



WELCOME



# NOTE AUCTIONS

WHAT THAT MEANS FOR A BORROWER?

WEBCAST Presented by:

**Ann Hamby**

Founded 1st Service Solutions in 2005

**Ed Hannon**

Renowned tax attorney with Freeborn & Peters

**Lawrence Vo**

Formerly with LNR. Currently Senior Asset Manager with 1st Service Solutions

# SPEAKERS



## **Ann Hambly**, Founder and CEO, 1<sup>st</sup> Service Solutions

Ann Hambly created 1st Service Solutions in 2005 recognizing the need for a borrower advocate in commercial real estate. Hambly has over 30 years of commercial real estate servicing experience and has served as the CEO of servicing for Prudential, Bank of New York, Nomura, and Bank of America. In 2011 she was recognized as one of the most influential woman in commercial real estate by National Real Estate Investor. She has also been recognized as one of the top 25 CEOs across all industries in a book called True Leaders. She has been at the forefront of setting industry standards for commercial real estate and has led many initiatives for industry groups that included attorneys, rating agencies, master and special servicers, trustees, and bondholders.



## **Ed Hannon**, Tax Attorney, Freeborn & Peters

Edward J. Hannon is a Partner both in the Business Law and the Real Estate and Land Use Practice Groups. Mr. Hannon has been named a “Leading Lawyer” in the areas of International Business and Trade Law, Real Estate Law and Finance and Tax Law in 2009, 2010 and 2011 ([www.leadinglawyers.com](http://www.leadinglawyers.com)). A seasoned tax advisor, Mr. Hannon regularly advises property owners, real estate investors, note purchasers and developers in connection with tax, governance, entity formation and other matters related to real estate partnerships and joint ventures. His work in this area includes note purchaser roll-up transactions, the restructuring of existing limited liability companies in real estate recapitalizations and the formation of joint ventures between landowners and developers for the development or repositioning of real estate projects.

# ABOUT 1<sup>ST</sup> SERVICE SOLUTIONS



SPEAKING



# AGENDA



SPEAKING

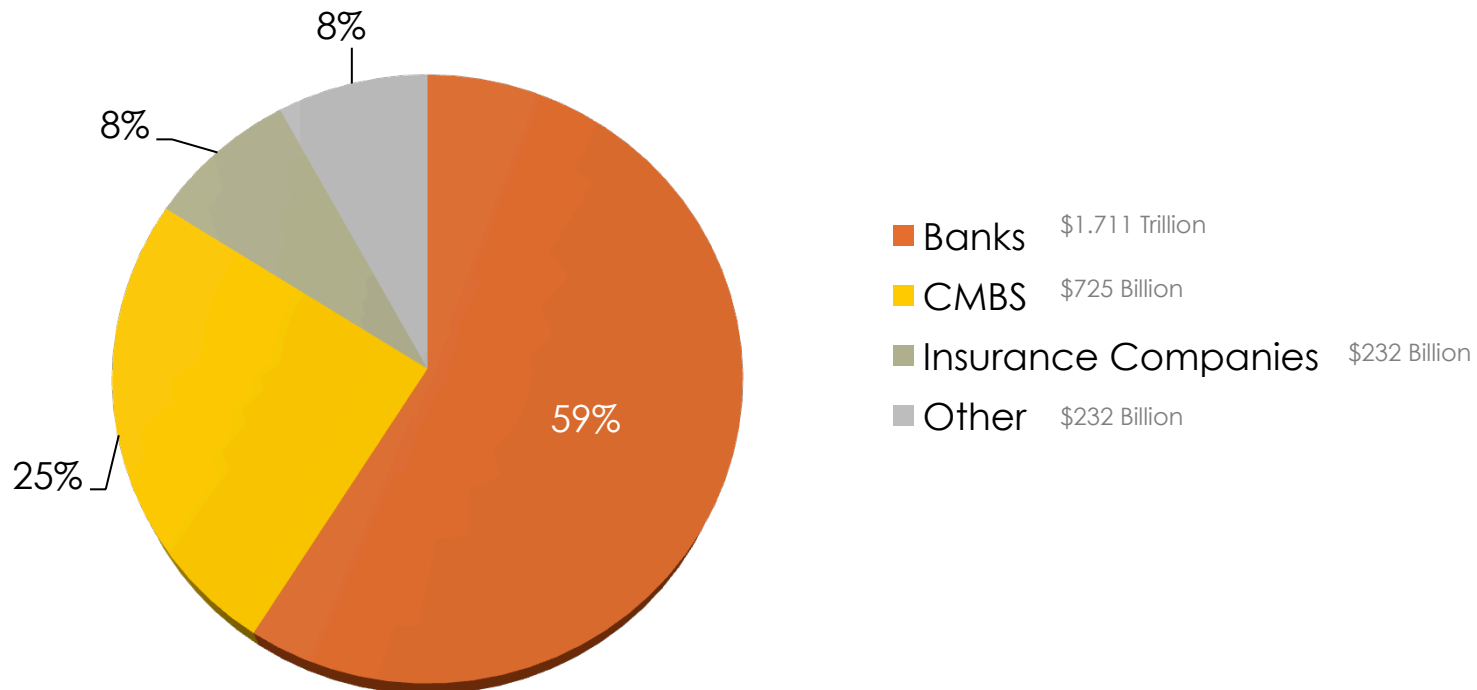
- CMBS Defaults and Resolutions
- Why is a note auction a popular resolution method today?
- Process for bidding at the Note Auction
- Can a borrower buy his own note?
- What are the tax considerations to do this?

