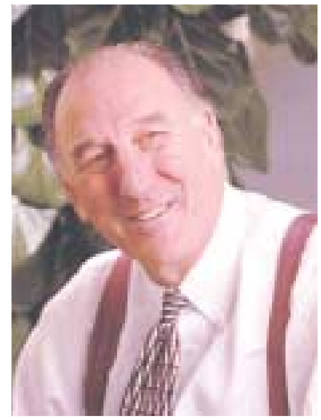
GMAC Commercial Mortgage: Fine-Tuning a Global Focus

An Interview with David E. Creamer, Chairman and Chief Executive Officer of GMACCH, and Eric Lindner, President of GIA.



GMAC Commercial Holding Corp. (GMACCH) is one of the leading financial services firms serving the commercial real estate industry. Through its varied business units and subsidiaries, the company is an industry leader in loan origination and servicing, asset management and investment advisory services. With more than 100 offices worldwide, the company expects to originate approximately $20 billion of financing products in 2002 and significantly grow its servicing portfolio, which is approaching $160 billion.

GMAC Institutional Advisors LLC (GIA), one of the company's rapidly growing subsidiaries, is an investment manager that invests institutional capital in both public and private real estate-related debt and equity. As of June 30, 2002, the company had nearly $5 billion investments under management. With a capital allocation from its parent company, GIA actively co-invests alongside client capital in a wide array of tailored investment strategies.

Recently, PricewaterhouseCoopers financial services partner Mike Kelly sat down with GMACCH Chairman and Chief Executive Officer David E. Creamer, and GIA President Eric Lindner, to discuss the organization's steadily evolving presence and commitment to the real estate industry and how it plans to identify and take advantage of opportunities in the changing global marketplace.

PwC: *Many knowledgeable people in the financial services industry are not fully aware of the breadth of GMACCH's activities. Furthermore, to some your activities may appear widely dispersed and unrelated, whereas they really are part of an interconnected underlying strategy. Perhaps we could begin with a description of the vision you had when you first established the company and the evolution of that vision since that time.*

DC: Through 1994, when we were a division of GMAC Mortgage, our residential mortgage affiliate, we were essentially a traditional mortgage banker with a servicing operation and production offices that originated loans for third party take-outs. Our strategy upon separating from our affiliate and establishing a distinct identity was to become a full service operation for both borrowers and commercial mortgage-backed security (CMBS) investors. In the early 1990s, we were all operating in a very fragmented market in which one organization did one piece of business and another organization did another piece. In some cases it was necessary to bring together four or five different players to accomplish one transaction. We decided to make it easier for borrowers and investors to get what they need by putting it all under one roof.

Over time, we either found or created new businesses that supported our strategy. For example, we started out originating and servicing loans. But what about master servicing, we asked ourselves. As loan securitization activity expanded, we said, what about investing in the subordinate tranches until there's more liquidity in the market? What about special servicing in the event there are defaults to be resolved?When we saw that the needs of some borrowers were not being served in the securitization marketplace, we acquired an investment banker whose professionals helped us to structure transactions that brought more borrowers and investors together. Expansion of the investment banking

business eventually introduced us to an array of opportunities in the tax-exempt/tax credit world. From there, it was a natural extension to be in property management. And, of course, I'm just speaking of a few of our business.

GMAC Institutional Advisors (GIA), which we organized in 2000, is yet another extension of these activities. We knew we possessed expertise in real estate. We also knew we were skilled at capturing repeat business with strong borrowers. Why not establish a funds platform where we could offer our talents to help pension funds and other qualified investors achieve attractive returns in real estate?

It is really just one progressive step after another. As you address one underserved part of the marketplace, you sometimes identify another opportunity to fill a need, and you add that to the mix.

PwC: *As you think about the company's evolution, were there two or three business deals that, in particular, significantly expanded the breadth and depth of your capabilities?*

DC: Clearly, our acquisition of Hanford-Healy was significant. That was in 1996, and it started out very simply with the recognition that their expertise — problem loan resolution and asset management — was a skill set we wanted to have under our roof. But we got much more than that. The transaction also helped us establish our B-piece unit, which I think is second to none. Second, there was our transaction with Newman Financial Services, which brought us deep real estate investment banking talent, our broker-dealer and how all that fits into the puzzle.

