STANDARD & POOR'S

STRUCTURED FINANCE

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Cash CDO Of Leveraged Loans Presale Report

Harbourmaster Pro-Rata CLO 2 B.V.

€602 Million Fixed- And Floating-Rate Notes

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Class	Prelim. rating*	Prelim. amount (Mil. €)	Available credit support (%)**	Scenario default rate (%)	Interest	Legal final maturity
A1 variable funding notes	AAA	150.00	40.6	50.4	Three-month EURIBOR plus a margin	Oct. 15, 2022
A1	AAA	199.00	40.6	50.4	Three-month EURIBOR plus a margin	Oct. 15, 2022
A2	NR	120.00	20.2	N/A	Three-month EURIBOR plus a margin	Oct. 15, 2022
A3	NR	43.50	12.8	N/A	Three-month EURIBOR plus a margin	Oct. 15, 2022
A4E	NR	6.00	10.6	N/A	Three-month EURIBOR plus a margin	Oct. 15, 2022
A4F	NR	6.75	10.6	N/A	Fixed	Oct. 15, 2022
B1E	NR	2.00	7.8	N/A	Three-month EURIBOR plus a margin	Oct. 15, 2022
B1F	NR	14.50	7.8	N/A	Fixed	Oct. 15, 2022
B2	NR	17.50	4.8	N/A	Three-month EURIBOR plus a margin	Oct. 15, 2022
C	NR	42.75	N/A	N/A	N/A	Oct. 15, 2022

**The ratings on the class A1 variable funding notes and the class A1 floating-rate notes are preliminary as of Aug. 16, 2006 and subject to change at any time. Final credit ratings are expected to be assigned on the closing date subject to a satisfactory review of the transaction documents and legal opinion. Standard & Poor's ratings address timely interest and principal on the notes. **The available credit support of each class is the amount of target portfolio par that can be lost without a loss to the given class. It is calculated as the target portfolio par, minus the balance of the given class and all senior classes, divided by the target portfolio par. NR—Not rated. N/A—Not applicable.*

Transaction Participants	
CDO manager	Harbourmaster Capital Ltd.
Arranger	Banc of America Securities Ltd.
Trustee	Deutsche Trustee Co. Ltd.
Collateral administrator	Deutsche Bank AG, London branch
Liquidity facility provider	Deutsche Bank AG, London branch
Bank account provider	Deutsche Bank AG, London branch
Paying agent	Deutsche Bank AG, London branch

Supporting Ratings	
Institution/role	Ratings
The London branch of Deutsche Bank AG as liquidity facility provider and bank account provider	AA-/Stable/A-1+

Transaction Key Features	
Expected closing date	August 2006
CDO asset type	Loans
Structure type	Cash
Portfolio composition	Portfolio of senior secured and unsecured loans
Purpose of transaction	Arbitrage
Rating approach	Statistical
Portfolio management type	Managed
Level of management	Fully managed
Liability structure	Fully funded
Reinvestment period (years)	7
Ramp-up period (days)	270
End of noncall period (years)	5
Portfolio weighted-average rating	B+
Weighted-average maturity of assets at the end of the reinvestment period (years)*	7
Default measure (DM) (%)	2.14
Variability measure (VM) (%)	1.62
Correlation measure (CM)	1.40
Minimum spread (bps)**	218
Minimum weighted-average recovery rate (%)**	50
Size of trading bucket (annual %)	20

**Corresponds to the maximum weighted-average life of assets allowed at the end of the reinvestment period but it is expected that at the effective date the actual weighted-average life of the fully ramped portfolio will be around 6.5 years. **Indicative levels for initial tranching. It is expected that the final transaction documents will include a matrix.*

