

## 2006 European SF Outlook Chart

Market Sector	Asset Class	2006 Outlook		2006 Areas to Watch
		Asset Performance	Ratings	
<b>European Consumer ABS</b>				
	Germany	Stable/ Improving	Stable/ Positive	Asset sector performance is expected to deteriorate in some jurisdictions such as Portugal but remain stable to positive in others. Growth in auto issuance is expected. In the UK, the trend towards unsecured from secured auto lending to counteract Voluntary Termination risk may lead to increased default levels.
	Italy	Stable/ Declining	Stable	
	Portugal	Stable/ Declining	Positive	
	UK Credit Cards	Declining	Stable	Further growth of consumer indebtedness which may negatively impact performance particularly if combined with interest rate increases. Growth in personal bankruptcies and subsequent effect on charge-off levels. The impact of any reduction of interchange and penalty fees on yield.
<b>European C&amp;I</b>				
	Corporate and Infrastructure	Stable	Stable	Some trade receivables transactions have high industry concentrations (e.g. Galp Energia (Energy) and CAP-TDA (construction) but these are not currently areas of concern for Fitch. Individual transactions which are linked to the ratings of sovereigns or sub-sovereigns may show greater volatility. European EETC rated by Fitch for Air France and Iberia are subject to the same asset-value stresses as their US counterparts resulting from new supply/oversupply issues. However, although there is the same risk relating to terrorism and bird flu in terms of potential passenger downturn as well as high fuel prices, these 'flag carriers' are perceived as less vulnerable than the US independent.
	Aircraft Finance	Declining	Negative	
<b>C&amp;I - Whole Business</b>				
	Pub sector	Stable/ Declining	Stable	The Pub sector faces a number of challenges going forward: any slow down in consumer spending is likely to have an impact on the profitability of the industry; the result of eventual implementation of extended licensing hours remains uncertain with increases in revenue likely to be offset to some extent from increased staff costs; and the sector also has to begin to come to terms with smoking bans which are due to come into force in Scotland in 2006 and England and Wales in 2007, reduced revenue and increased required capex may be seen as a result. With one exception (Craegmoor, currently on RWN), the care home sector is fairly robust and demographics are in favour of improvement in performance and ratings unless major new supply of beds appears. Some non-pub WBS transactions carry specific performance related issues (e.g. Wightlink, Roadchef, Tussauds) but generally stable outlook for asset performance and ratings.
	Care Homes	Improving	Positive	
	All other	Declining/ Stable (transaction-specific)	Stable/ Negative (transaction-specific)	
<b>European RMBS</b>				
	Prime	Stable	Positive	Germany still the area to watch, particularly transactions with high percentage of loans secured on investment properties or located in the East. Second liens are also experiencing near 100% loss represented by an extension in foreclosure timing and declining house prices in some regions. Arrears levels now seemed to have stabilised following interest rate rises in the previous year, but house prices should still be viewed with caution, as although prices appear stable, stagnation in the market may continue.
	Sub-prime	Stable	Positive	
<b>European CMBS</b>				
	Standard	Stable	Stable	Credit linked tranches on single borrower transactions have seen more downgrades in recent years and again are likely to do so in 2006. Fewer transactions remain and as seasoning continues upgrades are likely in all areas.
	Non-performing Loans	Stable	Positive	

Source: Fitch

## ■ European Consumer ABS

**Ratings Outlook: Germany: Stable/Positive; Italy: Stable; Portugal: Positive**

**Asset Performance Outlook: Germany: Stable/Improving; Italy: Stable/Declining; Portugal: Stable/Declining**

Whilst the outlook for the consumer sector overall is declining, Fitch expects stable to improving performance of European Consumer ABS transactions in 2006, subject to the comments below and with the exception of the UK credit card transactions which are discussed in more detail below as well.

