

CMBS Master and Special Servicing

CMBS loans have a complicated servicing structure with multiple parties and different responsibilities

- **Master servicer is responsible for administering performing loans**
 - Master servicer has limited ability to modify loans
 - Primary servicer, typically the originating mortgage banker may service performing loans and provide borrower customer service
- **Master servicer is responsible for transferring loans with credit issues to the special servicer**
 - 60 days delinquent or in default, including maturity
 - Borrower bankruptcy
 - Loans judged to be in imminent default
- **Special servicer is responsible for the management and resolution of delinquent, defaulted and credit impaired loans**

Special Servicer Process

- **Site Inspection**
- **Borrower Meeting**
- **Asset Business Plan**
 - Special Servicer prepares with analysis of resolution and disposition alternative
- **Valuation**
 - Appraisal requirement
 - Internal valuation based on market analysis and brokers price opinion
- **Controlling Classholder Rights**
 - Subordinate investor has the right to review and approve the asset business plan
 - Control rights can be wiped out by cumulative losses
 - Right to appoint and replace the Special Servicer
 - Conflicting Interests and Standard of Care
 - Special Servicer can override the Controlling Classholder to do what is in the best interests of the collective bondholders
- **Senior Investor Rights**
 - Senior CMBS investors have no review or approval rights
 - Realized losses accelerate return of principal; extensions increase duration

Special Servicer Alternatives

Significant flexibility in restructuring, modifying, extending or liquidating defaulted or credit impaired assets

- Accrue or change interest rates
- Reduce or defer principal
- Forbearance
- Extend maturity
- Release or substitute collateral
- Approve subordinate financing
- Accept discounted payoff
- Foreclose or accept deed in lieu of foreclosure
- Sell defaulted loans or REO properties
- Special Servicer restrictions:
 - Extending new credit or advance funds to borrower
 - Accepting an equity interest in the collateral

Analysis of Resolution Alternatives

The special servicer evaluates alternative resolution strategies based on maximizing net recovery on a present value basis

- The master and special servicer act in accordance with the servicing standard set forth in the CMBS transaction pooling and servicing agreement
- Analysis includes all income and sales proceeds, less all costs and expenses associated with resolution and disposition, discounted back to present value
- With current market conditions, property values and lack of financing, cash sales proceeds are deeply discounted
- Forbearance or extension with continued debt service payment and full payoff will typically yield higher net present value than foreclosure
- Property sale and discounted payoff may be viable alternatives

Is There a Universal Solution?

- Each asset is unique
 - Different properties
 - Different tenants
 - Different markets
 - Different borrower capabilities and circumstances
- The special servicer evaluates the resolution alternatives for each asset on an individual basis
- Borrower must demonstrate that they can be part of the solution and add value to the process

Borrower Must Be Part Of The Solution

- The borrower must demonstrate an ability to add value to the asset and ultimately payoff the loan
 - Asset and property management
 - Leasing
 - Recapitalization or refinance
- Financial capabilities to pay debt service and capital expenses
- Additional equity
- Additional collateral
- Personal guarantees

What can borrowers bring to the table

- Develop a plan to effectively manage the asset and payoff the loan
- Keep the loan current, or make partial payments
- Cooperate with the special servicer
- Be honest and forthright in communications
- Keep lawyers under control
- Financial considerations
 - Principal paydown
 - Reserves for debt service, escrows, tenant improvements, leasing commissions
- Pay reasonable fees to special servicer for asset management and modification

Recent Changes in REMIC Rules

Treasury recently modified the REMIC rules which govern the CMBS structure and affect modifications to CMBS loans

- **Changes permit special servicers to make significant modifications to loans based on a significant risk of default**
- **Changes do not affect:**
 - Borrowers obligations under the loan documents
 - Master and special servicers obligations under the pooling and servicing agreement
 - Change the master to special servicer transfer process
 - Permit modifications that are not in the best economic interest of the CMBS trust and its investors
- **Changes will have a very limited impact on existing CMBS transactions**