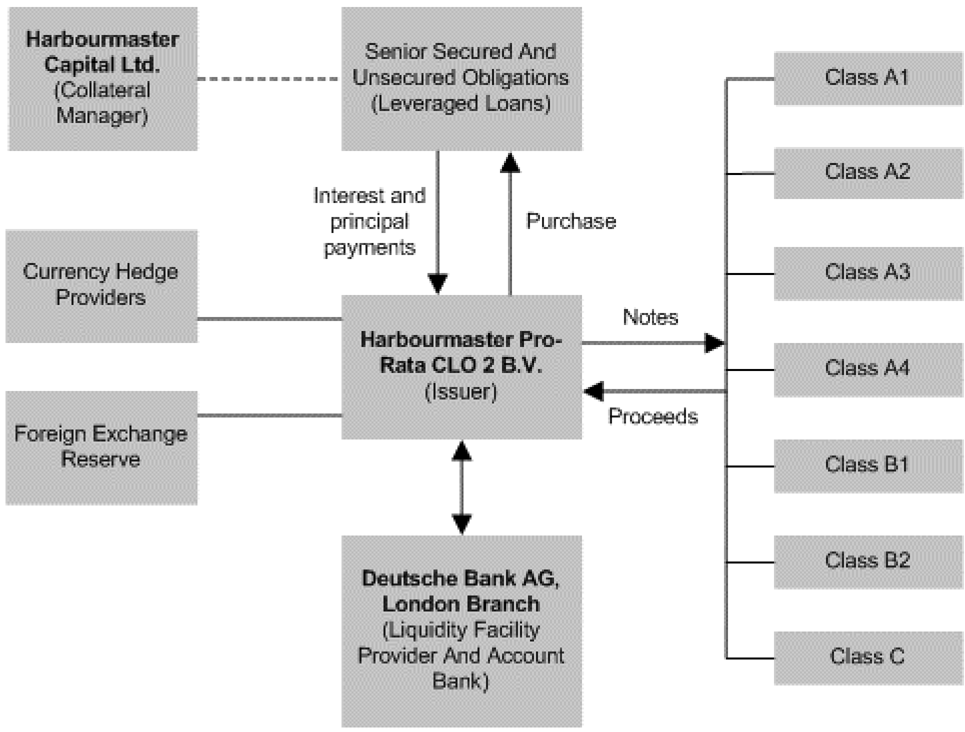
Transaction Summary

Preliminary credit ratings have been assigned to the class A1 variable funding notes (VFNs) and the class A1 floating-rate notes to be issued by Harbourmaster Pro-Rata CLO 2 B.V. At the same time, the issuer will issue €253 million of unrated notes.

The issuer is a Dutch-domiciled SPE that is expected to comply with Standard & Poor's bankruptcy-remoteness criteria. Its activities will be limited to acquiring the portfolio, issuing the notes, and certain other related activities.

At closing, Harbourmaster Pro-Rata CLO 2 will issue the notes and use the proceeds to acquire a portfolio of senior secured and senior unsecured leveraged loans (see chart 1). The portfolio will be managed by Harbourmaster Capital Ltd. (HCL). This will be the ninth transaction under HCL's management. The transaction is expected to be 70% ramped at closing, with the target balance being acquired over a nine-month period.

Chart 1: Harbourmaster Pro-Rata CLO 2 B.V. Structure



Notable Features

This is the second Harbourmaster transaction where the collateral consists of different tranches of senior corporate debt acquired predominantly on a pro rata basis.

Harbourmaster Pro-Rata CLO 2 may include up to €88 million of revolving and delayed drawdown assets denominated in a noneuro currency. These assets are expected to be match-funded with advances in the same currency from the VFNs. Various mechanisms will be used to control foreign exchange (FX) risk.

Strengths, Concerns, And Mitigating Factors

Strengths

- HCL is highly experienced in the senior secured loan market, having originated loans in excess of €8 billion since its inception in 2000.
- Reinvestment criteria should limit the extent to which reinvestments reduce the credit quality of the portfolio.
- Unused proceeds will be used either to acquire further assets or to delever the notes once the target par amount has been reached.
- There is a conservative payment structure, whereby after the reinvestment period, principal cannot be used to repay interest or principal on subordinate classes unless senior classes have been redeemed in full.