In the first three quarters of 2005, the European consumer ABS sector demonstrated positive performance, with upgrades of 16 tranches across 10 transactions. The upgrades were mainly due to a combination of better than expected performance and increased credit enhancement. An exception was Driver One GmbH, a German auto loan deal, where the upgrade was attributed to revised static net loss data provided to Fitch by the originator, Volkswagen Bank GmbH. Performance of German consumer loans is expected to be stable to slightly positive in 2006 against a background of continued low unemployment and a reduced propensity for consumers to borrow due to uncertainties over economic and political developments and Fitch expects this to be reflected in the German Consumer ABS performance in 2006.

The majority of upgrades was seen in the Portuguese Consumer ABS transactions resulting from the highly seasoned nature of some of the transactions and increased levels of credit enhancement. Fitch also considered the performance of these transactions in terms of delinquency, default-and-loss and excess spread

ratios. All transactions where tranches were upgraded reported high levels of excess spread with defaults and losses in line with or better than Fitch's base case expectations.

The Portuguese consumer market has performed well after recovering from the stressed economic scenario seen in 2002/3. Whilst performance of existing transactions in 2006 is expected to be positive due to seasoning factors, the consumer market as a whole may be impacted if interest rates are increased as is widely expected and inflation climbs. Proposed new Government measures may also affect performance.

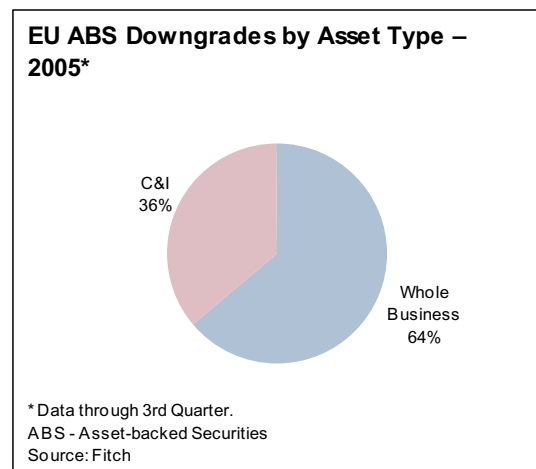
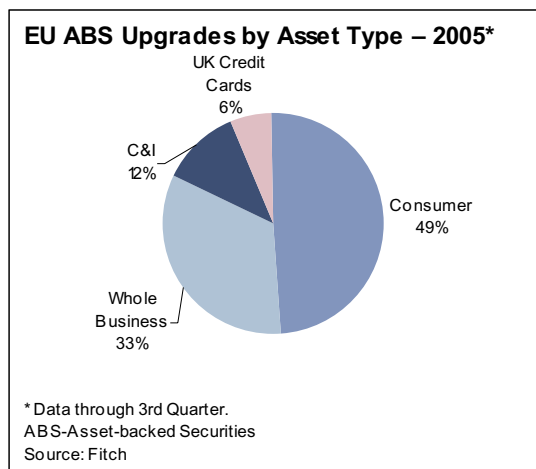
The Italian Consumer ABS market, including Italian leasing transactions, has seen no upgrades since the start of the year and indeed a number of transactions are still in their revolving phase. The majority of these transactions to date have been performing in line or better than Fitch's original expectations. However, the agency expects a minor deterioration in the performance of the Italian consumer market in 2006. Rapid growth of the sector in is likely to lead to a lowering of underwriting standards and a subsequent downturn in performance. In addition, general economic conditions have worsened in 2005 and it is expected that this will have a negative impact on performance in the coming year. The agency expects that this will result in a slight deterioration of the performance of the Italian Consumer ABS transactions.

## UK Credit Card ABS

**Ratings Outlook: Stable**

**Asset Performance Outlook: Declining**

Fitch's outlook for 2006 is stable. Fitch does not anticipate the expected deterioration in performance will be severe enough to lead to ratings downgrades.



