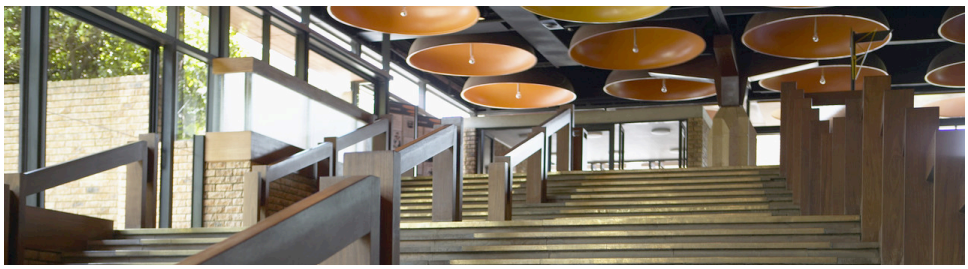
Modifying Your CMBS Loan

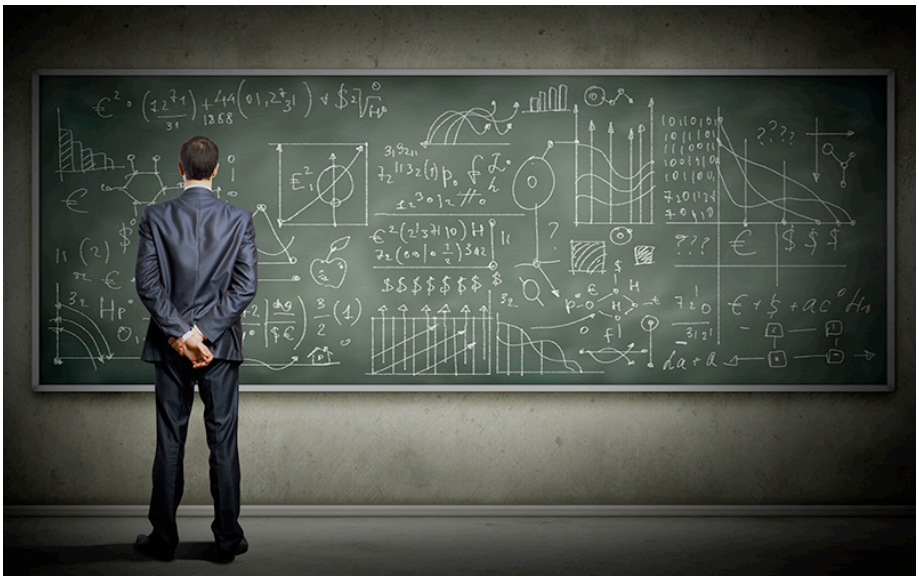


Commercial Loan Restructure

- What are the basic types of restructures?
- Who are the parties involved in the process & what are their roles?
- When is the right time to start the process?
- How long does the process usually take?
- What happens if the Special Servicer changes during the process?
- What impacts the Special Servicer's decision?
- Why do you need an advocate?

1ST SERVICE SOLUTIONS®

Do you know the types of restructures available, the parties involved, and the details of the process? Find out why you need an advocate while going through this process.



1. Do I qualify for a loan restructure?

If you answer 'yes' to any of the following questions, you may qualify for a restructure, so you should schedule a consultation with us to understand your options.

- Is your cash flow negative?
- Will your cash flow be negative in the next few months?
- Is your property worth less than your loan?
- Do you have any significant tenant leases expiring in the next year that will cause your cash flow to be negative?
- Does your loan mature in the next 12 months and you are confident you cannot pay it off?

If you answer 'yes' to any of the following three questions, you need to seek *immediate* help!

- Have you stopped making your loan payments or are you contemplating doing so in the next few months?
- Have you been transferred to Special Servicing?
- Does your loan mature in the next few months?

If you answer 'yes' to any of these questions, you may qualify for a restructure.

2. What are the basic types of restructures?

1. **Maturity Date Extension –** an extension of the maturity date only when you can prove that you are not able to obtain sufficient replacement financing to pay your loan off at maturity.

2. **Payment Modification –** modification of the payment terms such that the income from the property supports the new payment.

3. **Debt Deferral –** when the value of the property is less than the current loan amount and it is foreseeable that the value will return to the loan amount by the maturity date of the loan, a common type of restructure is the AB note split. The original note is split into two parts; an A note and a B note.

- The A note will essentially equal the appraised amount of the property or the amount of debt the current property's cash flow will support today.
- The B note will be the difference between the original note amount and the A note amount. The B note will typically not accrue interest and will essentially be due upon final payoff of the debt at the original or extended maturity.
- The borrower will be required to bring new equity in at the time of the modification. The new equity is often equal to the amount of capital (TI, LC) dollars the property will require between modification date and maturity, or roughly 10% of the A note.
- At the ultimate liquidation/payoff of the loan, the proceeds are distributed according to a set waterfall. The typical waterfall will be: A note, borrower's new equity plus a preferred rate of return on the new equity, then a split on the remaining proceeds (a portion to pay down the B note and a portion to the borrower). Any balance on the B note after the waterfall is typically forgiven.

