THE STEVEN L. NEWMAN REAL ESTATE INSTITUTE

Discovering Distressed Assets

Whole Loan Workouts and Recapitalization Opportunities

A research report prepared for the Steven L. Newman Real Estate Institute, Baruch College, CUNY by contributing author Ben Polen, MBA, Executive in Residence, Steven L. Newman Real Estate Institute[1]

A simple fact has been obscured by the market changes wrought by securitization – many structured products are composed of real estate loans. Understanding how to analyze and access these underlying property loans can provide ample opportunity for investors in today's crowded marketplace.

Though it sounds like a mouthful, Commercial Mortgage Backed Securities (CMBS) refers to a straightforward idea – a portfolio of mortgages that are held in single legal entity. Under the CMBS structure, payments from the pool of loans are passed through as payments to investors. This distribution of payments from performing loans is managed by a "Master Servicer." When loans become delinquent, the management and decision making is delegated to a "Special Servicer" which is usually a different company than the Master Servicer. Special servicers are delegated with managing loan workouts, foreclosures, and sales. For distressed investors, working with a special servicer is key to a successful workout.

Investors with an appetite for property-level investing and lending now have the chance to recapitalize or acquire whole loans that have been packaged into securitization. During the credit boom when there was investor demand for so-called "structured products," financial engineers could slice the bonds into different tranches with different risk profiles and corresponding returns. As such, attention was focused on the financial engineering of "credit enhancement" rather than an analysis of the underlying real estate collateral. Now, credit is back with a vengeance. Knowing that CMBS is simply a packaging of commercial real estate loans can open an investor's eyes to a new universe of potential investments that others fail to see.

While this article will provide an introductory overview of research tactics, the strategic endgame should be that of a managed loan workout, with an investor approaching a borrower with a capital offer and restructuring plan. Investor and borrower can then jointly present a workout plan to a special servicer. The special servicer should be more receptive to this approach then to a solicitation for a sale to an opportunistic investor. Investors approaching special servicers looking for a quick distressed loan sale may be disappointed. Fiduciary responsibilities to obtain the highest price will generally dissuade a special servicer from any fire sale, and instead the special servicer is more inclined to manage the foreclosure process and take ownership of the property. This lender-owned property, or REO in real estate jargon, will then be put through an auction process to elicit a fair price, whereby the fiduciary can show they have met their responsibility. The opportunity in current times is to develop a strategic

1 Benjamin Polen, Baruch MBA 2008, holds a dual degree in Real Estate & Finance and Investments from Baruch College, Zicklin School of Business.

plan to recapitalize a borrower and create new value.

There is certainly a large universe of property-level distressed loans inside CMBS structures for asset-hunting. According to Realpoint Research, as of September 2010 there were $62.19 billion in delinquent CMBS loan balances, representing 4,477 loans. With a total outstanding CMBS issuance of $773 billion, these delinquent loans represent about 8.0% of all CMBS. Of the $62.19 billion in loans that are currently delinquent, about $7.32 billion were REO, or lender-owned assets, while another $14.5 billion are in foreclosure. Due to those conditions, it would be too late for a potential "white knight" suitor to approach with a recapitalization plan. However, the remaining $40.4 billion in delinquent loans are potential candidates for loan restructuring. Further, Realpoint projects delinquent CMBS balance to remain between $60 billion and $70 billion until 2011, so investors can expect the opportunity to continue. This could result in more than 9% of CMBS loans entering delinquency, according to Realpoint, the potential remains "under more heavily stressed scenarios involving additional large loan defaults." Retail and multifamily loans currently make up the bulk of distressed CMBS loans, with 1,168 multifamily loans totaling $15.4 billion and 1,365 retail loans totaling $14.3 billion in delinquent loans. There is also ample opportunity for hotel investors, as $9.5 billion in hotel loan balances, representing 438 loans, are currently delinquent.