In the first three quarters of 2005, one transaction was upgraded and no transactions were downgraded among the UK credit card ABS. However, although the overall outlook in Q4 and 2006 for consumer ABS transactions is stable to slightly positive, that for UK credit card transactions is less positive. Consumers appear to be finding it harder to meet their debt obligations and performance of the credit card trusts has deteriorated in 2005 reflecting Fitch's outlook of stable to negative performance given at the beginning of the year. A notable rise in delinquency and charge-offs has been observed in several of the trusts and some have breached Fitch's base case assumptions. Fitch is closely monitoring each trust to see how these trends develop. A return to previous performance levels is not expected in the near future but no credit card transactions have been downgraded as, despite the downturn, performance has remained within acceptable levels. Overall Fitch expects to see some further deterioration of performance across the sector in 2006 before the performance stabilizes. However, Fitch does not expect the deterioration to be material enough to impact the current ratings of the outstanding transactions.

**European Corporate and Infrastructure Securitizations (Excluding Aircraft and Whole Business)**

**Ratings Outlook: Stable**

**Asset Performance Outlook: Stable**

Looking at the C&I sector but excluding European Whole Business, one C&I ABS transaction was upgraded during the first three quarters of 2005. The upgrade of 4 tranches of DZ Bank AG Gelt 2002-1 reflected better-than-expected performance and substantially improved levels of credit enhancement.

During the same period, 3 single-tranche C&I ABS transactions, Conca d' Oro Funding S.r.l.; Crediti Sanitari Regione Sicilia - Societa per la Cartolarizzazione s.r.l.; and Levante s.r.l. were downgraded for counterparty-related reasons. This was a result of Fitch's introduction of a one notch rating differentiation for debt originated under structured transactions and not accounted for as direct debt in the Region of Sicily's balance sheet.

In addition, Fitch placed Sagres STC – Explorer 2004 Series 1 on Rating Watch Negative (RWN) (12/05), and subsequently Fitch downgraded the 3 junior tranches, affirmed the most senior tranches and removed all tranches from Rating Watch (12/10). The rating action reflected poor performance of this securitization of unpaid tax and social security claims originated in Portugal. Although cumulative collections since placement on RWN showed some improvement against those in the initial 12 months,

they still represented only around 56% of the agency's base case at the time of the downgrade.

Apart from the particular circumstances affecting the above transactions, the overall C&I ABS sector remained stable in the year to 30/09. Asset classes such as social housing, term trade receivables and UK rail deals were all characterized by stable ratings. The outlook for both asset performance and the C&I sector as a whole (excluding European Whole Business) remains stable, with the exception of the aircraft ABS sub-sector. None of the Fitch rated C&I deals outside of WBS has any industry concentration that causes concern although 2 trade receivables transactions (Galp Energia (energy), CAP-TDA (Spanish construction)) are heavily concentrated by industry.

Because corporate securitizations are exposed to seller/servicer risk, even if the ratings outlook remains stable, individual situations may dictate rating actions in case of severe deterioration of the financial and operational capacities of a particular originator.

To a certain extent, the same potential concern exists with government securitizations. However, over the short term, the likelihood of a significant downwards rating migration of Western European sovereigns seems much more remote (i.e. event risk is much less than for corporates).

As in the past, there is no obvious trend of new C&I issues – trade receivables deals still tend to be financed largely via ABCP, there seems little prospect of new UK rail infrastructure financing and the social housing market remains well served by the banks operating in that sector although all or any of these may see one-off term deals. However, there is considerable scope for expansion of all these asset classes in new jurisdictions and Fitch continues to see an active market in equipment lease securitizations in several European countries and a growing interest in project refinancings, particularly in the toll road and energy sectors.

**European Aircraft ABS**

**Ratings Outlook: Negative**

**Asset Performance Outlook: Declining**

In the first three quarters of 2005, Fitch took no adverse rating actions on European aircraft ABS.

The European EETC transactions rated by Fitch (for Air France and Iberia) are subject to the same asset value risks as their US counterparts but the lessee risk - essentially that of 'flag-carrier' airlines - is perceived as lower than in the US. Nonetheless, the industry as a whole remains vulnerable to the threat

of terrorism and bird flu and their potential impact on the willingness of passengers to fly.

