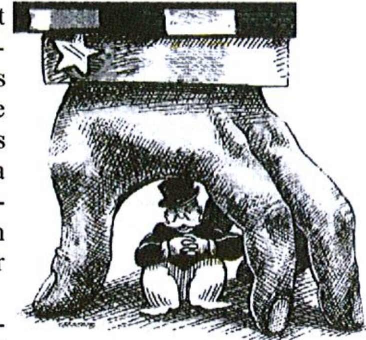
CALIFORNIA
REAL ESTATE JOURNAL
www.CARealEstateJournal.com September 28,2009

GUEST COLUMN

New CMBS Workout Rules Raise More Questions Than Answers

BY BRIAN S. WEINHART



On September 15, 2009, the Department of the treasury announced that it has released new tax rules that make it easier for owners of distressed property to restructure loans that have been securitized. At this point, there are still more questions than answers, but the key feature of the new Treasury rule is that the Treasury will now allow servicers of CMBS to (among other things) enter into modifications to extend the term of a securitized loan, even if that loan is currently performing and not in default. Previously, maturity date extensions could only be granted for loans that were in default or facing "eminent default" without creating adverse tax implications for the REMIC Trust that held the securitized loan.

The new rule is in response to tremendous pressure that the real estate industry has placed on the Treasury to respond to the illiquidity that plagues the capital markets. The harsh reality is that there are more than $150 billion of securitized loans that will mature between now and 2012, the vast majority of which — probably 80 percent or more — won't qualify for refinancing assuming a source is even available.

That is an astronomical volume of maturity default looming on the horizon. Presumably, this new rule will make it easier for borrowers to negotiate to extend their CMBS loans without having to wait until the loan has actually matured and is in default. Unfortunately, it is far from clear how this will work.

While the information still is sketchy, we would assume that the extension would have to be handled by the special servicer rather than the master servicer. Master servicers are not equipped or compensated to take on this responsibility. Assuming that the special servicer would be the party to handle the extension, the reality is that there are five special servicers in the United States that handle about 90 percent of the CMBS volume.

Those special servicers already are overwhelmed with huge volume of defaulted loans currently on their plates. One recent report placed an average of close to 40 defaulted loans on the desk of each of the special servicers' asset managers. Historically, 15 loans were considered a large load. How then are the special servicers going to cope with the tidal wave of requests for maturity date extensions that this new rule is sure to trigger?

The new rule also will place tremendous focus on the conflict of interest that special servicers currently face: the so called "tranche warfare." While special servicers are supposed to service their CMBS pools in the best interest of all of the bondholders, the reality is that the "interest" of each class of bondholder is radically different. The more senior bondholders have relatively little exposure to loss if a loan is not extended and the security (property) is liquidated (foreclosed).

Furthermore, the payoff date they bargained for did not contemplate extension. Presumably, those senior bondholders do not want the special servicers to grant the maturity date. Conversely, subordinate bondholders would likely welcome the peace of mind that would come with an early extension and relief from the otherwise foreseeable loss they will almost certainly face in the absence of an extension.

While the new rule, on its face, offers hope to borrowers it may well prove illusory. Until there is clarity as to how the special servicers will handle the increased volume of loan modification requests this rule is sure to create and until significantly divergent interests of senior and subordinate bondholders is reconciled, the new rules create more questions than answers for an industry already deep in turmoil.

Brian S. Weinhart *is a partner in the Los Angeles office of Steckbauer Weinhart Jaffe LLP and represents both borrowers and lenders in real estate and finance transactions*