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Glossary:

NY Capital Region: NY Capital Region includes the Albany, Columbia, Fulton, Greene, Montgomery, Rensselaer, Saratoga, Schenectady, Schoharie, Warren and Washington counties.

Securitization: The act of securitizing is the financial process of pooling various types of contractual debt such as commercial mortgages (CMBS), residential mortgages, auto loans or credit card debt obligations (or other non-debt assets which generate receivables) and selling their related cash flows to third party investors as securities,

RESEARCH: WHY NOT CMBS FOR THE NY CAPITAL REGION?

July 8, 2015

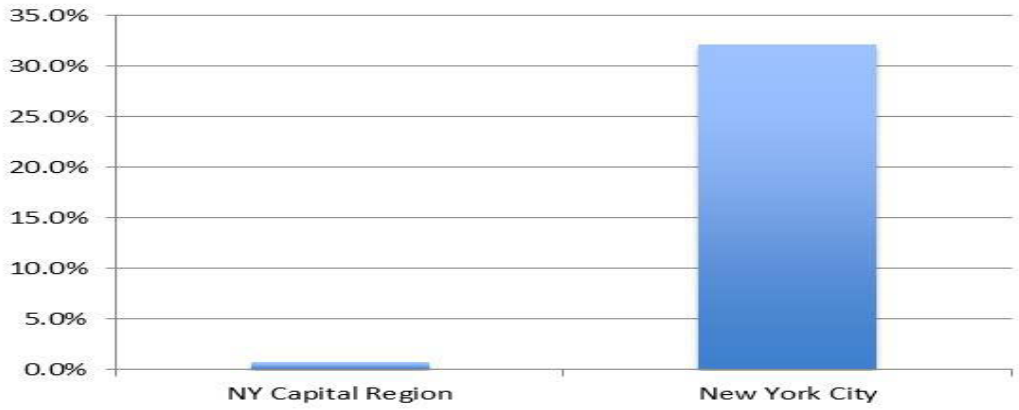
Less than 1% of commercial real estate property owners in the NY Capital Region accessed the capital markets via CMBS (Commercial Mortgage Backed Securities) compared to greater than 32% for the New York City metropolitan area within the past 2 years. Why not CMBS for the NY Capital Region? CMBS is currently the best option for most property owners looking for debt financing greater than $2.0 million.

Besides a potential Agency loan on a multifamily or healthcare property, if the commercial real estate property owner or borrower is in need of debt financing greater than $2.0 million on any stabilized office, retail, mixed-use, industrial/warehouse, self-storage, hotel, healthcare, and multifamily properties, the borrower should be accessing the capital markets with a CMBS loan through Saratoga Springs Capital LLC ("SSC").

Less Than 1% of NY Capital Region vs. Greater Than 32% of NYC Utilize CMBS. Why?

We used office properties for demonstration purposes because they comprise approximately 35% of the historical property type contribution within CMBS. Other property types have contributed less than office historically but show similar conclusions. In the past two years, borrowers in the New York City metropolitan area financed approximately 32% of office inventory available for securitization through CMBS compared to less than 1% for the NY Capital Region (see exhibit 1 below).

Exhibit 1: Securitizable Office Inventory Financed via CMBS over the Past Two Years



Sources: Saratoga Springs Capital LLC, CBRE, Trepp, and CoStar

Approximately 95% of borrowers in need of financing loans between $2.0 million and $25.0 million in the NY Capital Region have told us that they do not prefer CMBS, and in some instances do not want a CMBS loan, period! When we asked why, these borrowers stated three reasons: 1) "It's too expensive due to the initial closing costs and the defeasance call protection!"; 2) "There is no flexibility and it's difficult and time consuming to work with the CMBS servicer platform!" or 3) "My current broker told me that it's not worth it!"

