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Maturing CMBS loans creating win-win scenario for sellers and buyers of multi-family properties

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In the mid to late 2000s a popular multi-family loan product known as the commercial backed security (CMBS) was offered at the time at rates considered all-time lows in the 5.5 to 6.5% range. At the time most conventional loans had a five year term however the CMBS offered a fixed rate for a 10 years. The longer term offered the borrower stability in the event there was an upward spike in rates or a market correction which would make it difficult to refinance as was the case in the early 1990s.

The CMBS loans were very popular on Wall St. since the intent was to allow the bondholders to realize the same yield as if the loan was held to maturity. Unlike conventional loans where the pre-payment penalty is a set percentage of the principal balance owed the CMBS pre-pay is based on yield maintenance meaning the borrower would reimburse the lender for the loss of interest resulting from the prepayment of the loan. Based on this the CMBS loan was ideal for owners who had no intention of selling or refinancing during the loans term.

This was fine until 2009 when rates began to drop significantly to all-time lows in the 3.5 to 4% range. Due to the fact that the pre-pay penalty on the CMBS loan increased due to the decrease in rates it made it cost prohibitive for owners to take advantage of the lower rates through refinance.

Fueled by lower rates the multi-family market rebounded and surpassed previous record prices set during the last market boom of the mid 2000s. On many of these deals the penalty to pay at this time was in the several hundred thousand to million dollar range. The only way an owner could paying the pre-pay is if they sold with the new buyer assuming the existing debt. The problem for the buyer assuming the debt was it was usually at a rate 200 basis higher than current debt available. The loan-to-value on the assumable debt was usually 10% to 20% lower than the current financing available at 75% to 80% LTV due to principal reduction and appreciation. With the additional down payment required this eliminated most of the buyers in the marketplace.

Lastly most of the assumable debt written at this time was coming due soon and it is difficult to forecast where interest rates will be in 2017.

Buyers that were willing to assume the existing debt wanted the same cash on cash return they would have received if they were purchasing with new debt at the lower rates. The result was a significant discount in price that was too substantial for the owner to consider. The good news is that many of these loans are maturing soon making the penalty somewhat palatable for owners willing to pay it upon sale. By doing so the owner receives the full market value by allowing the buyer to obtain new financing at a much lower rate and higher loan-to-value allowing the buyer to come in with less money down.

For example we have been working on a transaction on and off for the past several years. Initially the only way the property could be sold was if the debt was assumed since the penalty to pay was just too high. The offers received during this period were in the $3 million range with the buyer having to assume the debt.

As time has passed the penalty has decreased to an amount somewhat bearable for the owner to pay. We advised the owner that they would get the highest possible price if they allowed a buyer to place new debt on the property. The result was offers in the mid $4 million range with the seller netting almost a $500,000 more even after paying the penalty.

It was a win-win for both sides with the seller getting full market value albeit with the penalty and the buyer locking in long term debt at today's low interest rates.

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