PwC: *Eric, can you tell us a little bit about what Hanford-Healy was doing before you merged the company with GMACCH?*

EL: We were a real estate asset management and appraisal company. It had been the most active manager for the Resolution Trust Corporation (RTC) on the West Coast in the early 1990s. It also worked for a number of investment banking firms and public pension funds that were involved either in rationalizing their own portfolios, or as in the case of some of the investment banks and real estate funds, acquiring distressed debt. We were involved in conducting the due diligence and actively managing the distressed debt that they were acquiring from failed saving and loans, insurance companies or commercial banks.

PwC: *Dave, why was Hanford-Healy's special servicing capability of such high interest to you?*

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DC: Although commercial mortgage securitization was really beginning to take off in 1996, there weren't a lot of buyers for the subordinate securities. We had issued several deals prior to the acquisition, but, like our competitors, were struggling somewhat with sale of the B-pieces. We wanted to be able to go to market and know that virtually all our bonds would be placed somewhere. In some cases, that could mean on our own balance sheet for later distribution in another form. In those days we were still trying to figure out what that would be. By adding Hanford-Healy, we gained the professional staff we needed to be a successful B-piece security investor.

All the parts are integrated and dependent on each other. Our collective viewpoint that we are dependent on one another, I think, has gone a long way to foster our team spirit. None of us operates in a vacuum. All the pieces work together to get the best quality paper in the hands of our investors. It's a question of the right opportunity, the right markets, the right borrowers, the right everything that constantly gets reshuffled and realigned based on what is going on in the marketplace.

PwC: *How has this impacted the evolution of GIA and its approach to the marketplace?*

EL: In our view, we have established a unique, differentiated business model. The mortgage banking industry generally has focused on being exclusively an intermediary. Typically such players have not exhibited capabilities as a financial principal. We have been able to blend our abilities as financial principal to leverage our capabilities as a financial intermediary. In terms of the evolution of GMAC Institutional Advisors, it was largely the result of being responsive to investor-client needs. In many cases, institutions came to us wanting to leverage off the infrastructure that we created to identify investment opportunities, to analyze those opportunities, to conduct due diligence, and then to manage and surveil all those opportunities.

A good example is our involvement in the CMBS investment area, particularly in the below-investment grade CMBS area where we have developed a sophisticated infrastructure dedicated to source, analyze and manage investment opportunities. It is an expensive proposition for investors — the special servicing capability, the due diligence capability, the portfolio management capability and the surveillance. It is a major financial and human resource investment. We have done that in connection with our core businesses of loan origination and loan servicing, and we were able to leverage those skills and provide those services to the institutional community, which has embraced the CMBS market from an investment standpoint.

PwC: *How would you rate GIA's management team today in terms of experience with real estate's up and down cycles?*

EL: A great number of our people had worked through the difficult real estate times of the late 1980s, early 1990s — particularly those professionals involved in due diligence, that is, looking at the underlying collateral in connection with our CMBS investment activity and mezzanine debt investment activity. That experience has reinforced the importance of access to information, and it certainly has reinforced the importance of integrating technology into the process so that we can enhance our productivity and our ability to quickly and effectively process information.

PwC: *If I'm an institutional investor considering either core or opportunistic investments, including CMBS investments, why should I entrust GIA with my money?*

DC: First of all, opportunistic real estate related investments, particularly CMBS, are our core business. It's what we do. We possess enormous expertise, and we are willing to share. Second, not only will we share that expertise, we share our data with our clients — through RealPoint — and help them understand the basis for our decision-making. Third, we are willing to co-invest with our clients. We will put our money in the same place they are putting their money. We go to great lengths to align the interests of all the parties to bring transactions to successful conclusions. We consider every aspect of every transaction to make sure we have the best product, the best borrowers and the best structures, to generate the best returns. We are investing our money to make a good return on it, too.

PwC: *How do you deal with the appearance of conflicts — governance questions that an investor might have? You look at a lot of deals. How do you assure your investors that they are going to get a piece of the best deals?*

EL: As is customary within the investment management business, we have a well-articulated allocation policy that guides us and obligates us to be fair and equitable in allocating investments among investors. As a general rule, we subordinate our role as a principal, from an investment opportunity standpoint, to those of our investors, but at all times and in all situations adhere to our allocation guidelines.

PwC: *How significant has your investment in technology been and how is it utilized throughout your organization?*

DC: When we formed the company back in 1994, we had recently converted to a servicing system offered by a relatively small company called McCracken. This is a good example of how you can benefit from adversity. In terms of converting computer systems, we did just about everything wrong.