Saratoga Springs Capital does not promote any one type of lending product, but we do advocate the best execution and cheapest cost of capital to our clients and we ask those that we are not currently advising, **"WHY NOT CMBS FOR THE NY CAPITAL REGION?"**

which may be described as bonds, pass-through securities, or collateralized debt obligations (CDOs). The ownership of the assets is usually transferred to a legal trust or special purpose, bankruptcy remote corporation to protect the interests of the security holders. Investors are repaid from the principal and interest cash flows collected from the underlying debt and redistributed through the capital structure of the new financing.

Commercial Mortgage Backed Security: Commonly referred to as CMBS, which are securities collateralized by a pool of mortgages on commercial real estate properties in which all principal and interest from the mortgages flow to certificate holders in a defined sequence or manner.

Defeasance: A process to substitute real property collateral when looking to sell or refinance an existing property, which was acquired through a real-estate loan that is call protected but allows defeasance at a certain point in time. The defeasance process is an act of making an investment whole by substituting real property collateral with a specified type of other collateral, typically government securities, that will generate sufficient cash flows on a schedule to closely mirror the principal and interest payments on the loan through maturity and including the maturity balance.

Call Protection: Protection against early prepayment of mortgages. If mortgages prepay early, then the bonds collateralized by those mortgages would be called or paid down, thereby affecting the total return on the original bonds. Therefore, bond holders typically require prepayment penalties on the underlying loans that come in the form of defeasance, yield maintenance, flat percentage penalty points, or a combination thereof.

Yield Maintenance: A prepayment penalty that allows bond holders to attain the same yield as if the borrower had made all scheduled mortgage payments until maturity. Yield maintenance premiums are designed to make bond holders indifferent to prepayments and to make refinancing unattractive to borrowers.

Basis Point (Bps): A basis point is one hundredth of one percent, which is used mainly to express differences in interest rates.

Non-recourse: Non-recourse debt is a type of loan that is secured by collateral, which is usually property. If the borrower defaults, the trust can seize the collateral, but cannot seek out the borrower for any further compensation, even if the collateral does not cover the full value of the defaulted amount.

1. "It's too expensive due to the initial closing costs and the defeasance call protection!"

Currently, we are finding that in most cases CMBS is actually cheaper to execute, despite the increased upfront closing costs. Closing costs for a CMBS loan can sometimes cost approximately double the amount compared to balance sheet or other lending platform loans. This, however, can be economically deceiving. The overall cost of financing in many instances is actually at least 10% cheaper. This is due to better CMBS loan terms such as a lower fixed rate for 10 years, which does not reset after 5 years, favorable amortization schedule sometimes with initial IO periods, as well as other economic and qualitative variables such as non-recourse. Thus, in layman terms, if the financing costs a borrower $10.0 million which includes interest, closing costs, and financing fees during the life of the loan, the CMBS loan can save the borrower at least $1.0 million, which further offsets the closing costs over the other alternatives.

CMBS is at Least 10% Cheaper Overall, Despite Initial Higher Closing Costs

There are approximately 50 CMBS lenders in the market and each one of them has a different appetite for property type, loan size, and/or geographical location. Due to this, if a borrower has received a few CMBS quotes, it may not be the most competitive CMBS quote in the market. We know that if the borrower doesn't execute a loan from the correct CMBS lender and does not know how to execute a CMBS loan properly, the consequences could include one or more of the following: potentially suffer 100 bps higher interest rate, fall short of valuable initial interest-only (IO) periods by as much as 120 months, receive approximately 50% less loan proceeds than desired, and incur initial financing costs as much as 25% or more. Additionally, this could impact other variables associated with the cost of capital, such as opportunity cost, time of closing, and a more stringent call protection structure than desired.

Saratoga Springs Capital knows which CMBS lenders are more favorable for the loan that the borrower is looking to execute and how to most effectively execute the financing, due to our past experience working in the capital markets at CMBS and balance sheet lenders, rating agencies, and/or as CMBS investors.

