by Loan Count; Can also be Shown by Principal Balance
- Enables focus on this '**High Risk**' Segment

**10 Highest Risk Loans**

Rank	Asset Reference	Loan Balance	Collateral Type	LTV	Zip	DXMark	DXScore
241	xxxxxxx	\$831,177	Retail	57.1%	15667	87.6%	73
242	xxxxxxx	\$496,714	Lodging	71.0%	02134	88.6%	73
243	xxxxxxx	\$482,585	Retail	56.8%	90210	86.6%	73
244	xxxxxxx	\$287,872	Retail	72.0%	10012	92.4%	73
245	xxxxxxx	\$2,860,369	Other	71.5%	55555	74.6%	71
246	xxxxxxx	\$594,980	Other	70.0%	02910	81.6%	71
247	xxxxxxx	\$523,612	Other	69.8%	60609	82.2%	71
248	xxxxxxx	\$9,300,830	Lodging	88.3%	02108	62.7%	68
249	xxxxxxx	\$119,980	Lodging	60.0%	04240	93.9%	68
250	xxxxxxx	\$804,009	Industrial	82.9%	02740	75.2%	61

- Easily identify riskiest loans
- Can be used as part of decision-making criteria
- Ability to “drill down” to understand why loan is considered ‘High Risk’:
  - I. LTV above 80%
  - II. DSC below 1.2x
  - III. Performance Issues – Recent Late Payments
  - IV. Refinance Risk: High LTV combined with Near Term Maturity
  - V. Refinance Risk: Low DSC combined with Near Term Maturity
  - VI. Low Occupancy
  - VII. Interest Rate Risk: Variable Rate; DSC at Risk upon Rate Reset

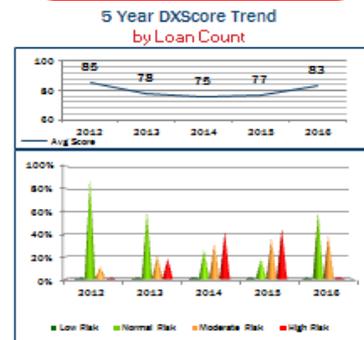
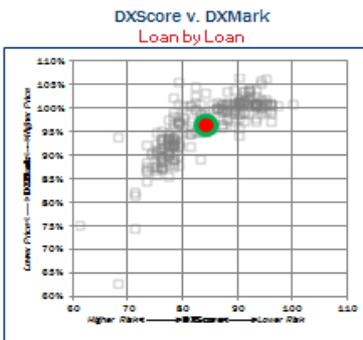
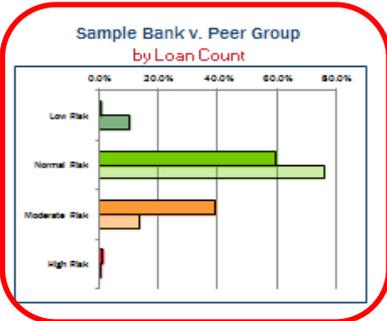
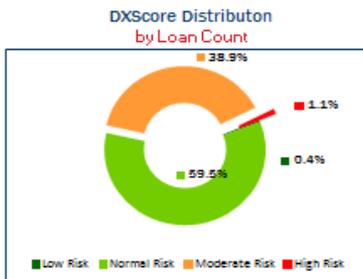
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**DXScore Snapshot**  
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Rankings of 100 Four Group Banks



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**DXScore Distribution by Cohort**

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100-104	1	0.4%	110,841	0.0%	463	4.4%	\$407,422,527	2.5%
98-99	0	0.0%	0	0.0%	533	5.1%	\$531,882,798	3.2%
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40-59	0	0.0%	0	0.0%	8	0.1%	\$22,650,934	0.1%
20-39	0	0.0%	0	0.0%	0	0.0%	\$0	0.0%
1-19	0	0.0%	0	0.0%	0	0.0%	\$0	0.0%
<b>Totals</b>	<b>250</b>		<b>\$225,875,656</b>		<b>10,548</b>		<b>\$16,584,683,545</b>	

