

# Freestone Finance Company (Proprietary) Limited – Series 1

CMBS / South Africa

*This pre-sale report addresses the structure and characteristics of the proposed transaction based on the information provided to Moody's as of 02 May 2006. Investors should be aware that certain issues concerning this transaction have yet to be finalised. Upon conclusive review of all documents and legal information as well as any subsequent changes in information, Moody's will endeavour to assign definitive ratings to this transaction. The **definitive** ratings may differ from the **provisional** ratings set forth in this report. Moody's will disseminate the assignment of definitive ratings through its Client Service Desk. This report does not constitute an offer to sell or a solicitation of an offer to buy any securities, and it may not be used or circulated in connection with any such offer or solicitation.*

## PROVISIONAL (P) RATINGS

Class	Rating	Amount (million)	% of Notes	Legal Final Maturity	Coupon
A	(P) <b>Aaa.za</b>	ZAR[335.0]	[67.0]	[May 2013]	3mJibar + [· ]%
B	(P) <b>Aa2.za</b>	ZAR[48.0]	[9.6]	[May 2013]	3mJibar + [· ]%
C	(P) <b>A2.za</b>	ZAR[117.0]	[23.4]	[May 2013]	3mJibar + [· ]%
Total		ZAR[500.0]	100.0		

*The ratings address the expected loss posed to investors by the legal final maturity. In Moody's opinion the structure allows for timely payment of interest and ultimate payment of principal at par on or before the rated final legal maturity date. Moody's ratings address only the credit risks associated with the transaction. Other non-credit risks have not been addressed, but may have a significant effect on yield to investors.*

### Estimated Closing Date

[30] May 2006

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## OPINION

### Strengths of the Transaction

- Loan with initial day one underwriter (“U/W”) LTV of [55.4]% and high U/W ICR of [2.44]x.
- Property diversity and current tenants: The portfolio consists of office, retail and industrial properties occupied by 550 of commercial tenants across different industry groups.
- The Borrower is a newly established Special Purpose Vehicle with no employees.
- A liquidity facility in an initial amount of [ZAR200,000,000] or [40]% of initial balance under the Notes will be available during the course of the transaction until legal maturity of the transaction, subject to any reduction in the initial commitment.
- The property management function for the underlying property portfolio is outsourced to RMB Properties (Proprietary) Limited a well known and established provider of property management services in South Africa.

### Weaknesses and Mitigants

- The loan is interest-only and as such there is no scheduled amortisation. This increases the refinancing risk at maturity. This is somewhat mitigated by a modest Day 1 UW LTV of [55.4]%.
  - [70.2]% of the properties (by open market value (“OMV”)) are located in, the Gauteng province. However, Gauteng is South Africa’s most economically most active area.
  - [64.3]% of the properties (by OMV) are office property type. Moody’s took into account this by reducing the diversity assumptions in deriving credit enhancement levels for the transaction.
- Initial pool concentration in respect of collateral exists as follows:



- Substitution risk exists as properties in the portfolio may be substituted by applying disposal proceeds to purchase other properties. The transaction allows significant flexibility to the Borrower to alter the portfolio composition. This risk is mitigated by applying limits to substitutions (lesser of 15% of the lesser of the initial OMV and the most recent OMV or 20% of the count of properties) and various substitution eligibility criteria to limit any significant deteriorating in the quality of the portfolio.
- New loans may be acquired under Series 1 and will be funded from tap issuance under the notes which may not be fungible with existing notes in respect of tenor, interest basis (i.e. fixed or floating) and issue margin. The issue of new notes may only take place to the extent that Moody's has confirmed that the current ratings of the existing notes will not be adversely affected.

## STRUCTURE SUMMARY *(see page 4 for more details)*

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Structure Type:	DMTN Programme
Issuer:	Freestone Finance Company (Proprietary) Limited
Borrower:	Freestone Property Investment (Proprietary) Limited
Bridge Loan Lender:	First Rand Bank Limited, acting through its Rand Merchant Bank division ( <b>Aa2.za/P-1.za</b> )
Loan Servicer:	First Rand Bank Limited, acting through its Rand Merchant Bank division ( <b>Aa2.za/P-1.za</b> )
Recovery Agent:	RMB Properties (Proprietary) Limited
Interest Payments:	Sequential, Quarterly
Principal Payments:	Sequential, Bullet
Credit Enhancement/Reserves:	Through subordinated tranches
Liquidity Facility Provider:	First Rand Bank Limited, acting through its Rand Merchant Bank division ( <b>Aa2.za/P-1.za</b> )
Swap Provider:	First Rand Bank Limited, acting through its Rand Merchant Bank division ( <b>Aa2.za/P-1.za</b> )
Administrator:	First Rand Bank Limited, acting through its Rand Merchant Bank division ( <b>Aa2.za/P-1.za</b> )
Owner of the Security SPV:	Freestone Security SPV Owner Trust
Security SPV (Issuer Level):	Freestone Security SPV Series 1 (Proprietary) Limited
Owner of the Issuer:	Freestone Finance Company Owner Trust
Guarantee SPV (Borrower Level):	Freestone Mortgage Bond SPV Series 1 (Proprietary) Limited
Arranger/Lead Manager:	First Rand Bank Limited, acting through its Rand Merchant Bank division ( <b>Aa2.za/P-1.za</b> )