## **European Whole Business**

### **Ratings Outlook:**

**Pub sector: Stable; Care Home: Positive;**

**All other sectors: Stable/Negative  
(transaction-specific)**

**Asset Performance Outlook: Pub sector:  
Stable/Declining; Care Homes: Improving;  
All other sectors: Declining/Stable  
(transaction-specific)**

With respect to the European Whole Business sector, Fitch upgraded 9 tranches of UK nursing homes sale and leaseback (S&L) transactions following a satisfactory review on both the transactions and the nursing home sector.

There were two Whole Business transactions downgraded during the first three quarters of 2005. Fitch downgraded and placed on RWN the junior tranches of Craegmoor Funding 2, a nursing homes secured loan transaction, reflecting poor performance (mainly a declining EBITDA). Following the unexpected departure of the CEO and Finance Director announced in October, Fitch is concerned that the appointment of a new CEO and FD may reveal some previously undisclosed issues. Fitch plans to meet with the new management and review the transaction after publication of the December 2005 report (which is 60 business days following year end). In addition, Fitch downgraded the unwrapped notes of the Eurotunnel-related debt repackaging vehicle, Fixed-Link Finance BV. This action was prompted by a review of the Eurotunnel performance and current stance in negotiations with debt creditors. Fitch remains concerned that management's attention has been focused on the financing structure rather than operational issues during this period.

Several Whole Business transactions underwent credit-neutral restructurings: Avebury sold 276 pubs from the security group and brought in 67 from outside the group, GHG Finance sold its PIC units as well as its BMI Health Services and UK Hospitals sold 9 of its hospitals. With the disposal of some of their businesses, those transactions also prepaid some of their notes either in part or in whole. One transaction, Priory Finance, was repaid in full.

In terms of outlook for Q405 and 2006 for the European Whole Business sector, Fitch expects to see new issuance, taps and refinancings across all sectors. Fitch continues to monitor the following transactions closely, given their recent restructuring and/or their underperformance relative to our base case assumptions: Avebury, FLF1, Spirit Issuer,

Tussauds, Roadchef and Wightlink. In addition, Fitch is wary of the potential impact of a smoking ban on the UK pub industry, now likely to be implemented a year ahead of the original 2008 schedule.

The pub sector faces a number of challenges going forward: any slow down in consumer spending is likely to have an impact on the profitability of the industry; the result of eventual implementation of extended licensing hours remains uncertain with increases in revenue likely to be offset to some extent by increased staff costs; and the sector also has to begin to come to terms with smoking bans which are due to come into force in Scotland in 2006 and England and Wales in 2007. The ban may result in reduced revenue (although there is a counter-argument that more non-smokers will be attracted to pubs to offset the loss of smoking customers) and increased required capex (e.g. to improve outside space). Any decline in profitability for any of the above reasons may be reflected in the ratings of these transactions.

Within the care home sector, the second largest sector of whole business transactions, performance is expected to be fairly robust as a result of improved performance of most operators since transaction close and of favourable – and improving – demographics within the UK. One exception is Craegmoor (currently on RWN), which has underperformed since close and has recently undergone a change of senior management which may lead to further one-off charges. Unless major new supply of beds appears this sector is generally expected to remain stable to improving both in terms of asset performance and ratings.

Some non-pub WBS transactions carry specific performance related issues (e.g. Wightlink, Roadchef, Tussauds) but the outlook is generally stable for both asset performance and ratings.

## ■ **European RMBS**

### **European Prime RMBS**

**Ratings Outlook: Positive**

**Asset Performance Outlook: Stable**

The 9M05 performances in the European prime RMBS market were predominantly good, with the number of transactions rated continuing to dominate issuance volume for Europe with asset performance good and ratings performance extremely positive. Negative rating action occurred on only one transaction, and the number of transactions upgraded outnumbered this by more than 10:1.

The downgrade was not particularly unexpected and involved the Provide Gems 2002-1 transaction, which was also downgraded in 2004. Secured on a large percentage of investment assets, mainly in eastern Germany, credit events continue to accrue and losses burn through the first-loss tranche at an ever increasing rate.

Generally, Germany remains the area of concern within European RMBS, particularly those deals heavily concentrated in eastern regions or with high numbers of investment properties.

