



CMBS Loan Restructures and the Role of Special Servicers



**By Tanya Little
Managing Partner
1st Service Solutions
CREW Dallas**

Tanya Little is Managing Partner of 1st Service Solutions, a real estate advisory firm that serves as a borrower advocate providing restructures, modifications, and assumptions of CMBS debt (www.1stsss.com). Tanya provides more than 25 years' experience in real estate, managing over \$3 Billion in loans and commercial portfolios with asset sizes from \$1M to \$200M. Additionally, Tanya is a board member of CREW Dallas. Tanya can be contacted at tlittle@1stsss.com.

As markets mature, competition increases. The CMBS market was no exception. The underwriting standards that existed when the market was in its infancy became more competitive as more and more borrowers were flooding to the market to take advantage of seemingly great deals. When you factor that into the recent commercial real estate meltdown in general, you have a disaster and that is what we have today.

For the first 10 years of CMBS lending, default rates hovered below 2 percent. By January 2010, default rates had soared to almost 6 percent. If you consider that approximately 20 - 25 percent of the \$3.5 trillion of commercial real estate debt is CMBS debt – you quickly see the magnitude of the problem. As of January 2011, CMBS default rates were above 10 percent and climbing.

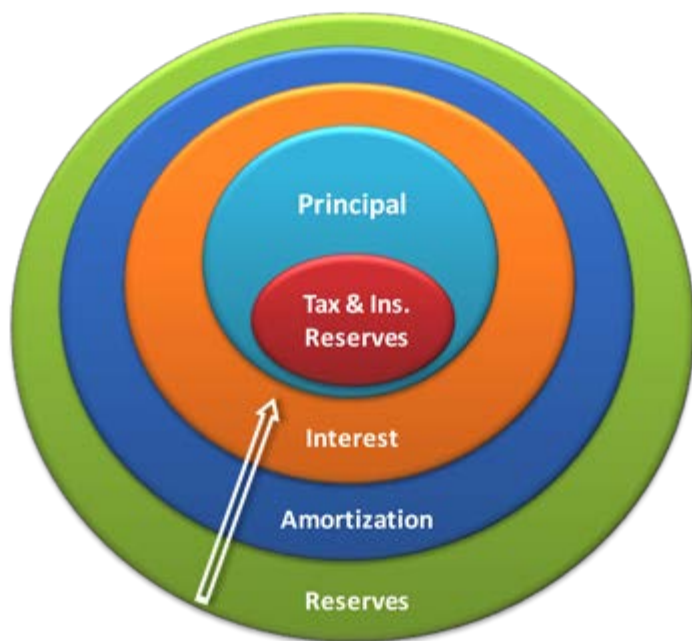
And unlike bank debt, where there are 7,000 or more banks handling the problems, in CMBS, 75 percent of the \$70 billion in default are handled by three special servicers. Needless to say, the system is quite overwhelmed.

To fully understand the role of the special servicer and how it impacts the ultimate restructure on a commercial property, you need to understand the CMBS risk structure. Securitized lending is where the Bank/Lender that originated the loan, sells off the risk of the loan to various bond investors in the secondary market. Many of these bond investors buy these bonds because of the yield on them; not for the real estate itself. The lowest rated bonds are called the controlling class certificate holders and they appoint the special servicer. If everything goes according to the original plan at origination and the property is performing, then the borrower will generally never know who the special servicer is.

Since the controlling class certificate holder appoints the special servicer, they are often the same company. So, ultimately the special servicer – in most cases – has some loss exposure on the loans in the pool they are specially servicing. It may seem like there is an inherent conflict in this structure; however, the special servicer is obligated to follow a standard set of performance criteria called the servicing standard. The servicing standard stipulates that the special servicer must choose the workout strategy that maximizes the net present value of the loan and to act in the best interest of all the bond holds *regardless of their own position*.

So, when a loan is not performing, and is either in actual default or is likely to default in the near future, the loan is actually transferred to the special servicer. The special servicer will evaluate all options and will ultimately make a decision based on the course of action that they deem to provide them with the best net recovery. A part of what the special servicer adds to this equation is their opinion of the market's recovery. If they believe that the market will recover by the time the loan would otherwise mature, they may choose to modify the loan in such a way that there is no principal loss or write down. If, however, they believe that the market will not recover by the time the loan would otherwise mature, they may choose to accept an offer from the borrower that would result in a principal write down or write off today.

The types of restructures special servicers are doing today depend on many factors, but generally fall into a few categories, as this graphic demonstrates:



Payment Restructure:

No restructure is simple, however, if the loan can be restructured by modifying the payment in such a way that the payment consists of interest only (with no principal amortization and no reserve payment), that is the likely way the loan will be restructured. Again, there are many other factors involved, such as the maturity date of the loan, the local market condition of the property, borrower performance and willingness of the borrower to contribute additional capital at the time of the restructure.

Debt Restructure:

If modification of the payment as described above will not result in a “performing loan,” then the special servicer will likely consider a restructure of the debt amount. This can be done through a discounted pay off, short sale of the property, or even a write down of the debt. There is also a hybrid that “temporarily” reduces the debt called an A B structure.

For a successful restructure to occur it is important that the borrower have a well thought out plan, access to capital, and more importantly, a good advisor.

CREW Network Premier Lead Sponsors





Platinum Sponsor



Gold Sponsor

Silver Sponsors



Bronze Sponsors

AMB Property Corporation
Ballard Spahr LLP
Wells Fargo

Contributor Sponsors

Eastdil Secured
HITT Contracting, Inc.
Jacobs Engineering Group, Inc.

Chapter Leadership Circle

Premier Partner Chapter



Contributing Chapter

CREW Houston
CREW Seattle and Sound

Friend Chapters

CREW Dallas
CREW Denver

Supporting Chapter

CREW Portland

CREW Network® 1201 Wakarusa Drive, Suite C3 | Lawrence, Kansas 66049 | www.crewnetwork.org