## COLLATERAL SUMMARY *(see page 9 for more details)*

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Assets:	[1] loan with a total securitised balance of ZAR500 million
Number of Properties:	[42]
Number of Borrowers:	[1]
Property Type Distribution:	[64.3]% office, [18.7]% retail and [17.0]% industrial
Type of Loan	Fixed rate loan
Geographic Diversity:	[70.2]% Gauteng, [12.3]% Western Cape, [10.1]% Kwazulu Natal and [7.4]% Free State.
U/W LTV:	[55.4]% based on the latest valuation of RMB Properties (Proprietary) Limited
U/W ICR:	[2.44]x
Remaining Term:	5 years
Amortisation Profile:	Interest only loan, no scheduled amortisation
Ownership Interest:	40 Freeholds, 2 Leaseholds

## NOTES

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<b>Class</b>	<b>Subordination</b>	<b>Coupon</b>	<b>Credit Enhancement</b>
A	Classes B, C	3-month Jibar + [·]%	33.0%
B	Class C	3-month Jibar + [·]%	23.4%
C	None	3-month Jibar + [·]%	0.0%

## TRANSACTION SUMMARY

**Moody's has assigned provisional ratings to the CMBS issuance of Freestone Finance Company (Proprietary) Limited Series 1**

**The Borrower can alter the composition of the portfolio subject to eligibility criteria and covenants**

**New loans and borrowers can be added to Series 1**

**Moody's has assigned provisional ratings to the Notes**

Moody's assigned provisional long-term national scale credit ratings<sup>1</sup> of (P)**Aaa.za** to the Class A Notes, (P)**Aa2.za** to the Class B Notes and (P)**A2.za** to the Class C Notes. Class A notes are senior to all other classes and benefit from the additional subordination provided by the other Classes.

This transaction represents the securitisation of one commercial mortgage loan. The provisional ratings of the Notes are based upon an analysis of the characteristics of the mortgage pool backing the Notes and the legal and structural integrity of the transaction. The transaction retains business risk due to the flexibility provided to the Borrower to incur additional debt, as long as the additional lender accepts to be a party to the Intercreditor Agreement. In addition, the Borrower has the flexibility to alter the composition of the securitised portfolio through disposals and substitutions.

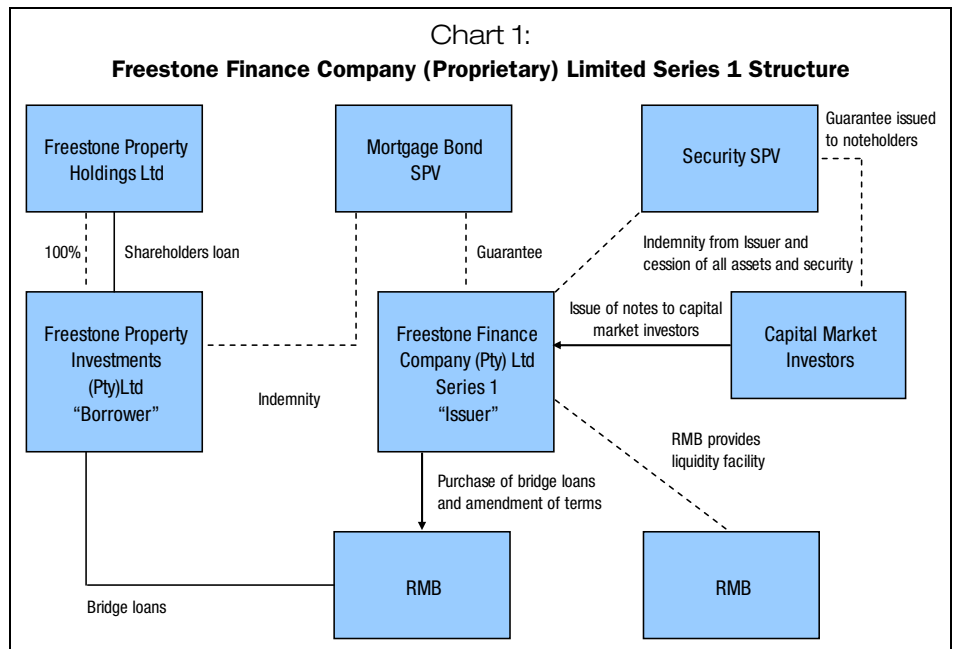
Although the covenants given by the Borrower limit the downside or the risk profile of the Notes, Moody's acknowledges that certain risk factors cannot be captured in the covenant restrictions. Moody's has taken into account (i) the experience of the sponsors fund management and (ii) the investment strategy of the Borrower, based on discussions with the fund management of the sponsor.