On the positive side, upgrades were again prevalent across Europe with the Netherlands dominating for the second year running. Based on good performing underlying assets, the two key factors driving upgrades were prepayment rates and, in turn, principal pays downs.

With a large number of seasoned transactions rated in the Netherlands, prepayment rates rose in 9M05, repaying the majority of deals sequentially and therefore building up available credit enhancement for the remaining notes. Italy and Spain reported lower prepayment rates and therefore this seasoning effect will take slightly longer to materialise; hence, the number of upgrades has risen in 9M05 from the numbers seen in 2004 but not to the same level as the Netherlands. The UK prime RMBS market is dominated by large master trust issuers, and with further notes issued or loans added to the trust each year, upgrades are less likely.

### European Subprime RMBS

#### Ratings Outlook: Positive

#### Asset Performance Outlook: Stable

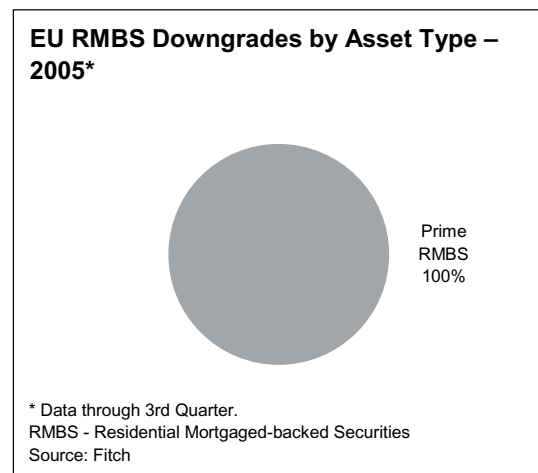
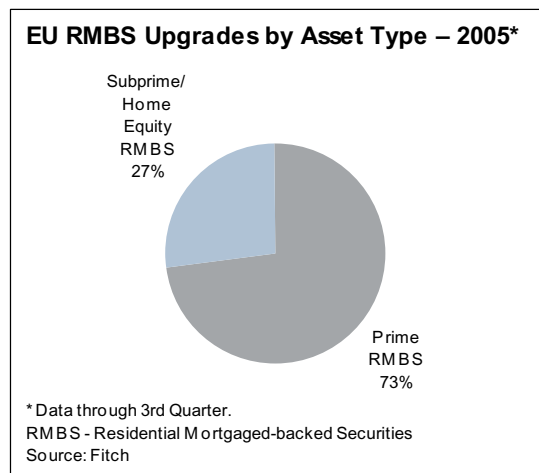
The subprime RMBS sector, which in Europe consists entirely of issues from the UK, saw an element of deterioration in 9M05, with rising arrears levels across the sector. This was due in part to

interest rate rises in 2004 and loans with initial fixed and discounted periods reverting to higher variable rates.

Most notably affected by this were the Kensington and Southern Pacific transactions, both of which saw high levels of borrower default; however each has seen a different impact on loss levels. In the Kensington transactions a number of loans were originated through underperforming counterparties which subsequently suffered significant losses, leading to drawings being required on the reserve fund to pay interest. Conversely, in the Southern Pacific deals, despite a number of foreclosures, losses have remained low. Both originators utilise a structure including detachable A coupons that effectively strip out all available excess spread, and thus drawings on reserves are more likely. Despite these events, all transactions from these originators were affirmed in July 2005 and there have been no negative rating actions in the sector to date.

Again, in 9M05 there were a number of upgrades seen. As in the prime sector these were mainly driven by high prepayment rates as borrowers improved their credit history and refinanced with prime lenders or, in some cases, refinanced down the credit spectrum to clear arrears with a current lender. Recent years have also seen the introduction of “teaser” rates, which, as they expire, encourage an element of prepayment.

During 9M05 the number of upgrades fell by comparison to 2004 for reasons of structural features. Many transactions now, following an initial period of sequential prepayment, revert to *pro rata* across all note tranches, often concurrently amortising the reserve fund, limiting the potential for upgrading the junior classes.