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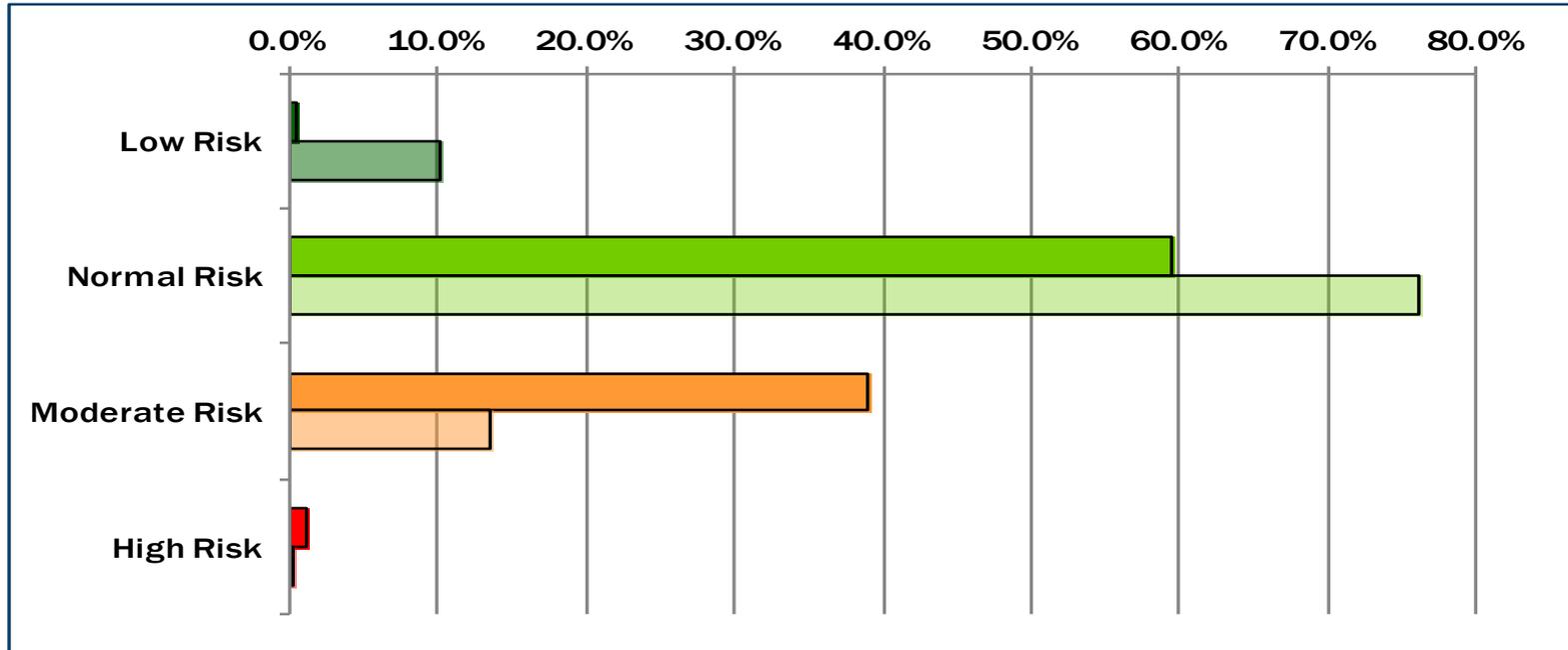
**Historical Default Statistics**  
Validation Data

Low Risk	Historical Incidence of Default				
	1-Year	2-Year	3-Year	4-Year	5-Year
2012	0.1%	0.1%	0.1%	0.1%	0.1%
2013	0.0%	0.0%	0.0%	0.0%	
2014	0.0%	0.0%			
2015	0.1%				
<b>Long Term Loss Given Default</b>					37.6%

Normal Risk	Historical Incidence of Default				
	1-Year	2-Year	3-Year	4-Year	5-Year
2012	0.7%	1.5%	2.2%	3.3%	
2013	0.4%	1.0%	2.1%		
2014	0.3%	1.3%			
2015	0.7%				
<b>Long Term Loss Given Default</b>					18.1%

Moderate Risk	Historical Incidence of Default				
	1-Year	2-Year	3-Year	4-Year	5-Year
2012	2.3%	4.4%	5.7%	7.3%	
2013	2.3%	4.2%	6.3%		
2014	2.8%	5.5%			
2015	3.4%				
<b>Long Term Loss Given Default</b>					22.3%