The Programme allows the Issuer to add new loans to Series 1 which may be granted to other borrowers (please see *Structural and Legal Aspects* section for further details).

Moody's has assigned provisional ratings to the Series 1 notes (the "Notes"). The transaction represents the securitisation of one loan advanced by the Bridge Loan Lender. The provisional ratings of the Notes are based upon an analysis of the characteristics of the pool backing the Notes and the legal and structural characteristics of the transaction.

The ratings address the expected loss posed to investors by the legal final maturity. In Moody's opinion, the structure allows for timely payment of interest and ultimate payment of principal at par on or before the rated final legal maturity date. Moody's ratings address only the credit risks associated with the transaction. Other non-credit risks have not been addressed, but many have significant effect on yield to investors.

## STRUCTURAL AND LEGAL ASPECTS



<sup>1</sup> For in-depth information on the definitions and methodology of Moody's National Scale Ratings for South Africa, please contact Moody's Client Service Desk in London at +44 20 7772 5454.

***This is the first series to be issued under the domestic MTN programme of Freestone Finance Company (Proprietary) Limited***

***The Notes are subject to the terms and conditions contained in the Programme Memorandum, the Series Supplement and the Pricing Supplement***

***Future Series may be added to the Programme. Each Series will be ring fenced from the others.***

***Additional loans granted to the Borrower and other borrowers may be added to Series 1.***

Various counterparties will contract with the Issuer in respect of Series 1 to provide services related to the Notes and corresponding loan under Series 1. These will include a security SPV to hold and administer security for the benefit of Noteholders and other secured creditors of Series 1, a loan servicer to service and administer the Series 1 loan, a calculation agent to manage the priority of payments of the Issuer for Series 1, a liquidity facility provider and hedge counterparty.

The initial loan for Series 1 will be advanced by the Bridge Loan Lender to the Borrower prior to the Closing Date. The loan will be acquired by the Issuer from the Bridge Loan Lender on the Closing Date with proceeds of initial issuance of Notes of various classes.

The Notes will be issued subject to terms and conditions set out in a programme memorandum. Any additional terms and conditions applicable to Series 1 and its tranches will be set forth in the Series 1 series supplement and Series 1 pricing supplement, respectively. Terms and conditions applicable to any tap issuances will be set forth in a further Series 1 pricing supplement.

Under the DMTN programme future series will be included in the Issuer on a ring-fenced basis.

Additional loans may be acquired prior to the maturity date of existing loans, which may be non-fungible with existing loans in respect of interest basis (i.e. fixed or floating), issue margin and tenor. It is expected that these additional loans will be funded from a tap issuance, which will be subject to conditions and requirements in respect of the Borrower, loan and collateral including the following:

- rating agency confirmation that the additional notes issuance will not cause it to downgrade or withdraw its rating of existing notes of the series;
- the Issuer is not in breach of any of its material obligations under the transaction documents;
- no Note event of default has occurred and is continuing;
- the Issuer has obtained a legal opinion confirming that such issue of notes is in conformity with and shall not breach any applicable laws; and
- prior written consent from the Security SPV.

Each additional loan will be cross-defaulted with all other loans in Series 1.

New co-borrowers can be added subject to the same conditions. Each co-borrower will have to be jointly and severally liable in respect of all loans within a series. Collateral for each loan within a series (being primarily mortgage bonds over property) will also be structured to ensure full cross-collateralisation.

### **Key Aspects of the Loans include the following:**

#### ***Borrower's Special Purpose Vehicle status***

The Borrower is structured as an SPV and incorporated for the purpose of this transaction. Sole owner of the borrower is Freestone Property Holdings Limited a listed property loan stock company.