We acquired McCracken as a defensive move. Even then we had the largest servicing portfolio in the industry, and although McCracken was burning through cash, had dated technology and was facing Y2K compliance issues with its system, we didn't have an alternative. We decided the best thing to do was buy McCracken, put cash in, and solve the problem not only for ourselves, but for the rest of the industry. In the process of doing that, we discovered that even with the problems it faced, the McCracken system was and still is the superior system out there.

McCracken has since proven itself to be a leader in the financial software industry. They have streamlined and simplified coding and changed the way programming is done. McCracken has also been successful at finding ways to facilitate communication between programmers and operators. By teaching programmers more about our business and helping the business people understand more about programming, McCracken has increased efficiencies.

With the evolution of the Internet, we asked ourselves, why should every client of McCracken need to have their own server and their own staff to run their own computer system? Why not have one main server and one set of operators? Clients could get out of the business of running computers, and McCracken could increase their market share by picking up smaller users who could not afford to maintain their own server. We now have back-up servers in Ireland and Japan, and are fine-tuning the fail-safe system so that as long as any one of the three servers is operating, the system can operate worldwide.

We have developed a technology-focused environment, and that has led us to think about innovative ways to pair technology with our other resources to come up with new products. As an industry leader in both loan servicing and loan production, we have access to a lot of data from appraisals and other sources. This led us to consider how we could pull all this together into a usable, one-stop database.

That was the concept behind RealPoint, and I'll let Eric talk about that.

EL: As Dave said, RealPoint was created in recognition of the fact that today we are servicing a portfolio approaching $160 billion. We are named special servicer on approximately $75 billion of the portfolio. Increased reporting and information requirements, particularly those associated with CMBS, provided us with a wealth of information and potentially a tremendous competitive advantage in terms of identifying and managing opportunities. The next step was to harness this information, and we went about developing systems to capture and analyze the information. The system, first used internally, goes by the name RealInfo. It provides GMAC Commercial employees with access to economic information and comparable sales and leasing information. They have instant access to information that helps them analyze opportunities and understand market dynamics and market trends.

We took the technology and created RealPoint, which is available to the public. RealPoint provides unequaled access to information about the CMBS marketplace. It provides the user with access to some 600 CMBS transactions, over $300 billion worth of loans secured by commercial real estate and information about the performance of those loans. The system and the platform enable an investor, a manager, a buyer, or a seller to access transaction specific information. If someone wants to understand how a certain security is performing, they can access the system through the Internet and very quickly look at the performance of a bond, the performance of the loan that is collateral for that bond, and also at the underlying property level. Users can drill down in a matter of minutes and get a good sense of the property and the collateral performance within the security.

PwC: *RealPoint obviously gives the user the ability to access a wealth of information, but what about sorting out what that information means?*

EL: It's not only access to information. It is also access to analysis. There are some 25 seasoned analysts who follow specific securities on an ongoing, real-time basis, who are available to RealPoint subscribers. We encourage subscribers who have a question or would like additional detail to call the analyst and get real-time, firsthand answers to their questions.

RealPoint also covers the REIT debt market and is initiating coverage and has product available for investors in whole loans. A whole loan portfolio could be put on the system and it would supported by analysts in a manner similar to our CMBS coverage. We think it has a tremendous application for whole loan investors and managers outside the CMBS market.

PwC: *Do you expect RealPoint to increase real estate investment transparency and, in turn, CMBS liquidity in the marketplace?*

EL: There is no question that a wealth of new information relating to the commercial real estate industry has been made available particularly compared to what was available in the late 1980s or early 1990s. RealPoint increases the transparency of the market. It not only uses information developed through our core of analysts and proprietary access to information, but we also are one of the largest purchasers of information, and we aggregate that information which supports RealPoint and RealPoint analysts.

DC: Prior to CMBS and prior to products like RealPoint, if you wanted to invest in commercial real estate debt or equity, you needed a staff of people who had knowledge about it, and you needed access to some kind of production vehicle to drive it through your door. But it was one loan or one equity deal at a time. Someone had to analyze it. There was a lot of paper work and a lot of overhead involved in investing in real estate.

