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Negotiating 2011 and 2012 CMBS loan maturities

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Whether your CMBS loan is current and with a master servicer or non-current and with a special servicer, a great deal ($110 billion) of CMBS loans is maturing in 2011 and 2012 and will require refinancing. The gap between the current property valuation and the underwritten mortgage debt may cause problems on the refinance as many properties have a debt service coverage ratio under 1.00x and are worth 60% to 80% of the existing 1st mortgage debt. The situation is not unlike an apartment construction project that failed to meet its projected occupancy and the lender is unable to underwrite the permanent take-out financing. The significant difference is that construction loans are generally portfolio or balance sheet loans and CMBS loans are securitized and sold to bondholders.

According to a recent Fitch Ratings report, "Most U.S. CMBS loans that transfer to special servicing are driven by borrowers looking to prevent future defaults... recent transfers are showing something else entirely; opportunistic borrowers looking to capitalize on current market conditions." This is where the master and special servicer have to make an important distinction as to which borrowers to negotiate with and what, if any, "relief" to grant.

"When a majority of loans are transferred to special servicing they are classified under the moniker of imminent default. However, this is a 'catch-all' classification that provides little color on what circumstances precipitated the transfer. Because of this lack of transparency, Fitch Ratings has been closely monitoring the transfer of commercial mortgage loans to special servicing" said Fitch senior director Adam Fox.

In certain thoughtfully documented and well-presented cases, discounted pay-off agreements have been negotiated prior to the loan ever going into default. These loans are transferred from the master servicer to the special servicer so that the workout process can begin.

Valid Cases for Early
Review by the Servicer:

Valid cases for early review by the servicer include: a property that has lost tenants and occupancy is measurably less than the securitization underwriting; 2010 net operating income is deteriorated to a point where the debt service coverage ratio is below 1.00x; a major tenant has a lease expiration in 2011 or 2012 which would severely hamper the cash-flow of the building; major capital expenditures are necessary to maintain the functionality, integrity and tenant-base. Even if the loan size is under $5 million, the loan may be considered for modification, extension, a DPO or A/B note structure.

Loans that are not candidates for early review include: loans that have no monetary, technical or imminent default, loans put into strategic default (borrowers simply looking for opportunistic market terms); loans that can support refinancing but the financing terms are unsatisfactory to the borrower. The borrower having to sign recourse on the refinance is not a reason for a borrower to request relief via a restructure.

Given that restructuring a CMBS loan requires 1) NPV calculations stipulated by the Trust documents 2) historical and pro-forma analytics 3) the trust of the master and special servicer and 4) defined resolution conflict skills over a prolonged period of time, it is recommended to start negotiations far in advance of the loan maturity date. Any loan maturing in 2011 should begin the process by mapping out a clear restructure and refinance strategy. A servicer expects the borrower to be proactive and submit a detailed action plan.

Borrowers who take practical measures to avert default on soon-to-mature loans have and should continue to have success restructuring their mortgages.

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