Concerns

- Leveraged loans are experiencing high levels of prepayments. If cash balances are not reinvested quickly, transaction cash flows may suffer.
- In calculating the par amount for the mezzanine and junior coverage tests, a haircut will not be applied to assets that have had their ratings lowered to 'CCC'. This implies that the coverage tests could be breached later than they otherwise would be, which would reduce the spread available to redeem the senior notes.
- The assets may pay interest less frequently than the interest paid on the liabilities. This could lead to a liquidity stress on the transaction if assets in the portfolio are skewed so as to pay in one period.
- Up to €88 million of the collateral pool may consist of non-euro-denominated revolving and delayed drawdown loans, match-funded with drawings in the same currency from the VFNs. This "natural hedge" is imperfect and may expose the transaction to FX and funding liability risks.

Mitigating factors

- The manager is highly experienced in the asset class and has shown a consistently good record in sourcing assets in the primary market. Because the manager is committed to buying the various tranches of senior debt issued pro rata, it can obtain higher allocations. Furthermore, the manager has covenanted to hold cash for a limited period only, and if any cash is not reinvested in new assets during that period, it will be used to redeem the notes instead.
- The 'CCC' haircut has been included for the senior coverage test. This structural feature will help provide further protection for the senior notes.
- An interest smoothing account was set up to mitigate any interest rate period mismatch and a €15 million liquidity line contracted with a suitable rated counterparty will be available from closing.
- The collateral administrator and manager are required to follow certain procedures to ensure the issuer can always fund its commitments under any revolving and delayed drawdown loans it holds. The same procedures are also intended to control the impact of FX movement on the transaction's leverage. These procedures, together with FX stresses, have been reflected in the cash flow model.

Collateral Pool Characteristics

The portfolio is expected to comply with a set of characteristics as shown in table 1.

Table 1: Portfolio Profile Tests

Maximum senior unsecured (Mil. €)	30
Maximum exposure to bivariate risk (%)	20
Minimum rating of selling institution for subparticipated loan	A
Maximum non-euro-denominated revolving and delayed drawdown loans (Mil. €)	88

The characteristics of the current portfolio are shown in charts 2 and 3**.**

Chart 2: Target Portfolio Breakdown By Industry

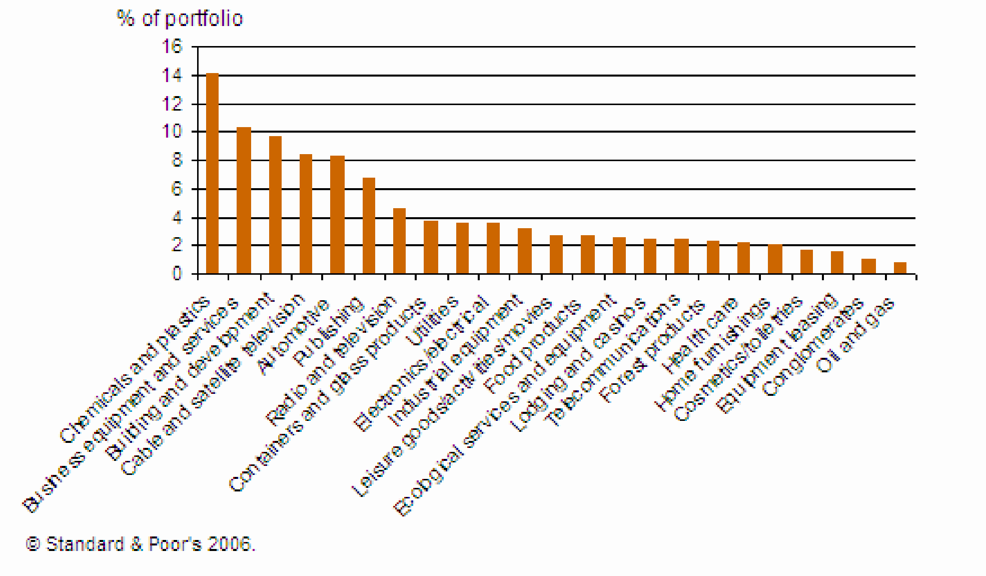
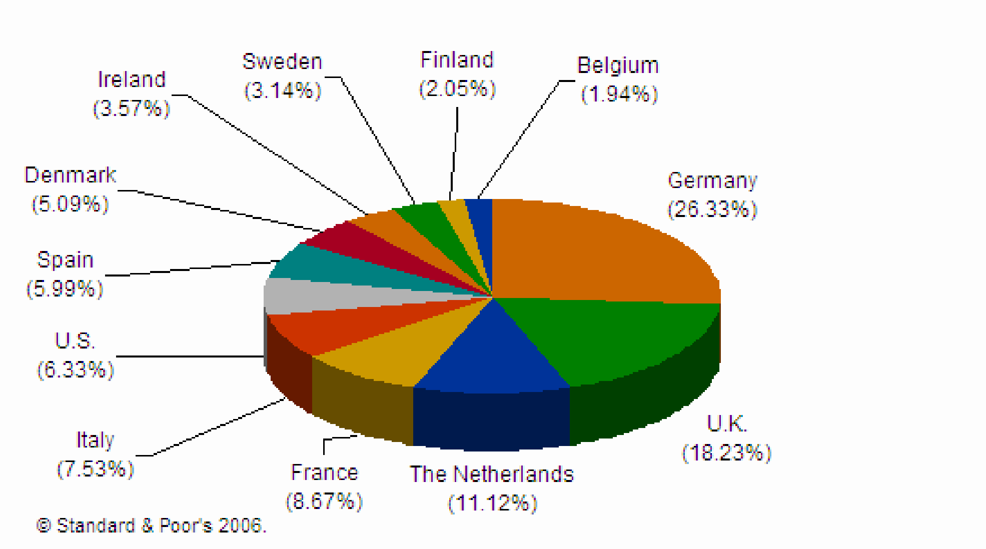