Because CMBS is owned by numerous parties, there is detailed information on the underlying loans available to the public, known as CMBS surveillance data, or informally as "loan tape." Contrast this to the secrecy and lack of disclosure surrounding loans held on a private balance sheet (whether owned by bank or fund) and the democratization of CMBS data is very appealing. The available information includes the property address, loan term, rate, payment history, income, and debt service. Investors with an appetite for distressed assets and recapitalization opportunities can target specific property types, geographic regions, and loan balances by using this information. These parameters narrow a large potential pool of assets to a targeted selection. There are several information gatekeepers that hold the keys to this garden of information. Which company you choose to work with may depend on your organizational structure, budget and how comfortable an investor is working with the information. However, the ability to search, organize, and present information will differ depending on which service is used.

Subscribers to Bloomberg can use the service to lookup and search for delinquent CMBS loans. Since a Bloomberg subscription costs from $1,500 - $1,800 per month, this solution

Using Bloomberg to Locate Distressed Loan Leads:

1. If using a Bloomberg terminal, type LRP <GO> to screen for CMBS loan opportunities.

2. To narrow a search by property type, enter 95 <GO> or click on the "Property Types" option to access this option (Figure 1). In this example, only hotel properties are chosen. Click on the update button, and you will be back in the LRP screen. In this example, the search is narrowed to select loans that are 60 or more days delinquent, with a balance of $10 million and greater, located in Florida.

3. Enter 1 <GO> to run the search, and 24 matching loans are found (Figure 2).

4. This example selects the Carlton Hotel located in Miami Beach. Clicking on the property in the results list pulls up a set of tabbed data (Figure 3). In Bloomberg, this includes up to seven tabs: Loan Details, Property, Financials, Payment Information, User Notes. Some loans also include Watchlist Commentary and Delinquency commentary tabs, though this is not present on all loans.

5. You can export either search results, found in steps 2 and 3 above, or the property results in step 4 to Excel.

6. Bloomberg also offers a loan lookup function, accessed by entering LLKU <GO>. This function is useful for recalling data on specific loans. However, the results screen and data format for researching a list of loans are in a more usable format when using the LRP function.

Figure 1:

Property Type Selection on Bloomberg

Source: Bloomberg

Table 1:

Florida - Delinquent CMBS Loans

Property Type	Balance ($mm)	Loans	Percent of Total
Hotel	$1,035	72	20%
Industrial	$209	45	4%
Mixed Use	$174	14	3%
Multi Family	$1,498	161	30%
Office	$881	77	17%
Retail	$1,168	134	23%
Other	$85	5	2%
Total	**$5,049**	**508**	**100%**

is more appropriate if you were already paying for or had access to the service. Through the Subotnick Center, located in the ground floor of the Baruch Library, members of the Baruch community can use Bloomberg terminals to access CMBS loan surveillance data. (Please see sidebar for step-by-step instructions) Both search result data and property result data can be easily exported to Excel, which may be a useful intermediate step for data analysis. While Bloomberg offers excellent access to data and search function, the company's staff training and technical support is geared towards CMBS bond traders, not investors seeking loan workout opportunities. The service is really not designed to support investors hunting for individual loan deals, though it does provide useful access to the data for investors who may be comfortable doing some legwork themselves.

For a more user-friendly solution for accessing CMBS loan surveillance data, investors should look to Investcap Advisors. The company's web-based "Loan Advisor" platform is designed for real estate investors seeking distressed CMBS leads, with a layout and design similar to most software. Investcap also offers personalized services to work with investors seeking loan workout opportunities from CMBS loans. The company is headed by a team with a background in both credit analysis and CMBS structuring. Investcap believes the current wave of loan defaults presents opportunities for investors, and its platform is designed to target these investment opportunities.

Similar to Bloomberg, Investcap users can target a search by geographic region, property type, loan status, balance size and other parameters. Loan level and property reports are also available on Investcap. In this example, the Radisson Resort in Kissimmee, FL is selected. According to the report, the loan has a balloon payment of $24.8 million due that the borrower has been unable to repay or successfully refinance. Under the property tab, an updated property valuation from December 2009 reports the property is only worth $14.4 million. The hotel's occupancy has dropped from 77% in 2007 to 59% for the most recent data from the first quarter of 2009. While most observers would agree that general economic conditions have improved since then, it would be difficult to argue that the property value is greater than the balance of the loan.