#### ***Borrower flexibility***

The transaction allows the Borrower significant flexibility to manage the assets, alter the composition of the portfolio and to incur additional debt as long as certain covenants are satisfied. The flexibility allowed in the management of the assets is described below ("Sale of properties and release premium", "Use of Debt Proceeds prior to event of default", "Substitution", "Repairs and maintenance capex" and "Developmental capex").

The Borrower is allowed to acquire additional properties and create security over the properties it owns which are not part of the collateral for the Series 1. The risk of having other lenders who can potentially sue the Borrower is mitigated by the fact that the Borrower covenants that it will not incur any additional borrowing unless the additional lender accepts to be bound by the terms of the Intercreditor Agreement.

In addition, there is a cash trap mechanism ("Springing Lock Box Trigger Event") which is triggered if:

- the backward looking interest cover ratios ("ICR") of the Borrower, together with any borrower added to the Series 1, fall below 1.60x; or
- the loan to value ratio ("LTV") in respect of the whole Borrower's portfolio (i.e. including non securitised properties) exceeds 70%;

### ***Amortisation***

For purposes of amortisation the following definitions will apply:

“Debt Proceeds” will be constituted from insurance proceeds on damage or destruction of a property or sale proceeds on any disposal calculated with reference to the Allocated Loan Amount of the relevant property plus any release premium.

“Allocated Loan Amount” will be the product of (i) the then LTV of the portfolio and (ii) whichever is the higher of the original OMV and the current OMV of the relevant property.

“Equity Proceeds” will be constituted as any remaining balance of insurance proceeds or sale proceeds (as above) after deduction of Debt Proceeds.

Debt Proceeds and Equity Proceeds will be held in an Issuer charged account (“Sale Account”) pending its application. The Borrower will be entitled to be paid any Equity Proceeds, provided that there is no event of default or potential event of default under the Series 1 loans.

Pursuant to a loan event of default or potential loan event of default, all Equity Proceeds will be re-characterised as Debt Proceeds unless such default is cured.

No amortisation will be required prior to expected maturity of the loan (or early maturity following an event of default) except in the following circumstances:

- Debt Proceeds will be required to be applied in redemption of principal under the loans on a quarterly loan payment date, if at any time in a loan interest period the ICR (see description under covenants below), calculated as earnings before interest, taxes, depreciation and amortisation divided by interest expenses, falls below 1.55x, or to the extent that the balance of the Sale Account exceeds ZAR100 million for more than 90 days;
- In other circumstances, principal under the loans may be redeemed at the election of the Borrower from Debt Proceeds (voluntary redemption);
- Additionally, at the election of the Borrower, principal under the loan may be redeemed from any Equity Proceeds or any other equity funds.

The Borrower can use equity proceeds or other funds available to it to prepay the loans.

### ***Sale of properties and release premium***

The Borrower may from time to time dispose some of the properties. All sale proceeds will be deposited into the Sale Account.

The release of mortgage bonds and monies from the Sale Account is subject to certain conditions and restrictions including that a premium is payable (the “Release Premium”). The Release Premium for a property is equal to 10% of the Loan to Valuation Ratio of the portfolio multiplied by the Funding Date Open Market Valuation of the relevant Property.

In addition, any voluntary prepayment of the loan funded by equity will also entitle the Borrower to procure release of properties subject to the same Release Premium.

### ***Use of Debt Proceeds prior to event of default***

In addition to the voluntary and involuntary redemption of principal under the loan as discussed above, Debt Proceeds may also be used for substitution of properties (see below), investment in authorised investments or a voluntary repurchase of Notes in the open market on a public auction basis and subject to sequential buy back. The latter will be followed by cessation of voting rights and cancellation of Notes.

### ***Substitution***

Properties may be substituted with other properties that meet certain eligibility criteria. In addition, covenants in respect of portfolio concentration limits and portfolio quality criterias will be provided and reported on a monthly basis. Furthermore the Recovery Agent has to confirm that substitute property is in all aspects of an equal or better quality than the substituted property including being of an equal or higher value than the substituted property.

Series 1 substitution covenants are, inter alia, that substitutions are just allowed if:

- the interest Cover Ratio of at least 1.55; and
- the portfolio loan to value ratio does not exceed 75%

Substitution limits in respect of Series 1 will be the lesser of:

- 15% of the lesser of the initial OMV and the most recent OMV; or
- 20% of the count of properties.

#### ***Use of sale proceeds following an event of default***

Pursuant to a loan event of default, all amounts standing to the credit of the Sale Account, including any Equity Proceeds, will be used to redeem principal under the loans and the corresponding Notes in accordance with the priority of payments.