High Risk	Historical Incidence of Default				
	1-Year	2-Year	3-Year	4-Year	5-Year
2012	3.5%	11.7%	13.7%	15.4%	
2013	7.3%	10.6%	12.9%		
2014	7.7%	10.3%			
2015	6.4%				
<b>Long Term Loss Given Default</b>					31.8%



- Upper set of bars shows an individual bank's portfolio distribution
- Lower set of bars show peer group distribution
- We have the ability to customize peer group from our data universe

**DXScore Distribution by Cohort**

DXScore	Sample Bank				Peer Group			
	Loan Count	Loan Count%	Loan Balance	Loan Balance%	Loan Count	Loan Count%	Loan Balance	Loan Balance%
105-120	0	0.0%	\$0	0.0%	68	0.6%	\$30,588,747	0.2%
100-104	1	0.4%	110,841	0.0%	463	4.4%	\$407,422,527	2.5%
98-99	0	0.0%	0	0.0%	533	5.1%	\$531,882,798	3.2%
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1-19	0	0.0%	0	0.0%	0	0.0%	\$0	0.0%
<b>Totals</b>	<b>250</b>		<b>\$225,875,656</b>		<b>10,548</b>		<b>\$16,584,683,545</b>	

**Peer Group is Customizable**

- All loans held by similar banks
- All loans within a specific geography
- Add CMBS loans
- Add Agency loans
- Add Lifeco and PE Loans

**Sample Bank**

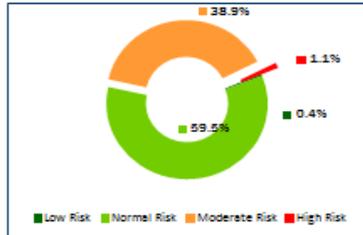
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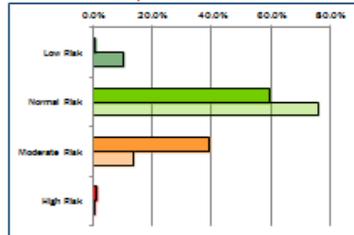


Rankings of 100 Four Group Banks

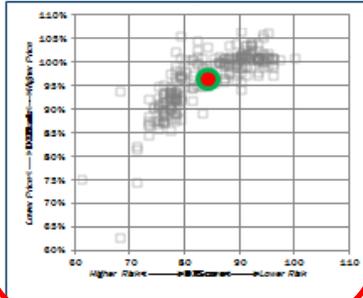
**DXScore Distribution by Loan Count**



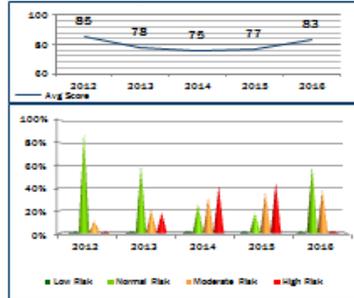
**Sample Bank v. Peer Group by Loan Count**



**DXScore v. DXMark Loan by Loan**



**5 Year DXScore Trend by Loan Count**



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**10 Highest Risk Loans**

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253	xxxxxxx	\$831,177	Retail	51.1%	02903	87.6%	73
254	xxxxxxx	\$496,714	Lodging	71.0%	01966	88.6%	73
255	xxxxxxx	\$482,585	Retail	56.8%	02903	86.6%	73
256	xxxxxxx	\$287,872	Retail	72.0%	04258	92.4%	73
257	xxxxxxx	\$2,860,369	Other	71.5%	01915	74.6%	71
258	xxxxxxx	\$534,980	Other	70.0%	02910	81.6%	71
259	xxxxxxx	\$523,612	Other	69.8%	02891	82.2%	71
260	xxxxxxx	\$3,300,830	Lodging	88.3%	02790	62.7%	68
261	xxxxxxx	\$119,980	Lodging	60.0%	04240	83.3%	68
262	xxxxxxx	\$804,009	Industrial	82.3%	02740	75.2%	61

**Historical Default Statistics Validation Data**

Low Risk	Historical Incidence of Default				
	1-Year	2-Year	3-Year	4-Year	5-Year
2012	0.1%	0.1%	0.1%	0.1%	0.1%
2013	0.0%	0.0%	0.0%		
2014	0.0%	0.0%			
2015	0.1%				
<b>Long Term Loss Given Default</b>					37.6%