This difficult situation presents a scenario ripe for deal making, at least for those with the right mindset. "The recapitalization process allows new capital to flow into the deal and create an equity shift by negotiating with the current owner/sponsor," Investcap Advisors Managing Director Scott Barrie said. The ability to move quickly also helps. "If recapitalization strategies can be negotiated early in the delinquency phase it creates a better opportunity for Special Servicers to response and increase the chances for a positive outcome," Barrie added. An investor armed with the information provided by CMBS loan surveillance can perform their own financial analysis before approaching the borrower or special servicer, creating a position of strength in negotiations.

The Delinquency Commentary tabs can also provide interesting and useful information. The information in this tab typically takes the form of a brief narrative describing the current status of the property and what actions have been taken by the special servicer and borrower. This kind of "qualitative" research is extremely useful for an investor to understand a property beyond numbers in a spreadsheet. It may describe if the borrower has presented a workout plan or hardship letter, if any payments are being made, or other circumstances unique to the property. A quick review of the Delinquency Commentary notes is helpful when deciding whether to invest more time and energy researching the loan and property. In some cases, a useful description will help a comprehensive reader determine whether or not a deal is worth pursuing and the mindset of the Special Servicer.

A property in Melville, Long Island, shows that one delinquent loan's epic narrative can reflect the entire real estate industry's rough seas. The building, at 538 Broadhollow Road in Melville, NY was previously the headquarters of American Home Mortgage Investment, a residential mortgage lender that filed for Chapter 11 bankruptcy in 2007. According to the Delinquency Commentary contained in the loan tape information, "The principal was a major

Figure 2:

Loan Search Results on Bloomberg

<HELP> for explanation. Index LRP

23 loan(s) found, 1<GO> to run search, #<GO> for details

Delinquent (60D+) Loans | 95) Property Types | 96) Options | Page 1/2 CMBS Loan Reports

Loan | Originator | Curr Bal 10 Mln - No Max

Deal | Origination mm / yyyy | City | State FL | Rgn All

Loan	Deal	Property Type	Loan Status	Mth Late	Bankrupt	Bkrpt. Dt
2) Best Western - Cl...	LBUBS 2008-C1	Hotel Full	In Foreclos...	10	Yes	10/08/2009
3) Best Western Fort...	BACM 2007-2	Hotel Ltd	Special	8	No	
4) Carlton Hotel - S...	JPMCC 2007-CB19	Hotel Ltd	Special	6	No	
5) ChampionsGate H...	BACM 2007-3	Hotel Full	Special	2	No	
6) Crowne Plaza Sa...	JPMCC 2006-LDP7	Hotel Full	Special	8	No	
7) Crowne Plaza Ta...	GECMC 2005-C4	Hotel Full	Special	8	No	
8) Estes - Best West...	MLMI 1996-C2	Hotel Ltd	Special	16	Yes	04/30/2009
9) Hawthorn Suites-...	BACM 2008-1	Hotel Ltd	In Foreclos...	4	No	
10) Hilton Garden Inn...	JPMCC 2006-LDP6	Hotel Ltd	In Foreclos...	6	No	
11) Hilton Rialto Plac...	CSMC 2006-C1	Hotel Full	Special	9	No	
12) Hotel Royal Plaza	CSFB 2001-FL2A	Hotel Full	REO	60	No	
13) Moody Florida One	CD 2007-CD4	Hotel Ltd	Special	9	No	
14) Ormond Beach Po...	JPMCC 2007-LDPX	Hotel Ltd	Special	19	Yes	09/12/2008
15) Palm Beach Garde...	BACM 2007-2	Hotel Full	Special	7	No	
16) Palm Plaza	GCCFC 2006-GG7	Hotel Ltd	REO	19	Yes	09/12/2008
17) Radisson Resort ...	BALL 2005-MIB1	Hotel Full	Matured No...	8	No	
18) Rocky Point Hotel...	LBUBS 2006-C3	Hotel Full	Special	9	No	
19) Royal Palm	CSFB 2005-CNDA	Hotel Full	In Foreclos...	30	No	

