

# Loan Restructures in CMBS

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Whether you call them broken, impaired, troubled or the “everyone-gets-a-trophy” inspired “special,” there is no arguing the fact that the bursting of the CRE bubble has left billions of dollars of these loans in the portfolios of banks, life companies and CMBS Special Servicers. CRE professionals under the age of 40 are witnessing their first severe market correction, learning valuable lessons that turn the underwriting question “what if?” into the workout version: “what now?” Many of us who pulled tours through workout shops in the early ‘90s can and will draw upon the experience gained and lessons learned during that last period of peak stress in the CRE market, which will be applicable today.

There is no intention to rehash how we as an industry came to this place—the causes are well documented and there is enough “blame” to go around. Unfortunately the excesses of our industry cannot be undone with a group trip to rehab, a cathartic prime time interview, or an apology tour. We can’t throw a “containment dome” over the problem. All of these loans, many with staggering levels of negative equity, will need to be dealt with head-on at some point. The added complexity of navigating through the multi-layered process within the world of securitized loans, with their REMIC regulations and pooling and servicing agreement restrictions, creates a unique set

of challenges for borrowers facing workouts in this arena.

As a borrower undertakes the workout process, taking a measured and disciplined approach towards their negotiation with the lender is critical. The following are a few thoughts and guidelines for borrowers who are dealing with the prospect of starting the workout process for a CMBS loan, including a description of some of the key players and operative documents and requirements that govern the process:

## The Special Servicer

The Special Servicer is generally (but not always) affiliated with the controlling-class holder who bought the “B-piece” (or highest-risk component) of the securities backed by the pool of loans that includes your loan. The Special Servicer, and not the Master Servicer (typically the party to whom you have been making your payments) handles loan restructurings. These shops are run by seasoned workout veterans who have a single mission – maximize recovery.

## Advice to Borrowers

- It is important to understand that there isn’t really a “Lender” with whom to discuss your loan;
- Have a plan, don’t simply state the obvious. They already know you have a problem – they want to know how you are going to fix it;

- Do not suggest that you and the Special Servicer are “partners” - the Special Servicer is not interested in a relationship;
- Be prepared to bring something to the table – this is a two-way street known as “Shared Pain;”
- Do expect the Special Servicer to put the foreclosure process in motion (assuming the loan is in default) while modification discussions are ongoing – the “dual track” to ultimate resolution;
- Be forthcoming with property-level operating information – this is the worst possible time for “surprises;”
- Do not hold operating cash-flow “hostage” – the Special Servicers do not negotiate with “terrorists” (not to mention this act triggers a “bad boy” carve out/springing guaranty);
- Do not threaten to file bankruptcy (another “bad boy” act) – this is a sure way to derail the conversation (and relegate you to an eternal voice mail loop).

## The PSA and the Servicing Standard

CMBS servicers administer loans in accordance with Pooling and Servicing Agreements (“PSAs”), which generally standardize practices and procedures to meet REMIC (Real Estate Mortgage Investment Conduit) requirements

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Plumber. Not fancy orators or experts. People who can hold an audience the old fashioned way—by telling a story—one that resonates with truth, facts, and COMMON SENSE.

And interestingly, I think we have what it takes, right here and right now. A crisis like we're experiencing

now is typically the very type of crucible in which real leaders are forged. Are you that leader? Can you step up and be the voice of the industry? Can you rally the troops to battle? Can you organize the disorganized and inspire others to greatness? You are among us. You

are none of us, and you are each of us, in a way. Each of us will know you in an instant. You are reading these very words, right now. Step forward and lead.

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and to protect the tax-free status of the REMIC Trust in which your loan is held (meet your "Lender"). Does the borrower get a copy of this important document at closing? No. Can the borrower obtain the PSA? Maybe – but not from the servicer.

The Special Servicer also follows what is known as the "Servicing Standard" which essentially requires that they service loans for the benefit of all bondholders, giving "due consideration to the maximization of the recovery of the loan on a net present value basis, without regard to relations the servicer has with the borrower or bondholders." Again – "maximize recovery" and "without regard to relations with the borrower."

### Workout Strategies

Once the loan is transferred from the Master Servicer (a separate process; by virtue of an actual, imminent or "reasonably foreseeable" default), the Special Servicer has a fair amount of latitude to pursue multiple resolution strategies, as set forth in the PSA and pursuant to the Servicing Standard, including the following:

- Maturity extension/ forbearance of covenants.

- Interest rate/prepayment premium relief.
- Suspension of amortization (extension or implementation of "Interest Only" period).
- Recapitalization (new borrower equity) and subordination of a portion of senior debt (A/B Note).
- Debt forgiveness in connection with discounted pay-off ("DPO") or sale of Note.
- Foreclosure or deed-in-lieu.

As you can see, once the multiple onion layers of the various servicers, governing documents, standards and restrictions are peeled, these workout strategies look like many of the tools from a 1990's vintage workout belt. A couple of big differences – the REMIC Trust (your "Lender") cannot advance funds and cannot participate in upside ("we're not partners").

Many borrowers will attempt to take on a CMBS workout on their own, and oftentimes will have their attorney represent them in the first contact with the servicer. This tends to put the servicer on the defensive immediately. We are frequently consulted only after the borrower has reached an impasse with the Special Servicer, discussions have become

contentious or phone calls are not being returned, and/or the Special Servicer has elected to foreclose or sell the note. Obviously it is extremely challenging to resurrect a constructive dialogue or to improve upon the outcome from this point. Hiring an experienced and reputable third party debt advisor who understands the loan modification process and resolution framework, as well as the Special Servicer's objectives and limitations, greatly increases the probability of a more favorable outcome.



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