#### ***Security and Intercreditor Arrangements***

Security will be provided for the loan which will include first-ranking mortgage bonds over all the properties (see “Collateral”) and security cessions of certain related rights of the Borrower.

In addition the Borrower has the option to enter into further loan agreements with the Issuer or other lenders provided that the new lender enters into an Intercreditor Agreement with the Borrower and Issuer and the new borrowings do not exceed an LTV of 75%. According to the Intercreditor Agreement the Issuer’s security interest over the borrower’s assets will rank prior to those of the other lenders. Furthermore the new lender has no right to take any legal action against the Borrower without prior written consent of the Issuer and security SPV.

#### ***Loan interest***

The interest rate under the loans will be the aggregate of the swap rate applicable to expected maturity, plus any margin on the Notes and an amount for senior costs and expenses of the Issuer.

#### ***Repairs and Maintenance***

The Borrower will covenant to undertake repairs and maintenance to the properties throughout the term of the loans in accordance with a reasonable and prudent repair and maintenance programme and budget.

If the Borrower fails to comply with these obligations, the Lender acting through the Loan Servicing Agent shall be entitled to carry out the repairs and maintenance and claim indemnity from the Borrower. Expenditures for repairs & maintenance are limited to a maximum of 5% per annum of the aggregate value of the properties in the Series portfolio. Further expenditures exceeding the 5% are subject to approval of the Recovery Agent provided that the Borrower is able to demonstrate that the Net Rental Income of the property portfolio can be increased within the next 12 months.

#### ***Capital Expenditures***

Capital Expenditures is limited to 1% of the aggregate open market value (OMV) of the properties but may be increased to a maximum of 5% of the portfolio OMV and subject to, inter alia, the following conditions:

- Issuer approval has been granted;
- capital expenditure is funded from equity proceeds or other cashflows not included in EBITDA;
- each contractor waives any lien acquired or any right to the borrower’s assets arising through the capital expenditure project;
- no adverse effect on the Lender or any of the secured assets;
- the Borrower establishes a contingency reserve of at least 5% of the estimated costs
- the Borrower is able to demonstrate that the expenditure will increase the Net Rental Income within the next 18 months.

#### ***Cash Flows and Bank Accounts***

Cash flows from rental and similar amounts are collected by the property manager and transferred to the Borrower’s rent collection accounts. Prior to the occurrence of a Springing Lock Box Trigger Event, transfers will take place on a semi-monthly basis and after the occurrence of such event, on a daily basis to the Spring Lock Box Account.

The issuer will have three bank accounts opened in its name in the books of the Account Bank. They are referred to as the “Springing Lock Box Trigger Account”, the “Sale Account” and the “Transaction Account”.

Amounts standing to the credit of the Borrower's rent collection accounts will be transferred daily to the Springing Lock Box Trigger Account following the occurrence of a Springing Lock Box Trigger Event.

The Sale Account will be used to receive the Sale Proceeds. Prior to the occurrence of a loan event of default, Equity Proceeds can be withdrawn from the Sale Account and paid to the Borrower. Upon the occurrence of the Springing Lock Box Trigger Event, Equity Proceeds will be treated as Debt Proceeds.

The Transaction Account will be used to receive any amount other than those which have to be paid into the Springing Lock Box Trigger Account and the Sale Account.

## **Property and Asset Management**

The Borrower has outsourced all property and asset management functions to RMB Properties (Proprietary) Limited. Within this function RMB Properties (Proprietary) Limited is responsible for, inter alia, monitoring and technical inspection of the portfolio, the day to day property management of the portfolio, including collection of the rents and paying expenses relating to the properties.

## **Loan Servicing**

The Loan Servicer will undertake to perform services in connection with the loan in accordance with an agreed loan servicing standard. These services will include, without limitation, timely collection of all sums due and services relating to occurrence of an event of default.

## **Hedging**

Any risk associated with the difference in basis between floating rate Notes and fixed rate loan will be hedged by means of interest rate swap entered into between the Issuer and the Swap Provider. The swap will reduce in nominal amount in the event of any prepayment.

In case the Swap Provider's rating falls below **A1.za** and **P-1.za.**, cash collateral will be required to be provided pending replacement of the Swap Provider and/or guarantee of its obligations under the swap, in each case by a party with at least the required rating. The minimum national scale rating levels for a swap counterparty and/or guarantor are **A1.za** and **P-1.za.**

Moody's analysis assumes that the Swap Agreement will be in accordance with Moody's guidelines (see related Research).