Australia 61 2 9777 8600 Brazil 5511 3048 4500 Europe 44 20 7330 7500 Germany 49 69 9204 1210 Hong Kong 852 2977 6000
Japan 81 3 3201 8900 Singapore 65 6212 1000 U.S. 1 212 318 2000 Copyright 2010 Bloomberg Finance L.P.
H428-954-0 16-Mar-10 20:59:30

Source: Bloomberg

Figure 3:

Carlton Hotel, South Beach, Loan Details on Bloomberg

<HELP> for explanation. EquityLRP

<MENU> return to List

96) Cashflows | 97) Options | JPMCC 2007-CB19 | CMBS Loan Description

Carlton Hotel - South Beach | Tape Dt 04/12/2010 | Currency USD

Asset Information		Payment Terms		Trustee Reported Information			
Loan ID	77	Amort Type	IO	Status	Del 90+ ss	Reserve Bal	15,067
Trustee ID	140205733	Calendar	USD	Date	11/2009	Actual Bal	13,000,000
Orig Bal	13,000,000	Coupon	6.25%	Months Late	6	Totl P&I Adv	426,322
Cutoff Tr Bal	13,000,000	Amort	0	PP/Liq'd	-	Non-Recoverability	No
Curr Bal	13,000,000	DayCount	Act 360	PP/Liq'd Dt	-	ASER	50,619
Trust Bal	13,000,000	Payment	-	Is Bankrupt	No	Recent ASER	17,435
Trust % of Deal	0.40%	Admin Fees	2.060b	Is Watchlist	No	ARA	3,250,000
Loan Age (mos)	36	Cap	-	Last SS Dt	11/2009	ARA Date	02/2010
Loan Cpn Type	Fixed	Floor	-			Workout	Other or TBd
Crossed Loans	No	Next Index	-				
Lockbox	-	ARD	-				
Loan Purpose	Refinance	Due Date	06/01/2012				
Lien Position	First Lien						
Ownshp Int	Fee Simple			Related Parties Information			
Escrow	-			Originator	CIBC	Orig Date	05/2007
Initial Reserves	-			Sponsor	-	Borrower	-
Target Bond	A2			Mstr Svcr	Wells Fargo Bank		7) View Contact
Rem. Protection	D(1), O(25)			Sp Svcr	LNR Partners		8) View Contact

Termination Information

Date	Amount	Liq. Expense	Proceeds	Loss
-	-	-	-	-

21) Loan Details | 22) Property | 23) Financials | 24) Payment Info | 25) User Notes

Australia 61 2 9777 8600 Brazil 5511 3048 4500 Europe 44 20 7330 7500 Germany 49 69 9204 1210 Hong Kong 852 2977 6000
Japan 81 3 3201 8900 Singapore 65 6212 1000 U.S. 1 212 318 2000 Copyright 2010 Bloomberg Finance L.P.
H428-954-0 16-Mar-10 20:39:05

Source: Bloomberg

tenant at the property occupying 95% of the space but is now in liquidation & property is physically only 5% occupied." Try as they might, the special servicers were unable to harpoon a buyer for the property, and not just one, but three prospective purchasers passed on the deal, according to the notes in the Delinquency Commentary. The Special Servicer "allowed borrower to engage broker & attempt to sell the collateral but 3 purchasers walked away." With a property sale out of the picture, a lease-up is the next best alternative. "Lender agreed to stay further action if borrower engaged a property manager, leasing/sale broker acceptable to the lender in an attempt to keep the debt alive for a possible assumption/modification transaction," the report reads. "Te new property manager/broker is in place. Primary goal is for property manager to attempt to lease up the building to increase value & borrower cooperates if a satisfactory buyer is found."