Exhibit 2 below demonstrates the difference between a SSC CMBS execution and other potential sources of financing. The cost of the least expensive finance execution (Saratoga Springs Capital) and the most expensive one equals approximately 26.0% less.

Exhibit 2: Borrower's Savings by Using SSC's CMBS Execution vs. Other Sources of Financing

Loan Terms	Saratoga Springs Capital's CMBS Fixed 10-Year (5-Yr IO)	Other Broker's CMBS Quote Fixed 10-Yr (Higher Rate)	Balance Sheet 10-Year / 5-Yr Reset	Balance Sheet Fixed 10-Year Term
Loan Amount	$10,000,000	$10,000,000	$10,000,000	$10,000,000
Term (Months)	120	120	120	120
Amortization (Months)	360	360	360	360
Interest Only Period (Months)	60	0	0	0
Interest Rate (Today)	4.00%	5.00%	4.00%	4.75%
Interest Rate (5-Years from Today)	4.00%	5.00%	6.00%	4.75%
Lender Loan Fees & Expenses	**$40,000**	**$40,000**	**$15,000**	**$15,000**
Liability	Non-Recourse	Non-Recourse	Recourse	Recourse
Debt Service				
Debt Service for 10-Year Term	$4,864,492	$6,441,859	$6,461,795	$6,259,768
Present Value of Debt Service	$3,933,088	$5,302,197	$5,258,588	$5,152,320
Comparative Scenario 1				
SSC's CMBS Fixed 10-Year (5-Yr IO) vs. Other Broker's CMBS Fixed 10-Yr (Higher Rate) -- Aggregated Nominal Debt Service Payments				**$1,577,368**
SSC's CMBS Fixed 10-Year (5-Yr IO) vs. Other Broker's CMBS Fixed 10-Yr (Higher Rate) -- Present Value of Debt Service Payments				**$1,369,109**
Comparative Scenario 2				
SSC's CMBS Fixed 10-Year (5-Yr IO) vs. Balance Sheet with 5-Year Reset -- Aggregated Nominal Debt Service Payments				**$1,622,303**
SSC's CMBS Fixed 10-Year (5-Yr IO) vs. Balance Sheet with 5-Year Reset -- Present Value of Debt Service Payments				**$1,350,501**
Comparative Scenario 3				
SSC's CMBS Fixed 10-Year (5-Yr IO) vs. Balance Sheet (Higher Fixed 10-Year Rate) -- Aggregated Nominal Debt Service				**$1,420,276**
SSC's CMBS Fixed 10-Year (5-Yr IO) vs. Balance Sheet (Higher Fixed 10-Year Rate) -- Present Value of Debt Service				**$1,244,232**

Source: Saratoga Springs Capital LLC

Master Servicer: A firm engaged to service the mortgage loans collateralizing a CMBS on behalf and for the benefit of the certificate holders. Common responsibilities include collecting mortgage payments and passing the funds to the trustee, transferring all loans to the special servicer that are at risk of imminent default or have defaulted, and providing mortgage performance reports for the bond holders.

Special Servicer: The special servicer is responsible for loans transferred by the master servicer due to a servicer transfer event, which includes loans at risk of imminent default or defaulted loans. The special servicer's responsibilities include modifying loans in order to cure the loan, foreclosing on the property, administering real estate owned properties, liquidating loans, and advancing the liquidation proceeds to the trustee.

Foreclosure: The process by which the special servicer takes back title to a property on which the mortgage has defaulted.

Real Estate Owned (REO): A term used for mortgaged property that has been acquired by the trust as a result of foreclosure or deed-in-lieu of foreclosure.

