CMBS Loan Restructures Part II: A Closer Look

We listen . . .

Speaker:
Ann Hambly
Founder & Co-CEO
About 1st Service Solutions

- Founded in 2005 by Ann Hambly
- Ann Hambly & Mike Meisenbach are Co-CEOs
- Advocated over $11 billion to date
- Current pipeline is over $7 billion
- National company based in Dallas, Texas
- Average loan size = $30 million, with loans ranging from $2-$300 million
Agenda

• How did we get here?

• The Special Servicers
  – Who are they? What rules do they live by? What if yours changes?

• Special Servicing Today
  – A look at CMBS loans currently in special servicing

• Maturities
  – CMBS debt through 2018

• Restructures
  – Decision tree
  – Four basic types
  – NPV
  – Case studies
  – Top 10 must-haves

• Q&A
How Did We Get Here?

Original Model

- AAA represented 70% of the first mortgage
- No I/O loans
- Reserves, lock-box, lender protection
- 1995 CMBS issuance: $14B

2005 – 2007 – 88% of CMBS Market

- AAA represented 90% of the first mortgage
- Mostly I/O loans
- Little lender protection
- 2007 CMBS issuance: $230B
# Parties in a CMBS Structure

<table>
<thead>
<tr>
<th>Loan Funded</th>
<th>Investment Banking Firm Creates Pool</th>
<th>Rating Agencies</th>
<th>Bonds are Sold</th>
<th>Special Servicer is Assigned</th>
</tr>
</thead>
<tbody>
<tr>
<td>Borrower</td>
<td>Loan contributed to Pool</td>
<td>Bonds are rated:</td>
<td>Bonds are sold:</td>
<td>B piece owner becomes Controlling Class Certificate Holder</td>
</tr>
<tr>
<td>Lender</td>
<td>Lender may stay in as Primary Servicer</td>
<td>AAA, AA, A, BBB, BB, B, UR</td>
<td>AAA, AA, A, BBB</td>
<td>“CCR”</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Rated Master Servicer is assigned to Pool</td>
<td>BB, B, UR</td>
<td>“CCR” selects Special Servicer</td>
</tr>
</tbody>
</table>

“CCR” selects Non-Investment Grade “B pieces”
The Special Servicers
Who Are They?

% Market Share of Top Special Servicers

- LNR Partners: 31.6%
- CW Capital: 25.5%
- C-III: 16.7%
- Midland: 6.6%
- Wells Fargo: 3.6%
- Situs/Helios AMC: 3.5%
- Torchlight: 3.5%
- Bank of America: 2.6%
- Berkadia: 2.1%
- KeyCorp: 1.9%

Source: Morningstar, April 2012
What Rules Do They Live By?

• Special Servicer Servicing Standard – Maximize return to all bondholders without regard to your own position and no benefit of 20/20 hindsight.

Pooling & Servicing Agreement
Effect of Losses on Special Servicers

- Current CCR appoints special servicer
- Losses hit lowest tranches of bonds first
- As losses wipe out a class of bondholder, CCR charges

### EXAMPLE ($100 pool)

<table>
<thead>
<tr>
<th></th>
<th>Original Face Amt of Bond</th>
<th>Losses</th>
<th>Current Bond Amt</th>
</tr>
</thead>
<tbody>
<tr>
<td>AAA</td>
<td>50</td>
<td></td>
<td>50</td>
</tr>
<tr>
<td>AA</td>
<td>20</td>
<td></td>
<td>20</td>
</tr>
<tr>
<td>A</td>
<td>10</td>
<td>5</td>
<td>5 (CCR)</td>
</tr>
<tr>
<td>BBB</td>
<td>10</td>
<td>10</td>
<td>0</td>
</tr>
<tr>
<td>B</td>
<td>6</td>
<td>6</td>
<td>0</td>
</tr>
<tr>
<td>UR</td>
<td>4 (CCR)</td>
<td>4</td>
<td>0</td>
</tr>
</tbody>
</table>
What If the Special Servicer Changes?

- Las Vegas Retail Property
- $17 MM loan
- Property value = $7 MM
- Borrower negotiated AB structure with special servicer:
  - ‘A’ note of $8 million, $3 million of new capital and 50 percent split of proceeds to trust.
  - Documentation in final stages
- Due to other losses in the CMBS pool, CCR changed and appointed a different special servicer.
- New special servicer scheduled note auction.
- Borrower negotiated direct sale of the note for $10 million.
- RESULT: Borrower ended up owning his whole note for significantly less than under the AB structure.
CMBS Special Servicing Today
CMBS Loans in Special Servicing

By Unpaid Balance

Source: Morningstar, April 2012
CMBS Loans In Special Servicing

By Property Type

- Multifamily: 18.3%
- Retail: 20.5%
- Office: 31.9%
- Hotel: 15.3%
- Industrial: 4.2%
- Healthcare: 0.2%
- Other: 9.6%

Source: Morningstar, April 2012
CMBS Loans in Special Servicing

By Year of Securitization

- 2007 = 39.5%
- 2006 = 32.0%
- 2005 = 13.9%
- 2004 = 4.4%
- 2001 = 3.2%
- 2003 = 2.1%
- 2002 = 1.6%
- 2000 = 1.4%
- 1998 = 0.6%
- 2008 = 0.1%

Source: Morningstar, April 2012
CMBS Maturities
Projected CMBS Maturities

Source: Intex, Trepp, Mortgage Bankers Association, Federal Reserve, Deutsche
CMBS Restructures
Restructure Decision Tree

Is property under water today?

YES

Will value recover by maturity?