Another hurdle is determining a way to identify and contact the borrower. Investcap's platform includes contact information for about one-third of deals, Barrie said. For a motivated investor, additional manual research may be required. This could include looking up recorded real estate documents, identifying company and borrower names, and cross-checking this with registered corporation information at the state government. Of course, a targeted Internet search may also yield useful results. In the event that these methods do not yield results, it may be necessary to visit the subject and look at posted public information such as elevator inspection records. While researching the property, an investor should perform a search for UCC filings, judgments, liens and mechanic liens. It also makes sense to conduct the same searches for principals of the borrower or loan guarantors. These public records can help an investor develop a thorough picture of the situation and prepare for negotiations. All this homework and due diligence will reward the interpid investor and allow one to move fast – the best thing an investor can do is know the opportunity ahead of time.

While investigating the loan and property, it is important to ask about and be aware of potential junior lenders that may push for a seat at the negotiating table or the ability to control a workout. In the case of mezzanine lenders who control an equity pledge of the borrower, there may be limited public and recorded information documenting their participation. So investors should be prepared to ask the borrower questions about junior lenders early on in the process to manage everyone's expectations.

Attracting the borrower's attention requires more than just the prospect of funds. While the ability to inject capital into a project is appealing, a borrower may be wary of an opportunistic investor attempting to seize control. To appeal to the borrower, an investor should highlight their expertise in the property type and their knowledge of realistic market conditions. Willingness to present creative solutions may also appear to a sponsor looking to protect its position. These solutions may or may not include permitting the borrower to continue to manage the property, a pledge of additional collateral, or other advice and assistance that an investor can offer.

Table 2:

New York City - Delinquent CMBS Loans

Property Type	Balance ($mm)	Loans	Percent of Total
Hotel	$252	6	5%
Industrial	$116	8	2%
Mixed Use	$26	9	1%
Multi Family	$4,070	43	83%
Office	$360	7	7%
Retail	$87	9	2%
Other	$4	2	0%
Total	**$4,915**	**84**	**100%**

Includes Stuyvesant Town/Peter Cooper Village

Figure 4:

Carlton Hotel Property Information on Bloomberg

Source: Bloomberg

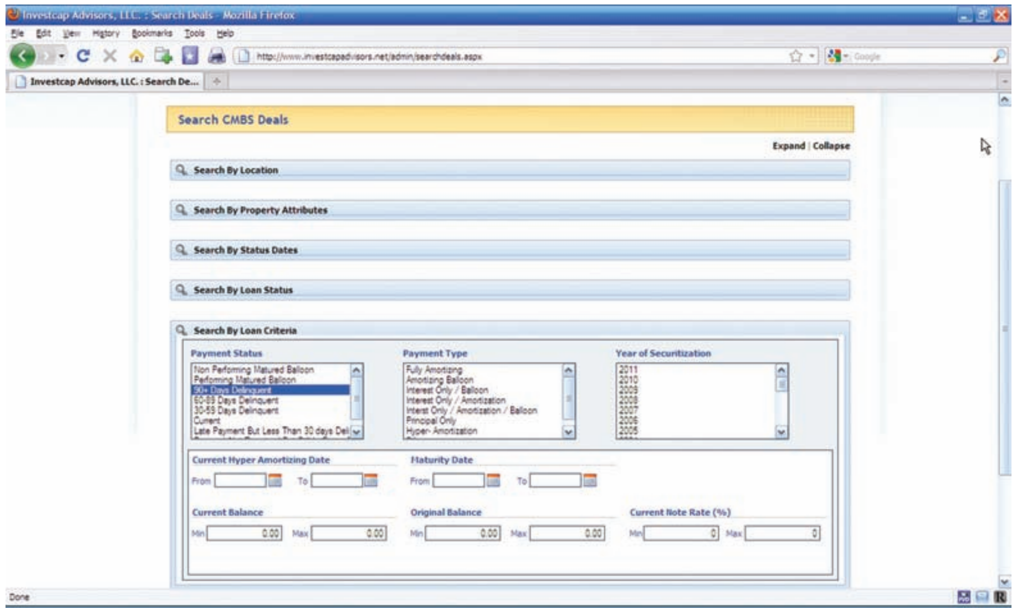
With the relative stabilization and nascent rebirth of the credit market (compared to the past two years), the market is nearing the end of the "amend, extend and pretend" period. As such, lenders and special servicers may now be more willing to materially restructure loans. This would allow borrowers and investors to negotiate new terms reflective of current conditions.