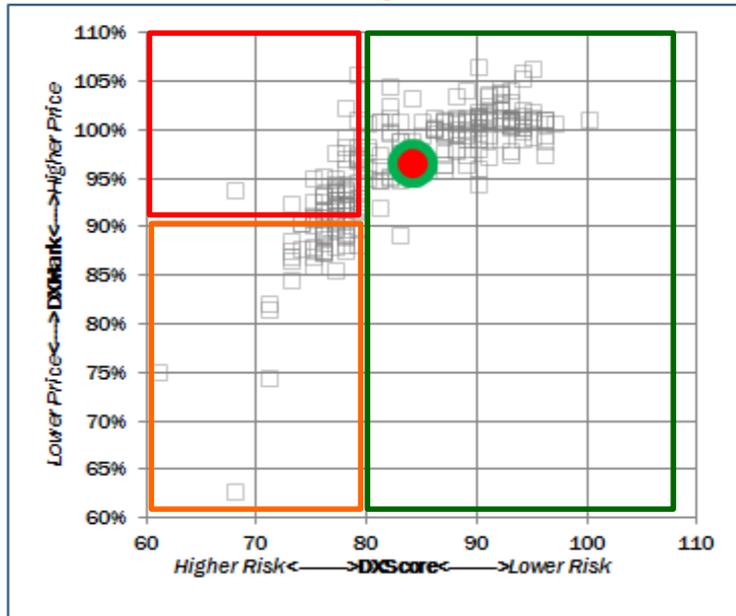
Normal Risk	Historical Incidence of Default			
	1-Year	2-Year	3-Year	4-Year
2012	0.7%	1.5%	2.2%	3.3%
2013	0.4%	1.0%	2.1%	
2014	0.3%	1.3%		
2015	0.7%			
<b>Long Term Loss Given Default</b>				18.1%

Moderate Risk	Historical Incidence of Default			
	1-Year	2-Year	3-Year	4-Year
2012	2.3%	4.4%	5.7%	7.3%
2013	2.3%	4.2%	6.3%	
2014	2.8%	5.5%		
2015	3.4%			
<b>Long Term Loss Given Default</b>				22.3%

High Risk	Historical Incidence of Default			
	1-Year	2-Year	3-Year	4-Year
2012	3.5%	11.7%	13.7%	15.4%
2013	7.3%	10.6%	12.9%	
2014	7.7%	10.3%		
2015	6.4%			
<b>Long Term Loss Given Default</b>				31.8%

**DXScore v. DXMark**

Loan by Loan



**Shows Relationship Between Risk & Price**

- Loans with risk ratings of 80+ considered solid

**Loans Scored Below 80 Are Higher Risk**

- However, risk for lower priced loans are likely already on a watch list or otherwise marked for monitoring.
- Risk is highest for low scoring but higher priced loans because who worries about a loan that prices above par?

**Sample Bank**

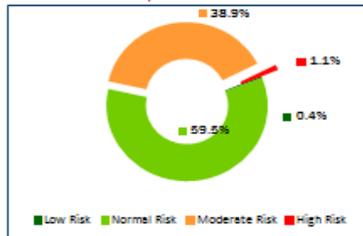
**DXScore Snapshot**  
Analysis As Of 10/31/2016

**\$225,875,656**  
250 Loans

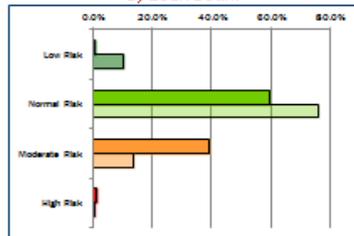


Rankings of 100 Four Group Banks

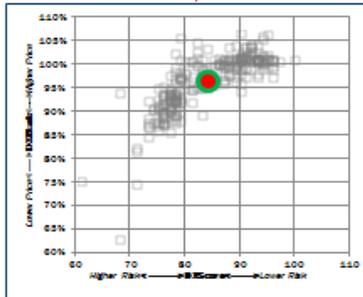
**DXScore Distribution by Loan Count**



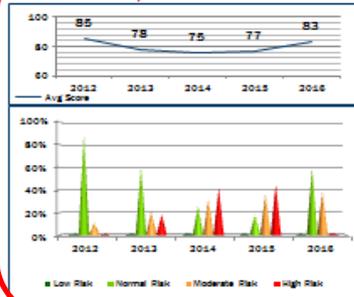
**Sample Bank v. Peer Group by Loan Count**



