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Troubled CMBS loans: Update and trends

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CMBS loan delinquencies continue to exceed the 8% mark through March 2012 according to Morningstar Credit Ratings. With \$59.19 billion (8.26%) of the total \$716.72 billion of total unpaid CMBS balances past due, the ratio is over 29 times the Morningstar recorded low point of the 0.283% reported in June of 2007. Monthly movements in the size and amount of loan liquidations, note sales, modifications, extensions, and discounted payoffs executed by special servicers, along with new balloon maturity defaults, make it difficult to predict which resolutions will be most favored by Special Servicers for the remainder of 2012.

In 2012, some of the larger Special Servicers have exhibited more of a willingness to aggressively pursue property ownership than in prior years. Certain servicers believe that the economic recovery is taking shape and certain marketplaces will improve over the next 2-3 years. The servicer may hold these assets as REO until property values return. This tact allows the trust to postpone potential losses rather than take an immediate loss by executing on a note sale or discounted payoff with the borrower today. (borrower tip: Pinpoint in your Pooling and Service Agreement ("PSA") the length of time a special servicer can hold your asset in REO.)

A second trend coming out of 2011 and continuing thus far into 2012 is the servicers more frequent use of the note sale process as a way to quickly remove troubled assets they don't want in their REO portfolios. Servicers appreciate that there is an excess amount of "sideline" capital that has accrued during the last real estate cycle. In these cases, the special servicer believes that the capital chasing the note may exceed the Fair Market Value of the property. The servicer is acting in accordance with its fiduciary responsibility to maximize net proceeds to the Trust by minimizing future losses and writing off the asset immediately.

The servicer may elect to sell the note and may invite the borrower to participate in the note sale process depending upon whether the servicer is 1.) comfortable with their borrower dealings to date and 2.) their PSA does not forbid a sale to the borrower. (borrower tip: Within the PSA, determine whether you are eligible to participate in the note sale process. Most PWR pools, for example, forbid the borrower from purchasing the note. Additionally, realize that borrowers are infrequently awarded the winning bid in the note sale process and should put most of their effort into a direct resolution with the servicer.)

Another key trend with which borrowers should be familiar is the servicers ramped up requests for more extensive reps and warrants as well as increased due diligence. As of January 1st 2012, a major servicer put in a place a "revised diligence/reps and warrants list" that must be completed prior to the execution of any resolution. Deals previously negotiated are not "grandfathered" and must comply with these stricter guidelines. For example, the borrower must rep that the servicer has been made aware of 1.) all prospective tenant conversations and 2.) any property sale plans post resolution. These reps along with several others have been installed to protect the trust and

eliminate borrower malfeasance. (borrower tip: Understand what reps and warrants the servicer requires and be prepared to provide accurate and expedient proof as servicers quickly tire of mercurial or non-responsive borrowers.)

Borrowers most likely reach their specified property goals with strong, consistent and informed advocacy.

David Goldfisher is a principal at The Henley Group, South Natick, Mass.

New England Real Estate Journal - 17 Accord Park Drive #207, Norwell MA 02061 - (781) 878-4540