# TODAY'S DEBT MARKET



SPEAKING

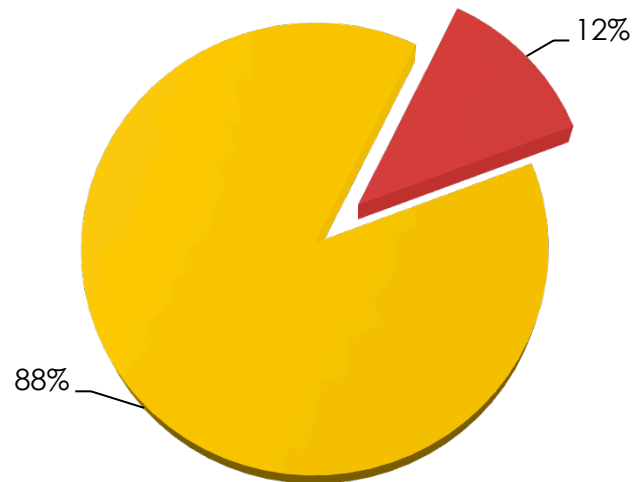
- Total outstanding U.S. real estate loans = \$2.9 Trillion



# CMBS DEFAULTS



SPEAKING



- Delinquent (\$85 Billion)
- Current (\$640 Billion)



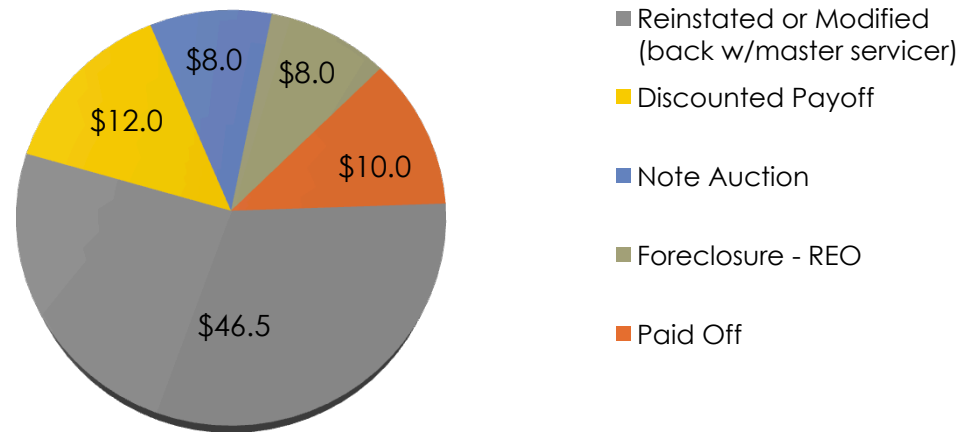


SPEAKING

# CMBS LOANS RESOLVED TO THROUGH 2011

- **2010**
  - First *real* year of loan resolutions  $\cong$  \$39.5 Billion
  - Resolution – “kick the can”
- **2011**
  - Loan resolutions  $\cong$  \$45 Billion