Capitalization Rate (Cap Rate): A real estate valuation measure used to estimate the investor's potential return on a property and to compare different real estate investments. It is a rate of return on a real estate investment property based on the expected income that the property will generate. This is done by dividing the income the property will generate after fixed and variable costs by the total value

As one can see in exhibit 2, the borrower's savings more than offset the slightly higher lender loan fees and expenses for a CMBS execution versus other lending platforms. If interest rates rise in the future, the savings the borrower could have realized today will only decrease as the opportunity to capitalize on these historically low interest rates will diminish with time. In addition, if investor demand for investment grade and non-investment grade CMBS bonds decreases, this savings margin for borrowers who access the capital markets will also decrease. As demonstrated, the capital markets are currently very borrower-friendly and SSC monitors and advises accordingly.

Interest Rates and Cap Rates are at "Eye-Opening" Historical Lows

Interest rates and cap rates are near "eye-opening" historical lows (see exhibits 3, 4 and 5 below). The 10-year Swap and Treasury rate are well below their long-term, historical average. Dating back to 1962, Treasury rates have not been this low. This has been the main driver for SSC's clients to refinance in this current economic cycle even if one has to pay a prepayment penalty, which may be negotiable.

However, if one thinks we are headed toward an even lower interest rate and a better cap rate environment within the next 12 to 36 months, as well as improved property performance, we would advise on a stretch floating rate loan, for which there is no shortage of available participants. There are over approximately 80 firms willing to stretch what may be a CMBS loan within the next year or two. These lenders also have different appetites for property type, loan size, and/or geography, and if one is not familiar on where to source the best stretch loan, the financing cost could be far greater than the cheapest cost (similar to the example in exhibit 2 above).

of the property.

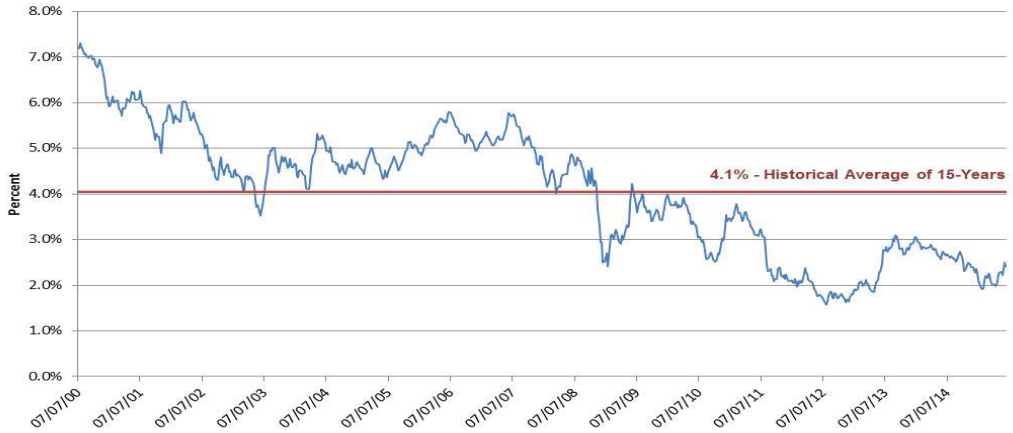
Stretch Loan: Stretch loans are variable interest rate loans that are higher levered and sometimes up to 90% LTV. The loans are financed based on the assumption that the loans will be refinanced within 24 to 36 months with CMBS financing.

Loan-to-Value (LTV): LTV is the ratio of loan amount to appraised value of the property. More specifically, LTV is the ratio between the principal amount of the mortgage balance, at origination or thereafter, and the current value of the underlying real estate collateral. The ratio is commonly expressed to a potential borrower as the percentage of value a lending institution is willing to finance. The ratio is not fixed and varies by lending institution, property type, geographic location, property size and other potential variables.

Investment Grade: A term to describe bonds or securities with a credit rating of BBB- or higher by rating agencies such as Standard & Poor's or Fitch, or Baa3 or higher by Moody's. Generally they are bonds that are judged by the rating agency as likely enough to meet payment obligations.