All restructures fall into four (4) basic categories, but just like food on a menu, each category can be ordered many different ways.

2. What are the basic types of restructures? (continued)

4. **Discounted Payoff –** when the value of the property is less than the current loan amount and it is clear that the value will likely NOT return to the loan amount by the maturity date of the loan, a form of discounted payoff is considered. A discounted payoff can take many forms:

- **Note sale -** Often the Special Servicer will validate the amount the borrower is paying for the discounted pay off by posting the note for auction. This insures the Special Servicer it is getting the highest price in the market.
- **Short Sale -** If the note is not auctioned, another way to validate that true market price is paid for the transaction is by marketing the property for sale and allowing the buyer to pay off the loan for the sale price; thereby eliminating a foreclosure on the borrower's record.
- **FMVPO -** The CCR has the right to buy a defaulted loan out of the pool under the Fair Market Value Purchase Option (FMVPO). Many FMVPO buyers are interested in 'flipping' the property to the borrower for a fee. This can result in an opportunity for the borrower to buy its own property for slightly above market prices.

3. Who are the parties and what are their roles?

Primary Servicer – this is typically the loan originator and when there is a primary Servicer, this will be the company that the borrower has daily contact with and where payments are made to.

Master Servicer – The Master Servicer is responsible to the CMBS Trust for the actions of the primary Servicer and is the entity which holds the Servicer rating. Therefore, all borrower requests submitted to the primary Servicer will require the review and approval of the Master Servicer. The Master Servicer is generally not able to waive or modify terms of any loan in the CMBS pool. Most material servicing requests, such as assumptions will require the approval of the Special Servicer.

Special Servicer – Upon the occurrence of a default or the notification of an imminent default, the administration of the loan transfers to the Special Servicer. The Special Servicer also retains approval rights over material servicing actions such as assumptions. The Special Servicer is selected by the Controlling Certificate Representative ("CCR") of the CMBS pool, and often is a related entity to the CCR. Most often the CCR retains the right to direct the actions of the Special Servicer on defaulted loans and for assumption approvals.

CCR – the investor of the most subordinate bond class at any given time. Given that losses come out of the lowest rated bonds first, they play an active role in the monitoring the performance of loans in the pool, make decisions on key loan issues and appoint and/or terminate the Special Servicer.

Trustee – the trustee's primary role is to hold all the loan documents and distribute payments received from the Master Servicer to the bond holders.

As of year-end 2015, the top Special Servicers were:

- CW Capital
- LNR Partners
- C-III
- Torchlight
- Situs
- Midland
- KeyCorp
- Rialto

4. When is the right time to start the process?

Let's start by first stating when the *wrong* time is to start the process. Logically, it would make sense to exhaust all resources available to you, the owner first and then, as a last resort, come to the Servicer for help. That is the exact wrong way to go about a CMBS modification.

All modifications require significant cash infusion by the owner, so if you have used up all available resources and continued to come out of pocket to keep the loan current as long as possible before reaching out for help, you will have less to offer up at the time of the modification.

As soon as you know you have a large tenant vacating, or as soon as you know your cash flow will be short; even if that event doesn't happen for a year that is the time to start the process.

If you can see that you will have a problem within the next 12 months, call us for a consultation and let us give you your options. Don't wait until it's too late!

5. How long does the process typically take?

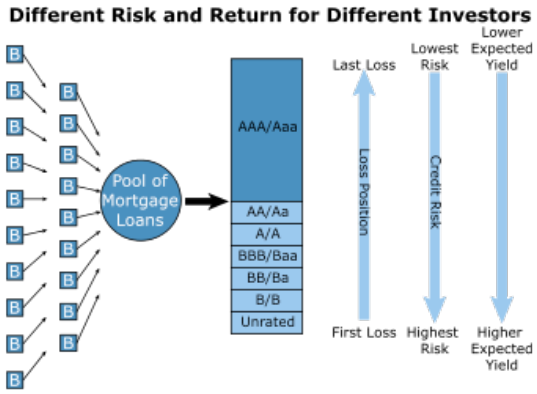
According to Fitch, the average time a loan was in special servicing was: 2012 – 19 months, 2013 – 23 months, 2015 – 40 months. The timeline is impacted by many factors, many of which are not real estate related factors.

Months 1 & 2	Loan is being transferred from Master to Special
Month 3	Spent getting the pre-negotiation agreement in place. A restructure proposal should be submitted to the Special Servicer
Months 4 & 5	Special Servicer is gaining an understanding of the value of the property, primarily by performing an appraisal. Special will also review the proposal
Month 6	Likely when negotiations begin (can take many months depending on complexity of transaction, responsiveness of Servicer and Borrower, and Servicer workload
Months 7 - 40	After negotiations are complete, deal is submitted to credit committee for approval. After approval, a term sheet is sent to the borrower. Then, legal documents are drafted and negotiated
Finally	After legal documents are finalized, transaction is closed

6. What happens if the Special Servicer changes during the process?

When the 2005 – 2008 vintage CMBS pools were created, the CCR typically bought enough of the subordinate bonds to ensure they would remain in "control" for the life of the pool. No one predicted at that time the losses for the pool would eventually wipe out the original CCR position in total.