Once a loan and property have been identified, the next step would be to approach the borrower with a recapitalization proposal. For example, in the case of the Carlton Hotel in Miami Beach, the outstanding loan amount of $13 million is subject to a 6.25% interest-only loan, with an annual debt service of $812,500. Generally, a stable, performing loan would have a debt service coverage ratio (DSCR) (annual debt service/net operating income) at a minimum of 1.3x or greater. By applying this metric, it is possible to see just how distressed this property is. The most recent annualized data shows a net operating income (NOI) of $626,000, resulting in a DSCR of 0.77. By contrast, in 2008 the property yielded a net cash flow of $1.45 million, for a DSCR of 1.78x. So it is obvious that something is not going according to plan. However, this distressed situation may be due in greater part to the overall economy and over-leveraging of the property, rather than to property-specific issues. Ultimately, it is up to the investor to perform due diligence and research the property, market and other conditions and assess whether there is value to be salvaged.

Another approach would be to work in conjunction with the borrower to negotiate a write down of the loan balance by the special servicer to a level more appropriate for the property's current cash flow. An investor and

Figure 5:

Investcap Advisors sample screen shot



Source: Investcap Advisors, LLC

borrower could also offer to buy out the note at a discount from the special servicer. The investor would provide the capital for the deal while perhaps allowing the borrower to continue to manage the property. An investor may be willing to make up the difference between the current income and the interest payments on the property in exchange for an equity stake in the property. The investor's equity stake could also have a "preferred return" attached to it, which in the absence of cash flow, could accrue new equity in the property instead. An investor could contribute new capital to be used for capital expenditures and improvements in the property, marketing and leasing, or other repositioning of the property.

Piecing together the property's picture will influence what an investor will want to offer and ask for. Beyond a financial contribution, there may be advice and assistance that an investor could provide. The distressed scenario presents several possible workout strategies, depending on the attitude and positioning of both the borrower and the special servicer. An intrepid investor might be willing to approach the borrower and offer to make loan payments in exchange for an equity interest in the property and a preferred return, based on the investment hypothesis that the current downturn is temporary and good times will arrive again.

For example, imagine a hypothetical office or mixed-use office/retail building with a $10,000,000, interest-only loan that has an annual debt service of $900,000. The property may have been underwritten with a top-of-the-market value of $15.4 million, with a loan-to-value ratio of 65%, an in-place NOI of $1.3 million and a DSCR of 1.45x. The tenants might have included large national retailers, banks or other businesses that were considered excellent credit risks just a few years ago. However, with some of these companies now bankrupt or out of business, or not renewing leases, vacancy in the property may be at 40% with a current DSCR of 0.80. The $10 million interest only mortgage has balloon payment that is now three months past due. Originally, the borrower had planned to renovate and upgrade the property and sell it at a greater price, or as a last resort obtain new bridge funding. With that option no longer available, and the property bleeding cash, a new investor might offer to pay down the balloon payment due in exchange for a large equity stake. Of course, it is in the self-interest of an investor to make the balloon payment and avoid foreclosure.

In exchange for this large equity contribution, the new investor may demand a substantial stake in the property. An investor may want to offer to take out the existing lender and establish itself as the first lien holder. Even in this scenario, the borrower benefits in several ways. First and foremost, the borrower is no longer responsible for a $10 million payment, which it could not afford. Further, the borrower avoids foreclosure and potentially detrimental litigation. Principals of the borrower may protect themselves in the instance of potential personal guarantees. Finally, the borrower may retain hope, and maybe able to negotiate a second equity position after the investor's return has met certain hurdles. This would allow the borrower the possibility of recouping a portion of its equity, and permit the retention of optimism.