## **Liquidity Facility**

A liquidity facility will be made available by the Liquidity Facility Provider in its capacity as liquidity facility provider to the Issuer to cover shortfalls in interest under all classes of Notes as well as senior costs.

The liquidity facility will have a maximum limit of 40% of the Notes in issue (initially ZAR200 million) which represents approximately 54 months of interest for all classes of notes.

In case the Liquidity Facility Provider's rating falls below **P-1.za.**, the Liquidity Facility Provider will be required to be replaced by a liquidity facility provider with at least the required rating. Failing such replacement, the liquidity facility will be drawn in full and deposited in the Issuer bank account.

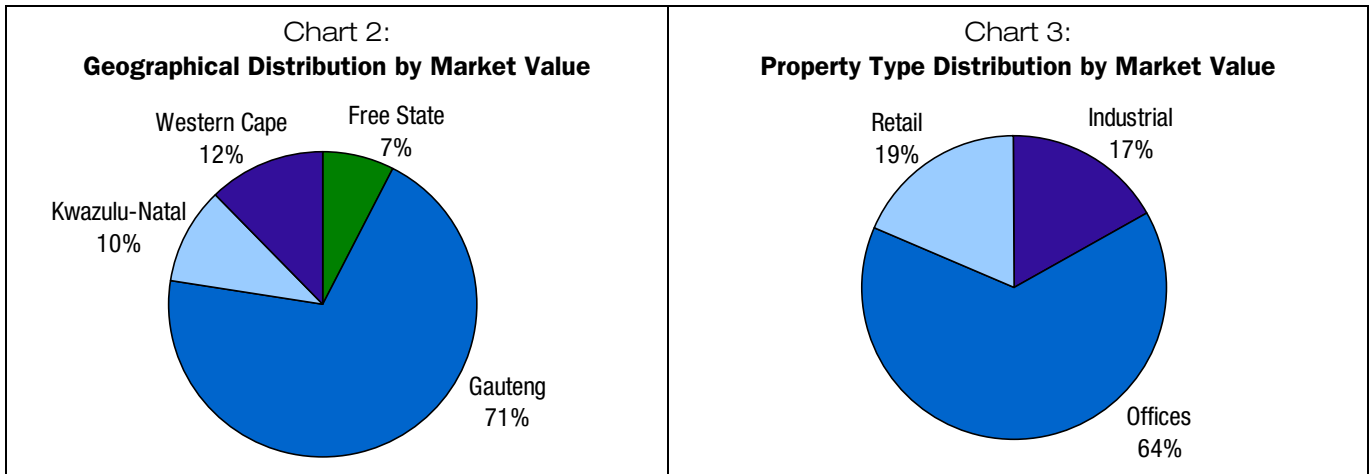
Moody's analysis assumes that the Liquidity Facility will be in accordance with Moody's Special report (see *related Research*).

## **COLLATERAL**

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The Notes are backed by the loan (ZAR 500 million loan amount) secured by a portfolio consisting of 42 properties with 291,643 square metres lettable area. All properties are located within South Africa.

The largest property represents 7.8% of the total pool by U/W market value and the five largest properties contribute 32.8% of the total collateral value (*please see Table 2 for further information*).



Moody's carried out site visits in respect of 21 properties representing 55.0% of the portfolio's initial UW OMV.

- **Form of Collateral:** The collateral consists of first mortgage bonds on the 40 freehold properties and 2 leasehold properties.
- **Quality Grade:** The weighted average quality grade, by OMV, is 2.7 on a scale of 1 to 5 (best to worst). Moody's quality grades reflect our assessment of the property relative to the national market taking into account construction quality, location, competition, etc.
- **Tenants:** As at the end of April 2006, the weighted average lease term, by net rent, was 2.6 years and the weighted average escalation rate, by net rent, was 7.1%.
- **Interest Coverage Ratio (ICR):** The Day-1 UW ICR is 2.44x: based on underwriters' cash flows.
- **LTV:** The LTV is 55.4% based on the latest available valuations prepared by RMB Properties (Proprietary) Limited in December 2005. Based on the latest available valuations prepared by third party independent valuers (June 2005) the LTV is 60.6%.
- **Property Valuation:** At least one third of the property portfolio will be re-valued each Financial Year by an independent property valuer and the remainder of the properties will be valued internally by the Borrower.

