Harsh CMBS Maturities Ahead

Plan for loans maturing in 2015 and beyond to avoid financial pitfalls

By Ann Hambly

More than $600 billion of commercial mortgage-backed securities (CMBS) loans were originated between the years of 2005 and 2007, making up a major percentage of legacy CMBS loans. With most CMBS loans having a 10-year maturity date, a huge swell of loans will be maturing in 2015 through 2017, totaling more than $350 billion.

Because of the hypercompetitive CMBS market from 2005 to 2007, these loans were typically originated as interest only, with little to no reserves and higher-than-average loan to values (LTV). To make matters worse, property values were inflated at the time these loans were originated, meaning that many of the loans were overleveraged by the time of the crash in 2008.

Given the characteristics of these CMBS loans from their time of origination, it is anticipated that a large portion of them will be overleveraged. Mortgage originators should be aware of this coming wave of overleveraged

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CMBS maturities and what they mean for their clients affected by them.

The spike in CMBS issuances from 2005 to 2007 and the substantial increases in year-over-year originations during that period — $168 billion in 2005, $203 billion in 2006 and $230 billion in 2007 — indicate that the CMBS market became more competitive each year before the ultimate crash of 2008.

As the originations became more competitive during these years, the higher the LTV of the loans tended to go, a conclusion supported by data from Fitch Ratings showing that when CMBS loans originated from 2005 through 2007 defaulted and were then resolved over the next few years, they had higher losses than loans originated in the years before and after this period.

Given that LTVs of CMBS originations increased yearly from 2005 to 2007, it is safe to assume that the loans maturing in 2015 will not be as overleveraged as the loans maturing in 2016 and 2017. Therefore, this article will focus only on the 2015 maturities, going on the assumption that unless property values skyrocket over the next two years, 2016 and 2017 CMBS maturities will likely be even more overleveraged than those in 2015.

High LTV rates

Of the CMBS loans maturing in 2015, slightly more than half of them have current LTVs lower than 80 percent, meaning that the rest of them have LTVs higher than 80 percent, likely the highest amount of leverage a new lender will offer. Keep in mind that special servicers will not focus on the amount of new proceeds borrowers can get, but rather on the total value of the property when considering their options at the time of maturity. This will become a critical component to borrowers.

Special servicers are obligated to maximize the recovery to bondholders on a CMBS structure, so when faced with a choice of allowing borrowers to pay off their existing loan at 80 percent of the total loan amount at maturity — because that is the maximum amount of new loan proceeds the borrower can get — or take the property back and sell it at full value themselves, they will likely do the latter nearly all of the time.

Options for borrowers

For borrowers with CMBS loans maturing in 2015, there are a number of basic options. In cases where the LTV of the loan is less than 80 percent, borrowers will be best served to find a way to pay off the existing loan because there will be a gap between the leverage they can get on new loans and the payoff amount.

For those who do not have the cash available to bridge that gap, the following options should be considered:

- **Get a mezzanine loan,** which could get the borrower to the maximum amount of leverage possible.
- **Get a bridge loan to pay off the existing loan,** because some bridge lenders offer as much as 90 percent LTV.

A loan extension may be an option for borrowers with LTVs between 80 percent and 100 percent who can prove that they have tried to get a new loan and been unable to — and believe that they will be able to pay off the loan if a few years are added to the loan term. Keep in mind that extensions of CMBS loans should be viewed as a last resort, however, as special servicers often charge a 1 percent fee for each year extended, and may require a paydown of as much as 10 percent for each year extended.

For borrowers with an LTV higher than 100 percent, there are a few options, although all are rather unpleasant:

- **Seek a discounted payoff of the loan.** The discounted payoff will likely be for the full market value of the property, so getting a new loan for the property will not provide sufficient proceeds to pay off the loan.
- **Pay off the loan out of pocket.**
- **Hand the property back via a deed in lieu of foreclosure,** because CMBS loans are nonrecourse.
- **Sell the property via a short sale,** if the special servicer allows it, which would avoid a deed in lieu foreclosure appearing on the borrower's record.

These are basic, generalized options. For mortgage originators and their clients to truly understand their specific options regarding an overleveraged CMBS maturity, they must consider all of the following factors: the special servicer's requirements, the controlling class certificate holder, the size of the loan and the future value of the property.

Inflexible maturity dates

A lesser-known fact about CMBS maturities is that the maturity date is critical. Many loans have an open period where the loan may be paid off with no penalty before the maturity date. The goal for borrowers is to hit that window perfectly: not a day before the open period starts and not a day after the maturity date. Otherwise, the borrower may be hit with large penalties.

To protect the bondholder's investment, CMBS loans have some type of prepayment mechanism incorporated into them. Typically, they include a yield-maintenance clause or defeasance. If there is a yield-maintenance clause, there will be much more flexibility on the payoff date, as long as the loan is paid off before the actual maturity date. In the worst-case scenario, borrowers who pay off the loan prior to the first day of the open period may also have to pay a few days of yield maintenance.

In the case of a defeasance clause, borrowers who want to pay off, say, a day before the open period date would be subject to the cost of defeasance — which may be substantial, even for one day, depending on the price of U.S. Treasurys and the loan's interest rate. Borrowers often mistakenly think they will have some flexibility on these dates, which is not the case.

The consequences of allowing the loan's maturity date to pass are even worse. Technically, the borrower may be liable for a late fee equal to 5 percent of the entire principal balance in some cases, and default interest will start accruing on the day after the maturity date. In this case, it is possible to seek forbearance for a short period of time so that the loan may be paid off within 30 days of maturity, but

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it must be officially requested and then approved, and there is no guarantee it will be.

The safest strategy is for borrowers to plan to pay off their loans between the open period noted in the loan document and their maturity date — not a day before or a day after. If the loan cannot be paid off in full, borrowers should seek the advice of a knowledgeable borrower advocate nearly a year ahead of the maturity date to fully understand all of their options and have time to act on them.

The overleveraged CMBS loans that were originated in the more optimistic, precrash years of 2005 to 2007 didn't just go away. Mortgage brokers should be aware that their clients affected by the CMBS originations from this period who aren't preparing for their impeding maturities risk painful financial consequences in the next few years. Don't be caught off guard — there's still time to prepare, but time is of the essence when it comes to the impending CMBS maturities. ■

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