Chart 3: Target Portfolio Breakdown By Country



Overcollateralization And Interest Coverage

Table 2 shows the coverage tests applicable to this transaction.

Table 2: Par And Interest Coverage Tests		
Class	Overcollateralization required at effective date (%)	Interest coverage required at effective date (%)
A1 VFNs	180.00	N/A
A1/A2*	114.75	N/A
A3	107.35	N/A
A4	106.55	110.00
B1	105.13	N/A
B2	103.61	N/A
Additional coverage test	103.81	N/A

**Only this test includes a par value haircut for assets rated 'CCC' and below.*
N/A-Not applicable.

Hedging

Currency and funding risks

The manager is permitted to invest in non-euro-denominated term loans up to a total of €88 million. To hedge the currency risk associated with non-euro-denominated term loans, the issuer is required to enter into asset-specific currency swaps.

The manager can also invest up to €88 million in non-euro-denominated revolving and delayed drawdown loans. These investments will be matched with advances in the same currency from the VFNs. Every purchase of a revolving or delayed drawdown loan (including those denominated in euros) will be subject to the following conditions:

- The sum of the undrawn amount of the VFNs and the excess balance in the FX reserve account must be greater than the total undrawn commitments under the revolving and delayed drawdown loans in the portfolio.
- The sum of the VFN commitment and the excess FX reserve balance must be more than the total commitment under the revolving and delayed drawdown loans in the portfolio.
- The amount of non-euro-denominated revolving and delayed drawdown loans, which are not hedged with asset-specific currency swaps, must not be more than €88 million.

When calculating the amounts above, non-euro-denominated amounts will be converted into euros at the then-current spot FX rate.

The above conditions will also be tested on any date on which an advance is required or is repaid on a revolving or delayed drawdown loan, on any determination date, and at least monthly. Noncompliance will trigger certain required actions, including the use of any principal proceeds and excess FX reserve amounts to fund requests for advances or reduce VFN advances, and a requirement to sell assets.

It is possible that a currency in which advances have been made by the VFNs could appreciate substantially in one month, and the VFN drawn amount would then equal or exceed the maximum VFN commitment. If this happens and the issuer gets a request for an advance under a revolving or delayed drawdown loan it holds, it can fund the request by using any available principal proceeds and excess amounts in the FX reserve account. Failing this, the noteholders of the VFNs will be required to extend the necessary funds, even though this advance would increase the VFN commitment above the maximum permitted. This ensures that the issuer is always able to honor its funding obligations.

If the VFN drawn amounts exceed the maximum VFN commitment, the issuer is required, among other things, to sell assets within 30 days to repay the excess amount drawn. In addition, the issuer must ensure that the drawn and commitment amounts of the VFNs are not lower than the drawn and commitment amounts under the revolving and delayed drawdown loans, respectively.