Table 1:

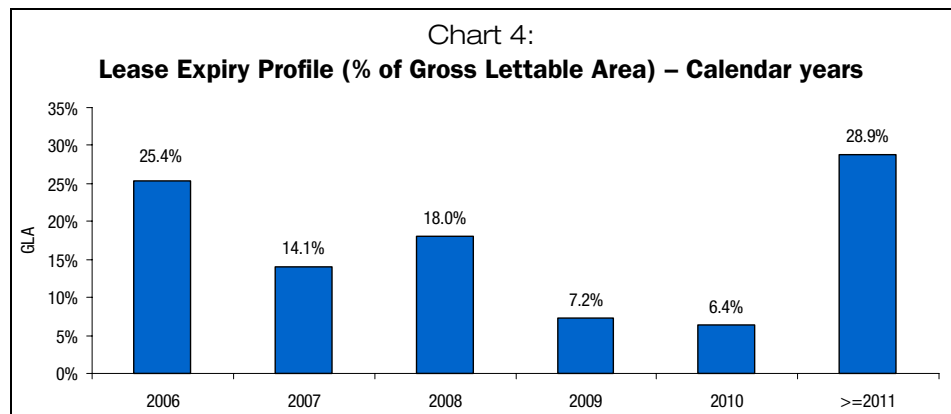
**Top 10 tenants**

	<b>Top 10 tenants</b>	<b>Gross Income</b>	<b>% of total</b>
1	SASOL LIMITED t/a SASOL	7,107,861.10	4.9%
2	HERDBUOYS Mc CANN-ERICKSON PTY LTD	5,363,527.50	3.7%
3	FLUOR SA (PTY) LTD	5,400,368.92	3.7%
4	FREE STATE LEGISLATURE	3,599,331.60	2.5%
5	Universal Print Group	3,304,884.00	2.3%
6	Jupiter Drawing Room (Pty Ltd)	3,445,210.56	2.4%
7	UNDP	2,949,266.04	2.0%
8	DEFY APPLIANCES LTD	2,158,212.12	1.5%
9	GRANT THORNTON	2,115,070.92	1.5%
10	BERRY BUSH / BBDO (PTY) LTD	1,810,939.08	1.3%
		<b>37,254,671.84</b>	<b>25.8%</b>

Table 2:

**Top 10 Properties**

	Property Name	City	Region	Property Type	% Total OMV	Area sp. m	OMV (ZAR)
1	Home Centre	Durban	Kwazulu-Natal	Retail	7.8%	17,648	70,541,000
2	Hyde Park Lane	Sandton	Gauteng	Offices	7.7%	15,411	69,530,000
3	The Pinnacle	Cape Town	Western Cape	Offices	7.1%	11,391	64,000,000
4	Fluor	Sandton	Gauteng	Offices	5.3%	7,382	47,500,000
5	Hurlingham Office Park	Hurlingham	Gauteng	Offices	4.9%	15,520	44,500,000
6	Herdbuoy's McCann-Erickson House	Sandton	Gauteng	Offices	4.6%	5,370	42,000,000
7	Albury Park	Dunkeld West	Gauteng	Offices	4.6%	8,144	41,500,000
8	The Colony Centre	Craighall Park	Gauteng	Retail	4.5%	7,273	41,000,000
9	Southern Life Plaza	Bloemfontein	Free State	Offices	4.3%	10,497	38,500,000
10	2 Sturdee Avenue	Johannesburg	Gauteng	Offices	3.6%	5,603	32,500,000
					<b>54.4%</b>	<b>104,239</b>	<b>491,571,000</b>



**Moody's carried out a servicing review of the borrower and met representatives of the asset manager and of the property manager**

**There are three key rating drivers:**

- **Loan shadow rating**
- **Correlation assumptions**
- **Recovery assumptions**

## BORROWER OPERATIONS REVIEW

The Borrower's parent company (Freestone Property Holdings Limited) is listed on the JSE Securities Exchange since 2001. Freestone Property Holdings Limited is managed by Freestone Management Company (Proprietary) Limited, an equal joint venture between Corovest Property Group and RMB Properties (Proprietary) Limited. All the properties provided as collateral for the Series 1 Notes are held directly by the Borrower and are wholly owned.

As part of its management and servicing review Moody's met representatives of the two joint venture partners.

## MOODY'S ANALYSIS

Moody's assesses the default probability of the loan; both during the term of the loan on an annual basis (term shadow rating) and at the maturity date (refinance shadow rating). Moody's applied its MoRE Analysis model, more specifically MoRE Assets to analyse the reference portfolio and to determine the default probability and the loss severity for the reference loan. For a traditional CMBS reference loan, MoRE Assets derives the annual term and the refinancing default probabilities taking into account the terms of the loans, the cash flows available from the tenants, quality and diversity of the tenants, property quality grades, Moody's Initial Model Values and the LTV of the loan. Since the loan is an interest only loan, the LTV at the maturity date determines the default probability at that point in time. There are three key rating drivers:

- loan shadow rating;
- correlation assumptions; and
- recovery assumptions.