**Total 2010 – 2011  $\cong$  \$84.5 Billion**



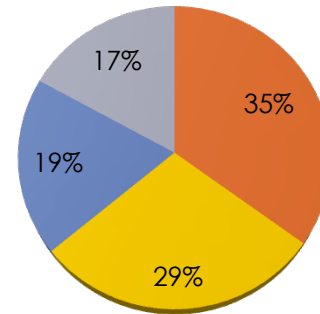


SPEAKING

# DOES THE SPECIAL SERVICER MATTER?



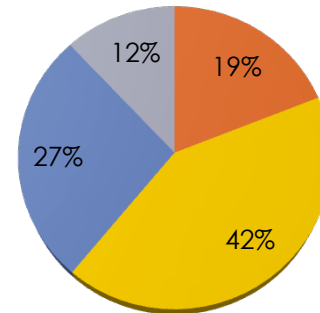
- **LNR:**
  - 35% Note Auction
  - 29% Modified
  - 19% Foreclosed
  - 17% Paid-off



- Note Auction
- Modified
- Foreclosed
- Paid Off



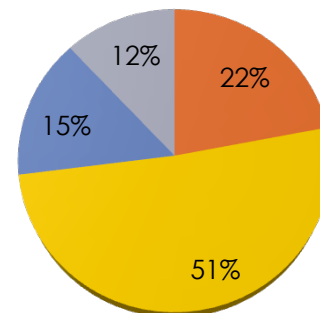
- **CW Capital:**
  - 19% Note Auction
  - 42% Modified
  - 27% Foreclosed
  - 12% Paid-off



- Note Auction
- Modified
- Foreclosed
- Paid Off



- **C-III**
  - 22% Note Auction
  - 51% Modified
  - 15% Foreclosed
  - 12% Paid-off



- Note Auction
- Modified
- Foreclosed
- Paid Off



# AVERAGE LOSS RATES BY LOAN RESOLUTION



SPEAKING

- **Modifications**
  - Unknown today - TBD
- **Discounted Payoffs**
  - 30% losses
- **Note Auctions**
  - 50% losses
- **Foreclosures – REO Sales**
  - 58% losses



# NOTE AUCTIONS



SPEAKING

- Average of 50% loss to bondholders
- So why is this a popular method of resolution when losses are higher than other resolution methods
  - Speed in resolution
  - Fees
  - Fully vetted pricing in marketplace



# SIZE MATTERS

SPEAKING

- Large loan has 100 tenants
- Small loan has 5 tenants
  - To an investor, that's 20 times more responsibility
  - To a lender, that's still 1 debt service payment
  - \$100 Million property loses 10% value - \$10 Million loss
  - \$10 Million property loses 10% value, \$1 Million loss
- The cost to service a large loan vs. a small loan is equal but losses are heightened for large loans
- The clearing mechanism that loan sales provide is vital to maximizing recoveries to the trust

# NOTE AUCTIONS 101

SPEAKING

- Common note auction firms
  - Auction.com
  - Debt x
- Typical note auction process
  - Live bidding format

# NOTE AUCTION PROCESS

SPEAKING

- STEP 1
  - Register to bid
- STEP 2
  - Do your research
- STEP 3
  - Arrange your financing
- STEP 4
  - Make your deposit
- STEP 5
  - Show proof of funds
- STEP 6
  - Entity documents
- STEP 7
  - Start bidding!
- STEP 8
  - Closing