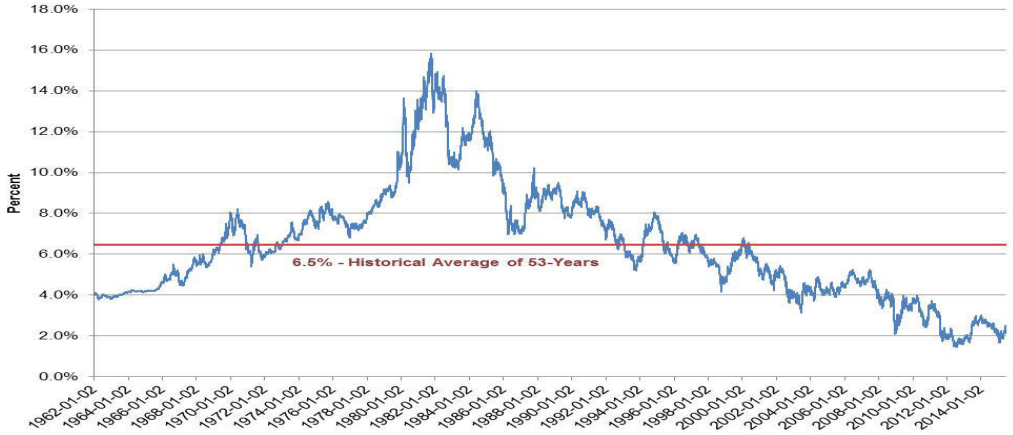
Non-investment Grade: A level of credit rating for bonds or securities that carry a rating of 'BB+' or lower by rating agencies such as Standard & Poor's or Fitch, or 'Ba1' or below by Moody's. Non-investment grade bonds are so called because of their higher default risk in relation to investment-grade bonds.

Exhibit 3: Historical 10-Year Swap Rate (7/7/2000 - 6/19/2015)



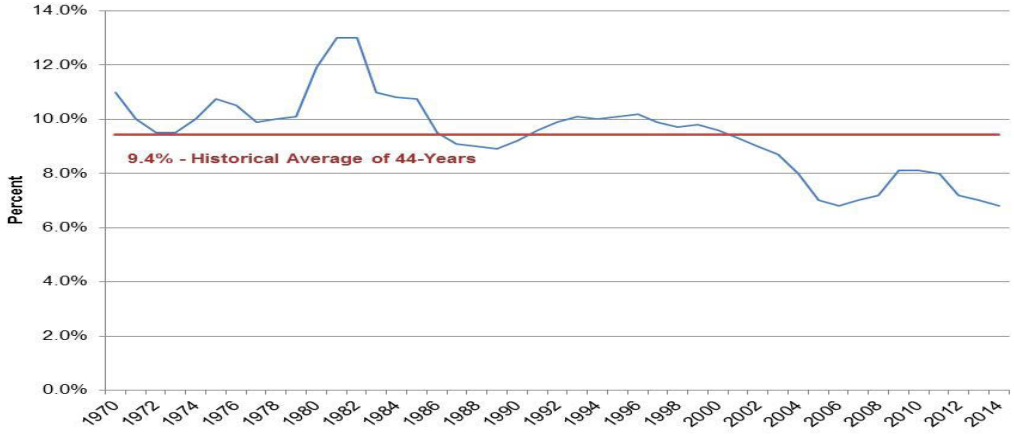
Source: Federal Reserve Economic Data

Exhibit 4: Historical 10-Year Treasury Rate (1/2/1962 - 6/25/2015)



Source: Federal Reserve Economic Data

Exhibit 5: Historical Commercial Real Estate Cap Rate (1970 - 2014)



Sources: CoStar Group, Inc., Moody's Investors Service, and Real Capital Analytics.