Moody's then used a Monte Carlo simulation to derive a loss distribution of the reference loans (MoRE Portfolio), where a loss distribution is defined as a function that applies to each portfolio loss level a probability of such a loss level occurring. There are two key variables that drive the simulation: the term and refinancing default probability of the loans, and the loan's severity upon default. The latter is derived by simulating the value

of the properties that secure the defaulted loan in order to determine the recovery value, hereby taking into account accrued interest over the foreclosure time and costs related to foreclosure. Given the nature of the simulation, the recovery rate for each property is assumed to vary over time, reflecting the uncertainties related to property values when a default occurs and also the location and quality of the properties. Within the pool, the value of properties in the same region and/or of the same property type are assumed to be correlated. Having obtained the loss distribution under consideration, a cash flow model is used to assess the impact of structural features of the transaction (MoRE Cashflow). Finally, the sum of the loss experience per note class weighted by the probability of such loss scenario will then determine the expected loss on each loan and hence the rating, consistent with Moody's target losses for each rating category.

The provisional ratings for each Classes of Notes are based on an analysis of:

- the characteristics of the current pool backing the Notes and the substitution conditions;
- the external valuations of the properties;
- the roles and creditworthiness of the transaction counterparties; and
- the legal and structural integrity of the Issue.

***The transaction contains some Borrower flexibility***

The asset pool securing the debt may change during the transaction and therefore certain characteristics of the pool at Closing may not be applicable as the transaction evolves. To rate this deal Moody's took into account both the collateral pool at Closing and also the covenants included in the transaction documents.

***Our analysis took into account that the pool could change due to the flexibility provided to the Borrower***

When analysing the asset pool Moody's considered and gave credit only to elements of the pool that cannot change due to the flexibility provided to the Borrower. For example, although certain tenants are rated, no additional benefit was provided since there is no requirement to retain a certain tenant rating in the pool. Benefit was provided for the diversity of the pool in terms of number of assets and different asset sectors; however, it was also taken into account that the diversity could be reduced due to disposals and substitutions.

***The transaction was further analysed based on the LTV and ICR triggers for the cash trap***

The transaction incorporates certain covenants to protect investors from a shift in the portfolio composition. Although Moody's acknowledges the benefit of imposing the covenant limits, reliance was placed on the experience of the Borrower's managers and the strategy presented to Moody's. If the strategy were to change significantly and these changes were not captured by the covenants, the rating of the Notes may be affected. The transaction was further analysed based on the LTV and ICR triggers for the cash trap.

Moody's acknowledges that the Borrower's managers are experienced property fund managers with a proven track record. The experience of the Sponsor's managers was a significant factor for accepting a dynamic asset pool composition within the structure.

## RATING SENSITIVITIES AND MONITORING

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***The Notes may be sensitive to a material change in the investment strategy or a change in the management***

Moody's will monitor the transaction on an ongoing basis to ensure that the transaction continues to perform in the manner expected, including checking all supporting ratings and reviewing periodic servicing reports. Any subsequent changes in the rating will be publicly announced and disseminated through Moody's Client Service Desk.

Moody's notes that the rating of the Notes may be sensitive to a material change in the investment strategy or to a change in the management of the Borrower. As mentioned previously, the Notes are partially protected from changes in investment strategy based on the covenant restrictions included in the transaction documents. However, if the investment strategy were to change, the leverage were to increase and/or the service quality of the asset manager and the property managers were to deteriorate the rating on the Notes may be affected.

## RELATED RESEARCH

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For a more detailed explanation of Moody's approach to this type of transaction as well as similar transactions please refer to the following reports:

- Update on Moody's Real Estate Analysis for CMBS Transactions in EMEA, June 2005
- Moody's Real Estate Analysis for CMBS in EMEA: Portfolio Analysis (MoRE Portfolio), April 2006
- Non-Sequential Payment Structures in European CMBS Transactions, February 2006
- Moody's European Country Tiering for CMBS Recovery Rate Assumptions: Focus on Key Jurisdictions, January 2005
- Liquidity Facilities in European Term Securitisations, August 2002
- Swaps in European Term Securitisations, May 2002
- 2005 Review and 2006 Outlook EMEA CMBS: Record Issuance in 2005 and Continued Growth Expected for 2006, January 2006

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