In the examples mentioned thus far, it has been assumed that the loans represent a small portion of the overall CMBS portfolio. When this is the case, bondholders are unlikely to object to the special servicer's decision making

Investors seeking to reap the rewards of a dislocated market can benefit from the ideas presented in this article by accessing underutilized new sources for distressed loan investment opportunities. The tactics outlined

Stuyvesant Town/Peter Cooper Village Distress Ignites Opportunistic Debt Plays

In two high profile maneuvers, activist investors have attempted to impose their will on special servicers and control loan workouts. In separate endeavors, two different hedge funds – Appaloosa Management, managed by David Tepper, and William Ackman's Pershing Square Capital (in a joint venture with Michael Ashner's Winthrop Realty Trust)— attempted to gain control of Stuyvesant Town/ Peter Cooper Village by pursuing opportunistic distressed debt strategies. The execution of each strategy was ultimately dependent on court rulings. One large, distressed deal forced the courts to clarify the rights and influence of bondholders on special servicers in a loan workout.

The problems surrounding Stuyvesant Town/Peter Cooper Village have been covered extensively throughout the real estate, financial, and New York media. The acquisition of Stuyvesant Town/Peter Cooper Village, with a total deal capitalization of $5.4 billion, was partially funded by $3 billion in senior mortgages securitized into five different CMBS deals. The Stuyvesant Town/Peter Cooper Village loans represent more than 18% of two of the CMBS deals, and more than 10% of another CMBS deal.

When a single property loan comprises a significant portion of a CMBS deal it can have an outsized effect on returns to bondholders. Generally, individual property loans make up only a small portion of a CMBS portfolio, with an average loan representing no more than 1% to 2% of the total CMBS deal size. Even the occasional larger balance loan will usually top out at no more than 5% of a deal. Individual loan workouts usually have a minimal impact on CMBS. This allows a special servicer to manage a loan workout, foreclosure, or sale without additional distraction or pressure from bondholders who are unlikely to be materially affected by a single, relatively small workout to spend the time and money to object.

In the spring of 2010, Appaloosa Management attempted to gain control of Stuyvesant Town/Peter Cooper Village by purchasing $750 million of the $3 billion CMBS. The hedge fund then litigated to block a planned foreclosure by special servicer CWCapital. Appaloosa argued that its 30% debt ownership gave it the power to control the loan workout. As CWCapital commenced a foreclosure action in court, Appaloosa objected to the foreclosure plan, claiming that up to $200 million in expenses, including New York mortgage recording tax and real estate transfer tax, would be unnecessarily forced onto bondholders. Instead, Appaloosa suggested forcing the project into bankruptcy, where the loan could be restructured without the same expenses. This was one of the few times that the CMBS special servicer structure and fiduciary responsibilities have been challenged in a significant way. The judge ultimately disagreed with Appaloosa's contention that it should be allowed to join into the case, preventing Appaloosa from halting the foreclosure.

After Appaloosa was shot down in court, Pershing Square Capital, in a joint venture with Winthrop Realty Trust, purchased privately-held mezzanine debt on Stuyvesant Town/Peter Cooper Village in an attempt to gain control of the property. This mezzanine debt is subordinated, or junior position, to the senior CMBS debt traded on Stuyvesant Town/Peter Cooper Village. Pershing and Winthrop reportedly paid $45 million for $300 million of senior mezzanine debt. (In contrast to mortgage debt, which is secured by property, mezzanine debt is secured by the equity interest in the company that owns the property.)