Losses pass through the pool from the lowest rated bonds to the highest.



The CCR is always the lowest rated class of bond holders at any given time; so as losses pass through the pool, the CCR can and does change. Since the CCR appoints the Special Servicer, when the CCR changes, it is likely that the Special Servicer will change.

At its worse, the change in a Special Servicer during the midst of a restructure could mean the whole process essentially starts over and the new Special Servicer re-analyzes the whole transaction and decides to pursue another course of action than the previous Special Servicer.

This can be very disruptive to the restructure process for a borrower.

7. What impacts the Special Servicer's decision?

There are a number of factors that impact the Special Servicer's decision about whether to modify or foreclose and then what type of modification to consider. As of 2016, these factors often far outweigh all real estate considerations and are often counter intuitive. Here is a sample of some of these factors (not an all inclusive list):

1. **CCR** – until about 2013, a large amount of the CCRs were affiliated with the Special Servicer assigned to the pool. Due to the large amount of losses in those pools, the lowest rated bond holder moved to other entities and in some pools, the losses are in the originally rated AAA bonds. The CCR has the ultimate authority in defaulted loans. That is why one special servicer may take a completely different approach on two seemingly similar situations - there are different decision makers.

2. **Bond Position of the Special Servicer –** or, who will be hit with the loss when one is taken.

3. **Special Servicer dynamics –** (a) menu (some special servicers will entertain certain types of modification structures that another special servicer won't), (b) agenda (i.e.; some special servicers are gearing up to put loans in a note auction), (c) negative predisposition to giving borrowers a concession of any sort.

4. **Asset Manager personalities –** some asset managers are interested in working out deals, some are interested in foreclosing, and there are some who merely don't respond to borrower requests at all. This may be shocking but it is no different than anywhere else in life. There is no way to fight this, but it is most important to KNOW IT going in!

5. **Fees –** although most borrowers would say this is the number one driver of a special servicer's decision, it is important to note that the special servicer receives a disposition fee on every deal once it is resolved, regardless of the resolution. Fees really don't drive the special servicer decisions as much as many people think.

One Special Servicer may take completely different approach on two seemingly similar situations.

8. Why do you need an advocate?

Restructuring a CMBS loan is not like restructuring your bank loan! Do not be trapped into thinking that you can make a phone call to your Master Servicer and have a discussion with them about your restructure options and the best next steps. That is not their job! Remember the Master Servicer does not handle the restructures.

CMBS loans are governed by a set of rules and/or documents which the borrower does not have access to and likely has never heard of before:

(1) Pooling and Servicing Agreement

(2) REMIC rules

(3) Series of industry standards which govern what the Servicers do

Don't expect that you can have that call with the Special Servicer either because they won't talk to you until you are officially transferred to them and even then; it will feel like a one-sided conversation. The Special Servicer expects you to make the first proposal to them about what kind of restructure you want, why it is necessary and most importantly, why it is in the best interest of the CMBS trust.

Even the most sophisticated owner of commercial real estate needs an advocate when they are dealing with their CMBS Servicers much the same way that they would need a lawyer when they are facing a judge in a courtroom. It is just important that the advocate have deep, first-hand experience within the CMBS servicing industry. Not just the CMBS industry as a whole, but the CMBS SERVICING industry. After all, that is who you are going to be facing off with; the Servicers.

CMBS loans are governed by a set of rules that the borrower does not have access to and likely has never heard before.

Commercial Real Estate Loan Restructures and Assumptions

The Original Borrower Advocate

Ann Hambly formed 1st Service Solutions in November 2005 after spending her entire career in commercial real estate servicing. In her role as CEO of Prudential's servicing, where she managed various types of loans (FHA, Fannie Mae, Life Company, CMBS, etc.), it was clear that one thing missing from CMBS loans from a borrower's perspective was the "relationship manager." After the loan was securitized, there was no one for the borrower to reach out to when they were having problems and needed help. After seeing the high level of frustration of borrowers first-hand, she finally decided to fill that need and created the first-ever firm devoted to serving as a borrower's relationship manager. In 2006, this role was named "Borrower Advocate."

By late 2006, 1st Service Solutions was highly recognized in the industry as the first borrower advocate.

Today, the firm has advocated more than $15 Billion of commercial real estate loans for owners. The team is primarily made of full time senior people from various servicing shops; which is essential to being a successful advocate for a borrower.

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1ST SERVICE SOLUTIONS®

Message from Ann:

"No one cares how much you know, until they know how much you care."