Now you can go out and invest, not only in one deal, but in a diversified pool of loans which further sheds your risk. You can get that diversity instantly by buying into a CMBS or a series of CMBS, but you still have to understand what is in there. For example, say you buy a CMBS that has one trophy property and several other smaller properties. Maybe the trophy property is 15 or 20 percent of the deal, but if that goes down, you can lose 15 or 20 percent of your value instantly. Investors need to understand — what is the likelihood of default, who is the property manager and, how is it occupied? RealPoint provides that information on an ongoing, real-time basis that tells you what is happening in your building or your particular CMBS.

PwC: *How do you see RealPoint's potential in the international marketplace?*

DC: When we look at other markets, finding the core data is really a problem because there is no transparency. Most of the portfolios have been held by institutions on their balance sheet. In most cases either the data was not accumulated, or it is not in a user friendly format or it is simply not available. The trick is to find ways to capture enough data to make RealPoint as effective in other markets as it is in the United States. That would allow for more transparency and more liquidity in those markets.

PwC: *Looking now at the global marketplace, what do you regard as some of your most attractive opportunities and what are some of the key factors that you see supporting your ability to be successful in pursuing them?*

DC: Clearly, the Hanford-Healy acquisition was a catalyst for a lot of different things, and it provided the infrastructure needed for our first significant investment outside the United States.

EL: The commercial real estate market in Japan in 1997 looked a lot like the commercial real estate market in the United States during the S&L debacle of the early 1990s. It was, and still is, a very opaque market. This is good news for those of us who have a strong infrastructure and access to information, because we can identify and capitalize on opportunities. Also, I think it underscores one of our core philosophies, which is to try to be positioned in counter-cyclical businesses. The real estate market historically has and will continue to go through cycles. Although in the United States they may not be as pronounced as they were in the past, we have always had a belief in positioning ourselves to take advantage of both ends of the cycle.

PwC: *How does that focus on diversification and counter-cyclical strategy work for you?*

DC: In Japan, the market was about 180 degrees out of sync with the United States when we entered it. Operating in different ways in two different economies simultaneously gave us a chance to play all the way around. We knew that we couldn't go in and only be an asset manager-workout type of player. That was just a way of entering the market and getting a lot of first-hand knowledge. We successfully fought to get the laws in Japan changed to allow for third-party servicing. Then we obtained the first license as a third-party servicer and helped foster a CMBS market in Japan. Although it is considerably weaker than what it is in the U.S., it is growing.

We have also entered the origination and property management business in Japan. The company we brought out

of bankruptcy had been in property management. They had expertise, and they had people. We could either throw it away, or we could grow it. We decided to grow it and have done a pretty good job. As a result of our experience and comfort level in that role, we were led into developing our property management in Europe and the United States. Our first entry into the European property management business was an acquisition in France. Later, we acquired Paramount Financial Services, a tax credit syndicator with a property management business, here in the U.S.

That idea of finding ourselves involved in one area, and exporting that piece into other areas has worked well for us. Recently our French, U.S. and Japanese property managers held a conference to get together and share ideas. One of the things we liked about the French company was their idea for developing software that could revolutionize the property management business. It has just been rolled out recently, but it is already exceeding our original estimates for its acceptance, its use, and the potential benefits that can be generated from it. When our friends in the U.S. saw the system, which was originally designed for Europe, their reaction was, "How fast can I have it?" We are in the process of bringing it to the U.S. and also taking it to Japan.

Geographic diversity has really helped us. But it's not without its challenges — languages, currencies, foreign governments, and foreign rules — all make for some interesting days. But if you go in with the right attitude, the right approach and the right partners, it simplifies a lot of things, and you can avoid a lot of mistakes.

PwC: *Who would you say are the key entities fueling your expansion into Europe?*

DC: Almost 100 percent of our production in Europe so far has come via U.S. contacts — U.S. developers who do business in Europe and who want U.S. style reporting and U.S. style deals. They have gravitated to us because they know we understand what they are looking for. Our first real contract in Japan involved a U.S. owner of Japanese real estate who wanted U.S. style property management. We have Japanese market expertise, and we have the American view of how to do it is the same in Europe. We can take advantage of the expertise of the entity with whom we've partnered, and yet we can bring American style events. It's a great advantage.

EL: In terms of GIA, this is a logical extension of our business. It is truly a win-win. It's a win for our institutional clients in that they have access to an infrastructure, access to deal-flow and access to our co-investment activities. All that gives them a competitive advantage in the marketplace. It is a win for us in that we expand our relationships and provide both our domestic and our international production offices, a very important part of our success, with additional products and services. It is almost a self-fulfilling prophesy from the standpoint of why it makes sense and why it is beneficial to investors.