# BORROWERS CAN BUY THEIR OWN NOTES

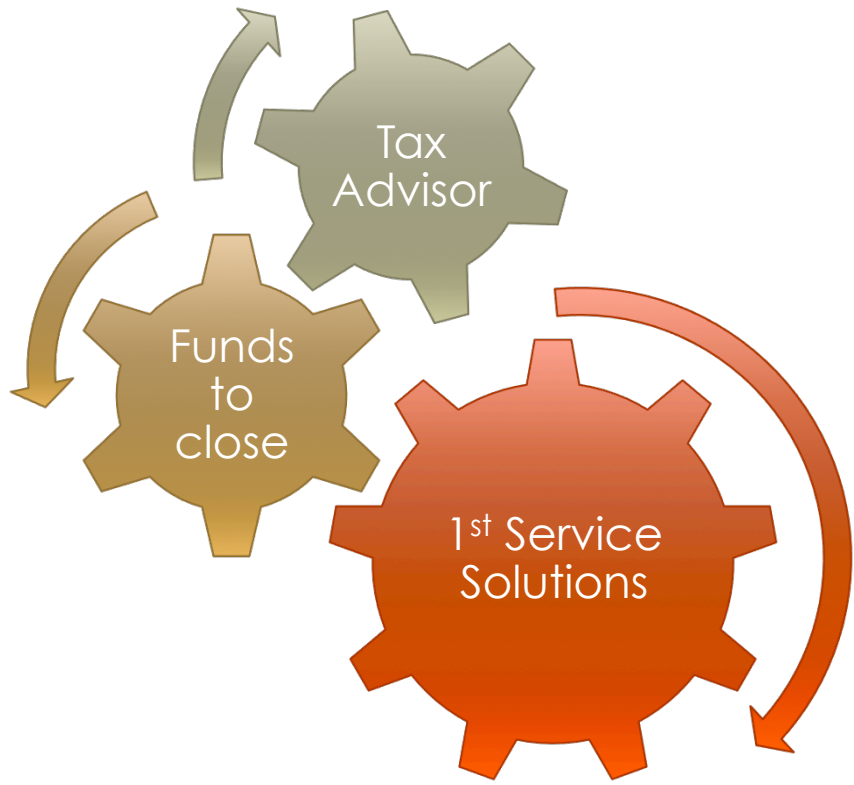
SPEAKING

- Process is really a Synthetic Discounted Payoff
  - WIN, WIN situation\_\_\_\_\_
- Special servicer gets fully vetted market pricing
- Borrower usually gets a DPO for less than a typical DPO



SPEAKING

# REQUIREMENTS FOR A SUCCESSFUL SYNTHETIC DPO





SPEAKING

# EXAMPLE

- **Facts:**

- Fair market value of the Property.....\$7 million
- Unpaid principal balance of the note.....\$8 million
- Purchase Price of the Note.....\$6.5 million

- **Tax Consequences**

- Under the related-party tax rules, the note is deemed paid for tax purposes once the borrower (or a related party) becomes the note holder.
- Because Borrower retains title to the Property, there is no sale or exchange for tax purposes. As a result, for tax purposes, once the borrower (or a related party) acquires the note in the auction, the \$8 million loan is treated as being satisfied for \$6.5 million.





SPEAKING

# EXAMPLE

- **Tax Consequences (Cont'd.)**
  - The deemed pay-off at \$6.5 million causes the borrower to recognize \$1.5 million of cancellation of indebtedness income.
  - The \$1.5 million of cancellation of indebtedness income will arise regardless of whether the mortgage remains in effect or is cancelled.

# FOR FURTHER INFORMATION CONTACT US

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If you are a commercial real estate owner and are experiencing a problem with your commercial real estate loan, let 1st Service Solutions analyze your situation and offer solutions. We welcome the opportunity to serve as your advocate and negotiate an outcome that is mutually beneficial for you and your capital partners.

*If you are getting a **new CMBS loan**, let 1<sup>st</sup> Service Solutions review your loan documents and provide feedback about ways to make your CMBS loan more flexible. There are many provisions that can be added to the loan documents at origination that will make a CMBS loan much more flexible and workable for owners.*

**Thank you** for attending our webinar