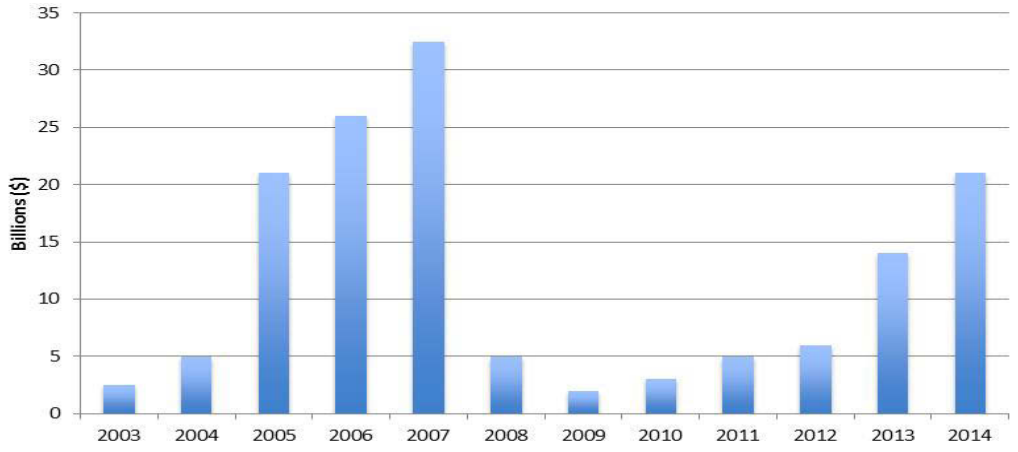
As exhibits 3, 4, and 5 demonstrate, the economic iron is hot for borrowers to lock in a longer term, fixed rate loan of at least 10 years, even if one has to defease or prepay their current CMBS loan.

Prepaying and Defeasance is the Name of the Game Right Now

Defeasance is a powerful call protection tool for investors at certain times within the economic cycle. One could argue that call protection in the form of defeasance during this historically low interest rate environment is harmless for a borrower because of the ability to refinance at a lower rate and overall better terms is slim to none during the life of the loan.

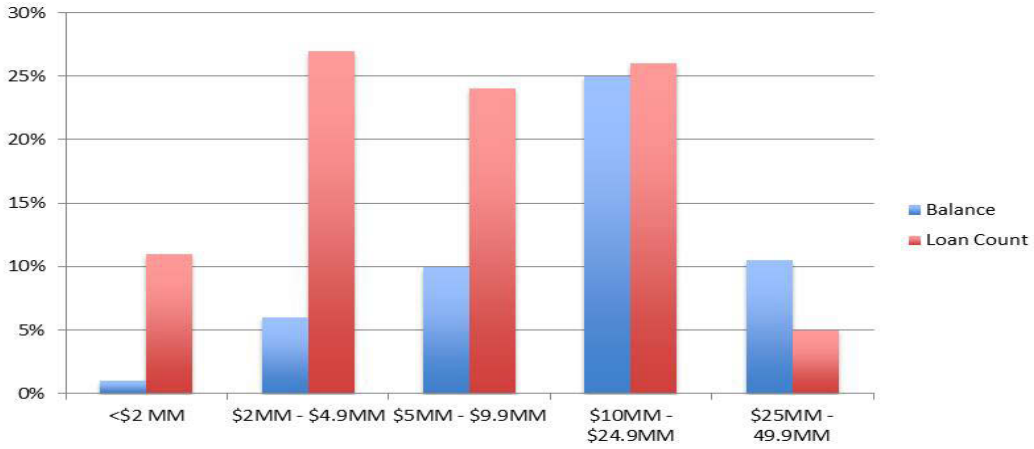
Approximately $20.9 billion and 1,275 loans defeased in 2014 alone (see exhibits 6 and 7 below). The upward swing in defeasance further exemplifies a favorable period for refinancing. At Saratoga Springs Capital, we will advise and execute the refinancing once the savings from the lower fixed interest rates and better terms more than offset prepayment/defeasance costs to our client. Our goal is to lock in the most financially optimal solution available to the borrower at any time in the economic cycle.

Exhibit 6: Annual Defeasance (2003-2014)



Sources: Moody's Investors Service and defeasance consultants.