NO

Payment Modification

NO

Debt Forgiveness
  • DPO
  • Note Sale

YES

Debt Deferral
  • A/B
Four Basic Types of Restructures

• Payment Modification
• Debt Deferral
• Debt Forgiveness
• Maturity Date Extension
Payment Modification

• When reduction of payment alone will cure “all ills”
• Typically for properties not under water
Debt Deferral

- Property under water today
- Some or all of value will be recovered by maturity date
- Borrower must make meaningful capital contribution
Debt Forgiveness

- Property under water today
- Little to no value will be recovered by maturity date
- Can be executed through:
  - Short Sale
  - Note Sale ($1 for $1)
  - Discounted Payoff
Maturity Date Extension

- Performing loans only
- Borrower must make pay down at time of extension (typically 10%)
- Cost = 1% per 12-month extension
What Drives the Decision?

• Special Servicer Servicing Standard – Maximize return to all bondholders without regard to your own position and no benefit of 20/20 hindsight.
NPV

- NPV is calculated for all options

**CURRENT APPRAISED VALUE OF PROPERTY**

- Hold Costs
  - Carry Costs
  - Advancing
- Foreclosure & Legal Costs
- Selling & Disposal Costs
- TI, LC
- Property Taxes, Insurance

**NET IS THEN PRESENT VALUED USING DISCOUNT RATE**

- Decision is driven off of highest NPV
Location Of Property Drives NPV

Days to Foreclose Varies by State

New York: 445
Texas: 21
Types of Restructures Actually Being Done
AB Structure Successfully Closed

- Retail
- California
- $27 million loan
- Matures in 2017
- Special Servicer agreed to AB Structure
  - $12 million A Note
  - $15 million B Note
  - $3 million new capital from borrower
- Current value of property = $12 million
- A few of the existing partners were able to contribute $1 million
- TI, LC needs for 2 years = $3 million

Solution

- Brokerage firm found new capital/buyer (REIT)
- REIT brought in $2 million of $3 million required
- New ownership structure
- REIT gets 100% control of property and management
- Broker received a sales commission based on $8 million purchase price (2/3 of $12 million)
- No immediate tax consequences to existing partnership since note stayed in place
- No other consideration to existing owners
DPO Successfully Closed

- Office building
- Michigan
- Loan originated in 2006
- $95 million loan
- Current value of property = $51.5 million
- NPV = $34.2 million

Solution
- Special Servicer agreed to $35 million discounted payoff
- Special Servicer agreed to 120-day closing
- Borrower obtained new loan equal to discounted payoff amount = 100% financing
Short Sale Successfully Closed

- Industrial (multi-tenant building)
- New York
- $48 million loan
- Loan originated in 2003
- Current value of property = $20 million
- NPV = $10.1 million

Solution

- Borrower sold property for $18 million
- Special Servicer agreed to $12 million discounted payoff
- Special Servicer agreed to give borrower 4 months to close with new buyer
- Borrower netted $6 million in profits less brokerage commission
- New buyer obtained $12 million loan
Top 10 Must-Haves

1. Know where the value of your property is TODAY.
2. Have a clear plan for the near-term and long-term of your property.
3. Have new capital to put to use.
4. Understand who you are negotiating with.
5. Understand what their motivations are.
6. Have a clear exit plan.
7. Submit a clear, comprehensive road map of the value creation for your property.
8. Be transparent.
9. Be prepared to remit all your net cash flow throughout the process.
Ann’s Resume

• CONTACT ANN
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  - ahambly@1stsss.com

• Founded 1st Service Solutions in 2005, recognizing the need for a borrower advocate in commercial real estate.

• 30 years of CRE servicing experience, including CEO of servicing for GE, Prudential, Bank of New York, Nomura, and Bank of America.

• At the forefront of setting CRE standards throughout her career:
  - Current member of prestigious Real Estate Roundtable, the NAIOP Capital Markets I-Forum and the Federal Reserve Bank of Atlanta’s “think tank” for commercial real estate.
  - 2003 Chairperson of the MBA’s Commercial Board, and in that role presented industry-changing initiatives to Congress.
  - Chairperson of CEO Servicer Roundtable, comprised of the major servicing firms across the nation.
  - Other board positions, including CREFC (f.k.a. CMSA), NMHC and RECRA.

• Named one of six National Real Estate Investor’s 2011 Most Influential Women in Commercial Real Estate and a True Leaders Top 25 CEO, a recognition crossing all industries.

• Sought-after speaker for CMBS borrowers, lenders, and attorneys groups as large as 4,000. Also has led CLE courses for attorneys.

• Frequent author of articles and quoted source for publications such as Wall Street Journal, Scotsman Guide, Globe Street, Hotel News Now and France Media publications.
Mike’s Resume

• **CONTACT MIKE**
  - 817.756.7221
  - mike@1stsss.com

• Nearly three decades of commercial real estate advisory and capital markets experience, working directly with principals, lenders and private, institutional and foreign investors.

• Professional affiliations including SIOR, CCIM, NAIOP, Mortgage Bankers Association and Real Estate Roundtable.

• Five years at Ernst & Young in the firm’s real estate consulting practice, working with banks, institutional investors, owners and the FDIC.

• A 17-year stint at Lee & Associates, a national commercial real estate advisory firm with more than 600 agents and 38 offices.
  - Served as president of investments and capital markets advisory services.
  - #1 investment sales broker company-wide over a 16-year period.
  - #1 producer company-wide in 2005.

• Member of the Real Estate Roundtable and the Real Estate Capital Policy Advisory Committee (RECPAC).
Q&A