## ■ European CMBS

### European Standard CMBS

**Ratings Outlook: Stable**

**Asset Performance Outlook: Stable**

Statistics can often be deceiving, and on the surface, based on the number of tranches downgraded in 9M05, the CMBS sector is among the worst performing in Europe. This, however, may be slightly misleading in that only three transactions were downgraded; two of these were credit-linked to one corporate, and a number of other tranches were *pari passu*, whereas the European CDO sector saw downgrades to six transactions but overall less tranches. Additionally, this was more representative of the good performance in the CDO sector in 9M05, as downgrades in CMBS have remained fairly constant since end-2002.

The single-borrower CMBS sector has traditionally seen the most downgrades as many tranches retain an element of credit linkage to the corporate. 9M05 was no exception as a downgrade to British Telecommunications led to further downgrades of a number of tranches. However more significant was the downgrade in the multi-borrower sector based purely on a worsening performance. The transaction affected, Deutsche Hypothekenbank Hannover, is secured on a number of smaller commercial loans in Germany, a large percentage in the east and all second-lien. Similar to the RMBS market in Germany, in most cases the loss severity on the second-lien portion of the loan has been 100%.

Another reason to suggest that CMBS is not performing badly is that there were more upgrades in

9M05 than the previous three years combined. These were all multi-borrower deals and primarily reflected a critical mass of transactions that are now seasoning and amortising. The majority of multi-borrower deals tend to have pools of up to 10 often large loans, therefore even a small number of prepayments would have a significant impact on the ratings of the transaction. This can be positive or negative, depending on which loans prepay; however, to date, with sequential paydown this has mainly proved positive. As more transactions adopt *pro rata* amortisation though, this may become more of an issue.

### European NPL CMBS

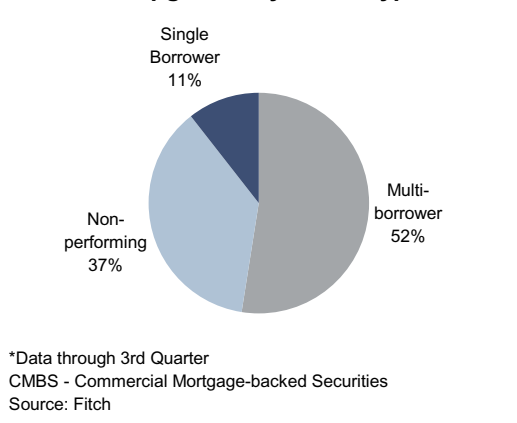
**Ratings Outlook: Positive**

**Asset Performance Outlook: Stable**

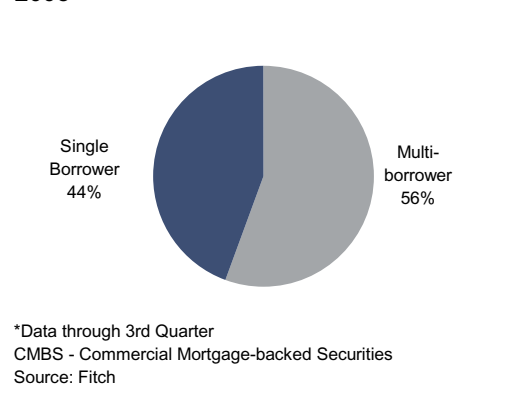
The number of transactions rated in this sector continues to decline as deals prepay without any new issuance to replace them. Although there have been a number of downgrades and performance issues in previous years, 9M05 only saw positive rating actions. This was again based on amortisation and outperformance against the original advance rates issued.

European NPL transactions are currently exclusively issued from Italy, but with the Republic of Italy's Long-term rating remaining on Negative Outlook, a number of transactions retain an element of credit linkage through pledged government bonds, as well as the portfolio of loans backing the notes. However, as the transactions season and show perform well, a downgrade in the sovereign rating will not necessarily trigger a downgrade on all credit-linked tranches.