Exhibit 7: 2014 Defeasance by Loan Balance and Loan Count



Sources: Moody's Investors Service and defeasance consultants.

Economics Favor Refinancing Despite Call Protection Penalties

If a commercial property owner has a loan that is call protected, they should evaluate and consider paying the prepayment penalty despite whether it has defeasance, yield maintenance, or a flat percentage prepayment penalty. Below in exhibit 8 is an example of a transaction that refinanced despite being call protected for another 24 months with defeasance. The borrower saved and cashed out approximately $3.8 million or 54.0% more than the original loan amount by refinancing their 2007 vintage loan.

Exhibit 8: Economics Favor Refinancing Despite Call Protection Penalties

Initial Loan - 2007 Note Date	
Loan Amount	$7,000,000
Interest Rate	6.500%
Initial IO Period (months)	36
Amortization Schedule (months)	360
Term (months)	120
Prepayment Penalty Description	LO (24), Def (94), O (2)

New Loan - 2015 Note Date	
Loan Amount	$10,000,000
Interest Rate	4.125%
Initial IO Period (months)	60
Amortization Schedule (months)	360
Term (months)	120
Prepayment Penalty Description	LO (24), Def (93), O (3)

Refinance Summary	
Defeasance Cost (24 months until open period)	($903,000)
Interest Rate Savings With New Loan	$1,662,500
Cash Out From New Loan	$3,000,000
Total Savings and Cash Out From Refinance To Borrower	**$3,759,500**

Assumed 10 year term, same loan balance, full IO, and did not NPV for savings calculation.

Source: Saratoga Springs Capital LLC

Net Present Value (NPV): The difference between the present value of cash inflows and the present value of cash outflows.

Given the current historically low interest rate environment and where interest rates are predicted to travel from here, prepaying your loan in order to lock in a low fixed rate for 10-years will outweigh the prepayment costs.

2. "There is no flexibility and it's difficult and time consuming to work with the CMBS servicer platform!"

This statement is sometimes true for borrowers who are not accustomed to the CMBS process. However, Saratoga Springs Capital is very familiar with the CMBS servicers and their platforms after collectively having decades of experience working with them. We execute efficiently and timely. Part of the process is understanding how it works internally and we do, thus making the process as easy as working with your local lender.

Most Likely Events for a Borrower to Contact Servicers

The act of refinancing or selling the property is the likeliest scenario in which a borrower would contact the servicer. This is when property owners may think they will experience a lack of flexibility and too much time consumption. However, interest rates are near all-time lows and may increase in the future. Borrowers should not be deterred by servicers in regards to refinancing because they will most likely not be refinancing at a lower rate when they obtain a 10-year term loan today. If a borrower wishes to sell their property,

their option is not just limited to potentially paying the prepayment penalties, since they can forego these penalties all together by pursuing a loan assumption if the loan was structured properly at origination. A loan assumption is where the buyer of the property assumes the existing mortgage, thus the loan is not prepaid and does not incur prepayment penalties. The loan assumption process is fairly simple and can be completed in 45 to 60 days at a cost similar to closing costs for a CMBS loan.

Historically, commercial real estate property owners have encountered the majority of their difficulties when either requesting a modification, facing imminent default or defaulting on their loan. The owners may have preemptively reached out to the master servicers at that time, and found them to be inflexible in a situation where the master servicers have limited authority to act. The owners could potentially request a loan to be transferred to the special servicers if they state a default is imminent, and the special servicers have the authority and power to act and modify loans. Saratoga Springs Capital makes this process easier by advising the property owner accordingly during and after the loan is executed.

Our deep understanding of the servicer's process and experience in working with trustees, master servicers, and special servicers offer yet another example of Saratoga Springs Capital's deeper value-add to the client. We also know what to identify, structure, and/or request from the lenders. The result is highly valuable savings of time and money.

3. "My current broker told me that it's not worth it!"

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