**DXScore v. DXMark Loan by Loan**



**5 Year DXScore Trend by Loan Count**



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**Sample Bank**

**DXScore Distribution by Cohort**

DXScore	Sample Bank				Peer Group			
	Loan Count	Loan Count%	Loan Balance	Loan Balance%	Loan Count	Loan Count%	Loan Balance	Loan Balance%
105-120	0	0.0%	\$0	0.0%	68	0.6%	\$30,588,747	0.2%
100-104	1	0.4%	110,841	0.0%	463	4.4%	\$407,422,527	2.5%
98-99	0	0.0%	0	0.0%	533	5.1%	\$531,882,798	3.2%
96-97	8	3.1%	7,853,285	3.5%	914	8.7%	\$1,232,344,860	7.4%
94-95	17	6.9%	11,226,734	5.0%	1,238	11.7%	\$1,816,432,335	11.0%
92-93	29	11.5%	20,310,583	9.0%	1,449	13.7%	\$2,621,680,765	15.8%
90-91	28	11.1%	29,430,258	13.0%	1,243	11.8%	\$2,448,561,004	14.8%
85-89	38	15.3%	33,058,918	14.6%	2,079	19.7%	\$3,224,231,459	19.4%
80-84	30	11.8%	21,231,072	9.4%	1,102	10.4%	\$1,900,723,431	11.5%
75-79	86	34.4%	83,265,876	36.9%	1,104	10.5%	\$1,747,564,705	10.5%
70-74	11	4.6%	10,055,156	4.5%	328	3.1%	\$547,072,054	3.3%
60-69	3	1.1%	9,332,934	4.1%	19	0.2%	\$53,547,926	0.3%
40-59	0	0.0%	0	0.0%	8	0.1%	\$22,650,934	0.1%
20-39	0	0.0%	0	0.0%	0	0.0%	\$0	0.0%
1-19	0	0.0%	0	0.0%	0	0.0%	\$0	0.0%
<b>Totals</b>	<b>250</b>		<b>\$225,875,656</b>		<b>10,548</b>		<b>\$16,584,683,545</b>	

**10 Highest Risk Loans**

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**Historical Default Statistics**  
Validation Data

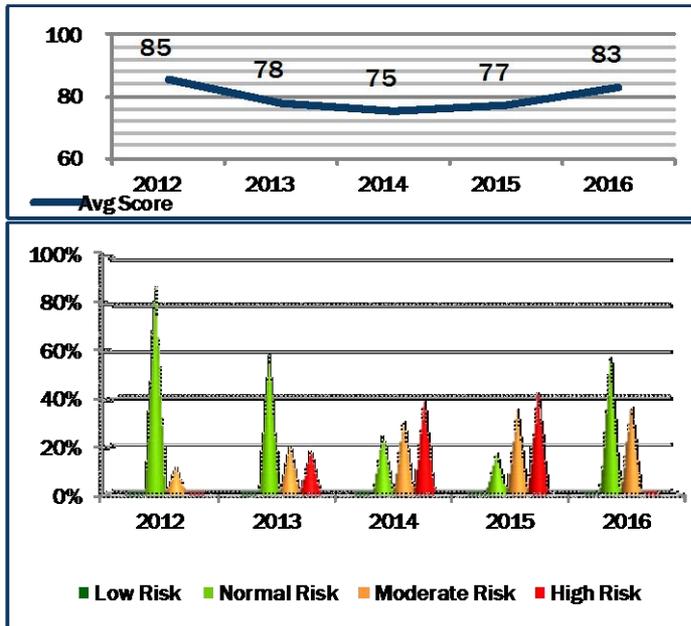
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2014	0.0%	0.0%			
2015	0.1%				
<b>Long Term Loss Given Default</b>					37.6%

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<b>Long Term Loss Given Default</b>				31.8%

**5 Year DXScore Trend**  
**by Loan Count**



**Simple 5-Year Trend Chart**

- Top Chart Shows W.A. DXScore
- Bottom Chart Provides Breakdown



### **For More Information:**

- Contact Will Mercer: [wmerc@debt.com](mailto:wmerc@debt.com) or 617-531-3429
- To run an individual loan's DXScore, go to [www.debt.com](http://www.debt.com) and click on "DXScore"