**EU CMBS Upgrades by Asset Type – 2005\***



**EU CMBS Downgrades by Asset Type – 2005\***



## 2006 Global CDOs Outlook Chart

2006 Outlook				
Market Sector	Asset Class	Asset Performance	Ratings	2006 Areas To Watch
Global CDOs	Global Investment-Grade Corporate CDOs	Declining	Negative	Possible uptick in credit events from several weakening sub-IG names, primarily in the automotive sector that are widely referenced in synthetic CDOs. This will have a negative impact on ratings.
	Global High Yield Bond CDOs	Declining	Positive	Default rates are moving up; challenges in the auto and airline sectors.
	Global Leveraged Loan CLOs	Declining	Positive	Problems in the auto and airlines sectors; second-lien loans.
	Global Market Value CDOs	Stable	Stable	Unique structural features not present in older vintages.
US CDOs	U.S. Structured Finance CDOs	Declining	Stable	U.S. Home Equity Risks.
	U.S. CRE CDOs	Improving	Positive	Emergence of unrated collateral.
	U.S. Trust Preferred CDOs	Stable	Positive	Challenging operating environment for banks (i.e. flat yield curve, increased competition, etc.).
European CDOs	EU Balance Sheet SMEs	Stable	Positive	Country dependent. Clean up call options likely to be exercised in Spanish deals. Look for structural protections in German SME CDOs with higher default rates to maintain ratings stability.
	EU Structured Finance CDOs	Improving	Stable	Early vintage diversified ABS CDOs with legacy exposure to poor performing sectors. Challenges facing managers of 2002-03 vintages in tight spread environment.

Source: Fitch

### ■ Global CDOs

Global CDOs enjoyed healthy issuance through 9M05. Tight spreads continued to be the overarching theme, and dictated the pace of issuance and innovations in cash and synthetic CDOs.

US cash flow CDO issuance approximated to USD115bn, up 88% from USD61bn yoy. US synthetic CDO issuance was USD25.7bn through 9M05, up from USD16bn.

On the cash side, ABS CDOs led the pack in the number of global transactions launched in 9M05, followed by collateralized loan obligations and investment-grade corporate CDOs. Commercial real estate CDOs were also popular in the US, but such transactions have yet to surface in Europe.

In the US, traditional cash investors were introduced to new collateral types such as commercial mortgage B-notes, mezzanine loans and whole loans in commercial real estate CDOs. The market also saw the launch of the first real-estate investment trust ("REIT") preferred securities-backed CDOs.

In Europe, issuance of cash flow CDOs has been dominated by ABS CDOs, followed by some regular CLO issuers. The synthetic market continues to demonstrate the kind of innovation that characterised it in 2004. Opportunistic products with short lifecycles and which exploited market anomalies emerged. Equity debt obligations, long/short CDOs, leveraged super senior structures with spread and/or loss triggers, constant proportion portfolio insurance and forward-starting CDOs also appeared.

Global cash CDOs have also increased the amount of credit default swaps they reference. The most recent global cash CDO transactions have provisions to include up to 30% synthetic securities. Asset managers have increasingly tapped the credit default swap market to add exposure to credits that may not be available in the cash debt markets and to take advantage of spread differences between the two.

Indeed, the synthetic market saw several creative developments with the growth of managed structures and the rise of leveraged super senior trades. In addition, the launch of the International Swaps and Derivatives Association's documentation template for credit default swaps referencing asset-backed securities (CDS on ABS) led to the growing issuance of synthetic CDOs referencing ABS, and is paving the way for further structural innovations, such as hybrid CDOs that blend both cash and synthetic CDO technologies.

There were 1,699 CDO rating actions taken globally in 2005, of which there were 244 tranches upgraded, 107 tranches downgraded and 1,348 tranches affirmed in 9M05, concentrated in the diversified structured finance, investment grade corporate and high-yield loan sectors. Diversified SF CDOs had the most number of downgrades among the asset classes.

### Global Investment-Grade Corporates

#### **Ratings Outlook: Negative**

#### **Asset Performance Outlook: Declining**

Fitch expects global investment-grade corporate CDO performance to be negative in 2006. Negative rating migration of corporate credit is expected in