If a non-euro-denominated revolving or delayed drawdown loan defaults, an amount of the VFN noneuro drawn amount equal to the expected loss will be redenominated into euros at the then-current spot FX rate. The redenomination will mean there is no further FX exposure on the expected loss from the time of default to the time recoveries are realized on the defaulted non-euro-denominated asset.

Currency options will be purchased with funds in the FX reserve account to lock into an FX rate close to the then-spot rate for any additional amount that may need to be redenominated if the actual loss is subsequently greater than the expected loss redenominated at the time of default. The required FX reserve amount has been sized on the amount of the non-euro-denominated revolving and delayed drawdown loans expected to default in a 'AAA' stress scenario and is based on historical analysis of option prices.

In the period between default and recovery, there will be a mismatch between non-euro-denominated VFN liabilities and non-euro-denominated revolving and delayed drawdown loans of an amount equal to the expected recovery on the defaulted asset. This mismatch exposes the transaction to euro depreciation, since yield earned on euro-denominated assets will be used to cover the cost of the excess noneuro liability not covered by assets denominated in the same currency.

To test the effectiveness of the FX management procedures and any residual FX risk, the transaction cash flows were subjected to FX stresses. A market value haircut was also applied on any sale of assets triggered by the FX management procedures. These stresses are reflected in the 'AAA' breakeven default rate of the transaction.

Liquidity Facility Agreement

The London branch of Deutsche Bank AG will provide the issuer with a 364-day revolving liquidity facility. This facility will enable the issuer on a payment date to draw an amount equal to the aggregate of all accrued and unpaid interest owing to the issuer from the assets that have not yet been received. The liquidity facility is for an amount up to €15 million.

The issuer will repay all interest and principal of any advances drawn under the liquidity facility on the next payment date after the drawdown date and in accordance with the priority of payments.

Cash Flow Assumptions/Payment Of Interest, Principal, And Contingent Payments

Standard & Poor's CDO Evaluator system is an integral part of the methodology for the rating and surveillance of CDO transactions. Through the Monte Carlo methodology, CDO Evaluator evaluates the credit quality of a portfolio, taking into consideration the credit rating, size, and maturity of each asset and the correlation between each pair of assets. The credit quality of the portfolio is presented in terms of a probability distribution for potential default rates. From this distribution, CDO Evaluator derives a set of scenario default rates that identify, for each credit rating, the maximum level of portfolio defaults a CDO tranche should be able to withstand without defaulting.

Cash flow analysis

The cash flow analysis evaluated by Standard & Poor's used:

- Specific interest rate stress scenarios;
- A variety of default patterns; and
- FX stress scenarios.

Under the cash flow analysis, the structure is expected to enable the issuer to pay timely interest and principal on the classes of A1 notes.

Transaction Management

Harbourmaster Capital Ltd. (HCL) (collateral manager)

HCL, the collateral manager, is a limited liability company incorporated in Jersey. HCL will be advised by Harbourmaster Capital Management Ltd. (HCM), a limited liability company incorporated in Ireland and established in November 2001. HCM was previously the collateral manager of Euro Capital Structures Ltd., which was established in July 1999. HCM currently employs 17 professional staff who focus on investment advisory services.

The collateral manager focuses on low volatility assets and currently has €4.7 billion invested in senior secured loans.

Sales and reinvestment of collateral

The collateral manager is permitted to sell any security if:

- It is a defaulted obligation;
- It is considered to be appreciated collateral; or
- It is considered to be credit-impaired.

The collateral manager is also permitted to sell any securities at any time as long as such sales do not exceed 20% of the portfolio balance in any calendar year. In addition to the sale of defaulted, credit-impaired, and appreciated collateral and the 20% discretionary sales, the collateral manager is permitted to sell securities at any time to comply with the FX management conditions (see "*Hedging*").

All sale proceeds may be reinvested during the seven-year reinvestment period, subject to compliance with a set of criteria. After the reinvestment period, all sale proceeds (with one exception) will be used to redeem the notes sequentially and in accordance with the priority of payments.