Having acquired this mezzanine debt, Pershing took its case to court, arguing it should be allowed to control the property through a foreclosure on the mezzanine debt, thereby giving it effective control of the legal entity. The court rejected this argument, ruling that Pershing would have to pay off the senior mortgage in full to control the property, an investment Pershing was unwilling to make. Despite the bruised egos, Pershing and Winthrop were able to walk away from this fight with nary a scratch. The two parties recouped their $45 million investment outlay when CWCapital agreed to purchase the mezzanine debt for what they had originally paid for it. By doing so, CWCapital removed risk, delays and uncertainty that would surround a potential legal appeal by Pershing.

In the future, CMBS originators and servicers might discuss strategies to mitigate this kind of litigation risk and avoid unexpected situations. Given the complications and delays that arose in this instance, should future CMBS deals restrict the ability of owners to obtain mezzanine financing? Limiting mezzanine debt may also mitigate the "frothiness" of real estate deals.

Perhaps parties could agree that limiting the exposure of a single property to no more than 5% of a CMBS deal provides enough diversification and protection for investors. This would also have the effect of making it difficult for an activist investor to control a workout by purchasing CMBS bonds.

On the other hand, it was the outsized exposure to Stuyvesant Town/Peter Cooper Village that motivated these funds to purchase the distressed CMBS bonds. For every buyer, there is a seller, and Appaloosa's purchases provided liquidity at a time many feared financial markets were freezing up. Rather than limiting the exposure of a single loan to CMBS bonds, greater exposure to a single loan may make CMBS prices more liquid and transparent. Witness the reboot of CMBS in 2010 which has shown the current market appetite for single-asset and single-borrower deals. From a credit perspective, CMBS investors have appreciated the underwriting transparency.

Disproportionately large deals may also improve the price performance of CMBS trading. For example, imagine an equally underperforming CMBS portfolio, but instead of one large deal comprising 18%, there are twenty underperforming loans. Does an activist investor have the ability and resources not only to analyze twenty separate deals, but also to then file legal objections and litigate across twenty different loans? That scenario is less likely. Bondholders of such a deal would be less likely to attract activist co-investors who would be willing to provide liquidity in distressed scenarios.

It will also be interesting to determine a threshold of significance for CMBS bondholders to get a seat at the workout table. Would a bondholder (or consortium) need to own 51% of a CMBS issuance to convince a court or regulators that it would be materially impacted? 70%? Even if an investor owned 51% of a CMBS issuance, how significant would the impact from one loan loss be if it the loan is only 5% of the CMBS issuance?

Perhaps bondholders will communicate with each other and work together to present alternative workout plans. Bondholders could also engage third party consultants to analyze the impact of a workout proposal on their own position and monitor special servicers. At present, it seems unlikely that this effort is worth it for many smaller projects. There may be a value to activist investing within the CMBS market. When firms that specialize in activist equity and bankruptcy investing succeed, their actions benefit passive investors in the same class, who also reap the higher returns. The ease of trading CMBS may be a true salve for liquidity and risk transference and the presence of large deals to prompt activists offer a reward for all investor classes.

in this article are intended to provide general ideas about how an investor can access, research, and ultimately utilize CMBS loan tape data to present creative workout solutions to distressed borrowers and special servicers. Real estate is famously populated by creative, optimistic individuals who will have their own thoughts and experiences. The workout ideas presented in this article are intended as starting points and many will have their own ideas, thoughts, and experiences that shape the decision making process. Whether hunting for distressed assets, managing a loan workout, or monitoring a CMBS portfolio, the techniques described in this article can be applied by a real estate finance practitioner to maximize access to useful information and insights waiting to be discovered. ■

This research report is published by the Steven L. Newman Real Estate Institute, Baruch College, CUNY.

The Newman Real Estate Institute gratefully acknowledges the support of the sponsors who make possible our efforts to promote critical thinking on topical issues for the real estate industry.

Please address inquiries to Jack S. Nyman, Director, at:

THE STEVEN L. NEWMAN REAL ESTATE INSTITUTE

Baruch College, CUNY
137 East 22nd Street
Box C-0120
New York, NY 10010

Tel: 646.660.6950 • Fax: 646.660.6951
www.baruch.cuny.edu/realestate