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A CMBS borrower/lender retrospective: The old, the new and the now

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A natural evolution has occurred in the CMBS world from the genesis of the industry in the early 1990s through present day and no doubt the industry will morph over the next decade. Like most human relationships, CMBS has experienced three distinct stages. CMBS had its "Romantic" phase (1993 -2007), albeit with a few relatively brief "breakups", its "Individuality" phase (mid-2007 to present) and according to most CMBS lenders, a "Co-Creator" phase is developing.

Discovery and romance are hallmarks of the first phase of any new relationship; the parties are steeped in excitement and holding onto the hope "that this person or thing will fulfill my every need." CMBS borrowers were no different. While CMBS issuances sputtered along in the early 1990s, by 1995 the industry had gained momentum and securitized $10 billion. As more borrowers flocked to CMBS loans, the volume jumped to $50 billion in 2000 and peaked at over $200 billion by mid-2007. (These statistics represent domestic issuances.) During this period, commercial real estate borrowers were largely disillusioned; believing that the CMBS credit train could not be derailed. CMBS loans were the answer to sparsely capitalized projects and provided borrowers: 1) maximum loan dollars 2) low coupons 3) little if any amortization and 4) no personal guarantees. CMBS defaults were less than 1% for many of these boom years.

While the CMBS borrower and CMBS lender enjoyed a long courtship, this phase came to a tumultuous end. In mid-2007, a jolt shuddered throughout the CMBS market that changed the way capital was to be deployed. En masse, CMBS lenders withdrew from commercial financing and the CMBS credit spigot was completely shut off.

The Rise of the Special Servicer:

During the second stage of the relationship and CMBS movement (mid-2007 to present) termed the "Individuality" period the parties recognized that their individual needs and differences may lead to divergent goals. CMBS borrowers who have negotiated with their special servicer can attest to this push-pull dynamic. At the end of September 2010, the percent of CMBS loans in default had passed 9% and had more than doubled the rate of just one year ago. Today, special servicers are overwhelmed with defaulted loans and are looking for the resolution that nets the highest NPV to the Trust. (NEREJ - How to Deal with CMBS loans...Nov. 2009). Borrowers must strategize and determine whether their best response is "fight or flight." "Fighting" comes in the form of loan extensions and modifications, discounted settlements, and A/B note structures. "Flight," while generally implying loss of the property (deed-in-lieu or foreclosure), may produce significant, unwanted tax consequences. Either way, consistent communication with the special servicer for a 12 to 18 month period is expected. Even though, like in true relationship fashion, this communication may seem (at times) like a one-way street. Eventually a sustainable and mature agreement can be reached.

The future stage of CMBS, which is where the CMBS borrower and CMBS lender can co-exist, is the "Co-Creator" phase. We learn to cooperate and realize that the new paradigm will not replicate the old paradigm. Legacy CMBS loans ($780 billion) account for 25% of the overall $3 trillion commercial real estate debt market. CMBS loans totaling $110 billion mature in 2011 and 2012. Former CMBS lenders like JP Morgan, UBS, Goldman Sachs, Citigroup, Wells Fargo, Deutsche Bank and new CMBS lenders like Cantor Fitzgerald, Starwood and Ladder have begun lending but with re-tooled parameters. Wall Street type firms are cautiously targeting large loans with well-capitalized sponsors. The middle market, non-institutional borrower must exhibit patience before favorable terms are again available.

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