The exception is that unscheduled principal proceeds may be reinvested for two years after the reinvestment period, provided the portfolio profile and coverage tests remain in compliance, the new asset has a maturity no longer than the asset it replaces, and the scenario default rate of the proposed portfolio is no greater than that of the current portfolio.

The reinvestment criteria require the manager to reinvest assets as long as these assets comply with the eligibility criteria. The portfolio profile tests include Standard & Poor's CDO Monitor test during the reinvestment period, followed by the CDO Evalutor test after the reinvestment period. The coverage tests must also be maintained or improved following any reinvestment. However, the coverage tests must be satisfied if any scheduled principal proceeds or sale proceeds from defaulted obligations are reinvested, and if any principal proceeds are reinvested after the reinvestment period. This ensures that reinvestments follow the assumptions made when the transaction cash flows were initially modeled.

Redemption Of The Notes

The notes will be redeemed on their maturity date, but the notes may be redeemed early—if the subordinated noteholders so choose—after the end of the noncall period, or earlier if certain tax events have occurred. This optional redemption may occur only if the proceeds from liquidating the collateral are sufficient to redeem the rated notes at par.

The notes may also be redeemed early through interest and principal proceeds if the coverage tests are breached and through unused proceeds if the portfolio tests are not met on the effective date. The manager can hold cash balances for a limited time only and will be required to use any proceeds that have not been reinvested over a predefined period to pay down the notes. Finally, the notes will be redeemed from any scheduled and sale proceeds received after the end of the reinvestment period.

The notes may be accelerated at the discretion of the trustee or, if so required, by a majority vote by the controlling class following an event of default. Events of default include, but are not limited to, failure to pay interest on the most senior class outstanding or failure to pay principal on any class of notes.

Key Performance Indicators

Key performance indicators in this transaction include the annualized weighted-average portfolio default rate (the default measure), the standard deviation of the portfolio default rate, and the correlation measure. The default measure encompasses all assets in the portfolio, including defaulted securities and cash, and it reflects the actual maturity of the assets.

The standard deviation of the portfolio default rate shows to what extent the portfolio default rate varies from its expected value. It incorporates the effects of relative concentration of the assets and the correlation between assets. It also reflects the effective diversity of the portfolio, which is directly applicable to estimating the probability of different default rates.

The correlation measure shows the contribution of correlation to the standard deviation of portfolio default rates.

Standard & Poor's models the transaction on the basis of the minimum covenanted spread and recovery rates. The minimum weighted-average spread and minimum weighted-average recovery rate are also therefore closely monitored.

The performance indicators are shown in table 3.

Table 3: Performance Indicators	
Default measure (DM) (%)	2.14
Variability measure (VM) (%)	1.62
Correlation measure (CM)	1.40
Minimum weighted-average spread (bps)*	218
Minimum weighted-average recovery rate (%)*	50.0
**Indicative levels for initial tranching. It is expected that the final transaction documents will include a matrix.*	

Criteria Referenced

- "*Global Interest Rate and Currency Swaps: Calculating the Collateral Required Amount*" (published on Feb. 26, 2004).
- "*Standard & Poor's Global Interest Rate and Swap Counterparty Rating Criteria Expanded*" (published on Dec. 17, 2003).
- "*Global Cash Flow and Synthetic Criteria*" (published on March 21, 2002).
- "*Global CBO/CLO Criteria*" (published on June 1, 1999).
- "*Criteria Regarding Legal Opinions in the Context of CDOs*" (published on May 12, 2003).
- "*European Legal Criteria for Structured Finance Transactions*" (published on March 23, 2005).

Related Articles

- "*Global ROC Report*" (published monthly).
- "*European CDOs of Leveraged Loans Review*" (published quarterly).
- "*Rating Transitions 2005: Activity More Muted But Upgrades Still Dominate In European Structured Finance*" (published on Jan. 11, 2006).

All criteria and related articles are available on RatingsDirect, the real-time Web-based source for Standard & Poor's credit ratings, research, and risk analysis, at www.ratingsdirect.com. The criteria can also be found on Standard & Poor's Web site at www.standardandpoors.com.