

CATCH THE WAVE: TIMING IS KEY IN CMBS LOAN WORKOUTS

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During the next three years, a little more than \$1 trillion in commercial mortgages will be maturing. In and of itself, the sheer volume of this tidal wave of maturities will be a challenge for lenders to digest. More significantly, approximately one-third (~\$350 billion) of these mortgages are CMBS loans, the majority of which originated from 2005 through 2007. While memories can be somewhat short in our industry, most will agree that these CMBS loan vintages are arguably among the most aggressively structured and underwritten commercial mortgages currently outstanding. In general, while properties within primary markets may be positioned to obtain viable takeout financing, given today's stricter underwriting guidelines and lower values, many other assets will struggle to be refinanced. The extent to which they struggle is dependent on many factors not directly within a borrower's control. However, one very important aspect is firmly within the borrower's grasp. As in surfing, a key factor to successfully catching a wave is timing.

Currently, the CMBS delinquency rate is about 6%, comprising approximately \$31 billion in loans. This is down from the 2012 peak of 10.3% or about \$60 billion. However, while the amount of loans more than 30+ days past due has dropped steadily from 2012, it actually increased in two of the last four months. The upcoming 2015-2017 loan maturities, which comprise 2.5 times the amount that matured from 2012 to 2014, appear to already be taking their toll. Many property owners with overleveraged loans are finding it difficult to justify expending capital for lease-up costs or deferred maintenance or even for persistent monthly debt service shortfalls. Frankly, if there is little chance of refinancing their current loan in any economically reasonable fashion, making significant contributions to the property makes little sense, especially given the non-recourse nature of CMBS debt. While handing the servicer the keys is always an option, due to tax consequences, reputational concerns, etc., a modification of the current loan may yield much better results.

The first step to solving any problem is realizing that you have one. As it also turns out, the sooner you initiate conversations regarding a resolution, the higher the probability of successfully retaining the property. The Henley Group, a CMBS loan workout specialist, has tracked data on the \$1.5 billion in loan workouts that they have advised upon since 2009. Approximately two-thirds of the properties where the owner was either "proactive" or "active" in dealing with issues resulted in retaining the property. If the property had just defaulted, successes dropped to about 50%. If the servicer had started the foreclosure process with little to no borrower engagement, the probability dropped to less than 30%. Once the process was underway for some time, chances of success diminished further, to less than 10%. The below table illustrates this risk paradigm and how it relates to the upcoming loan maturities.

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The moral of the story is this: when it comes to dealing with the loan on your overleveraged property, procrastination can be the main difference between success and failure. The sooner you realize that there may be an issue and pick up the phone to explore your options with a capital markets advisor, the better the chance of riding the wave to a successful resolution.

THG'S CMBS RISK PARADIGM

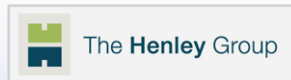


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