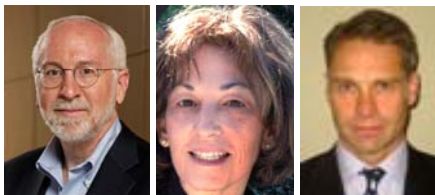


# The Challenge of Restructuring Securitized Commercial Loans

December 11, 2008



**Tom Muller**  
**Ellen Marshall**  
**Bill Whalen**

## Speakers



**Tom Muller, Manatt, Phelps & Phillips, LLP, Partner in the Real Estate and Land Use Group**

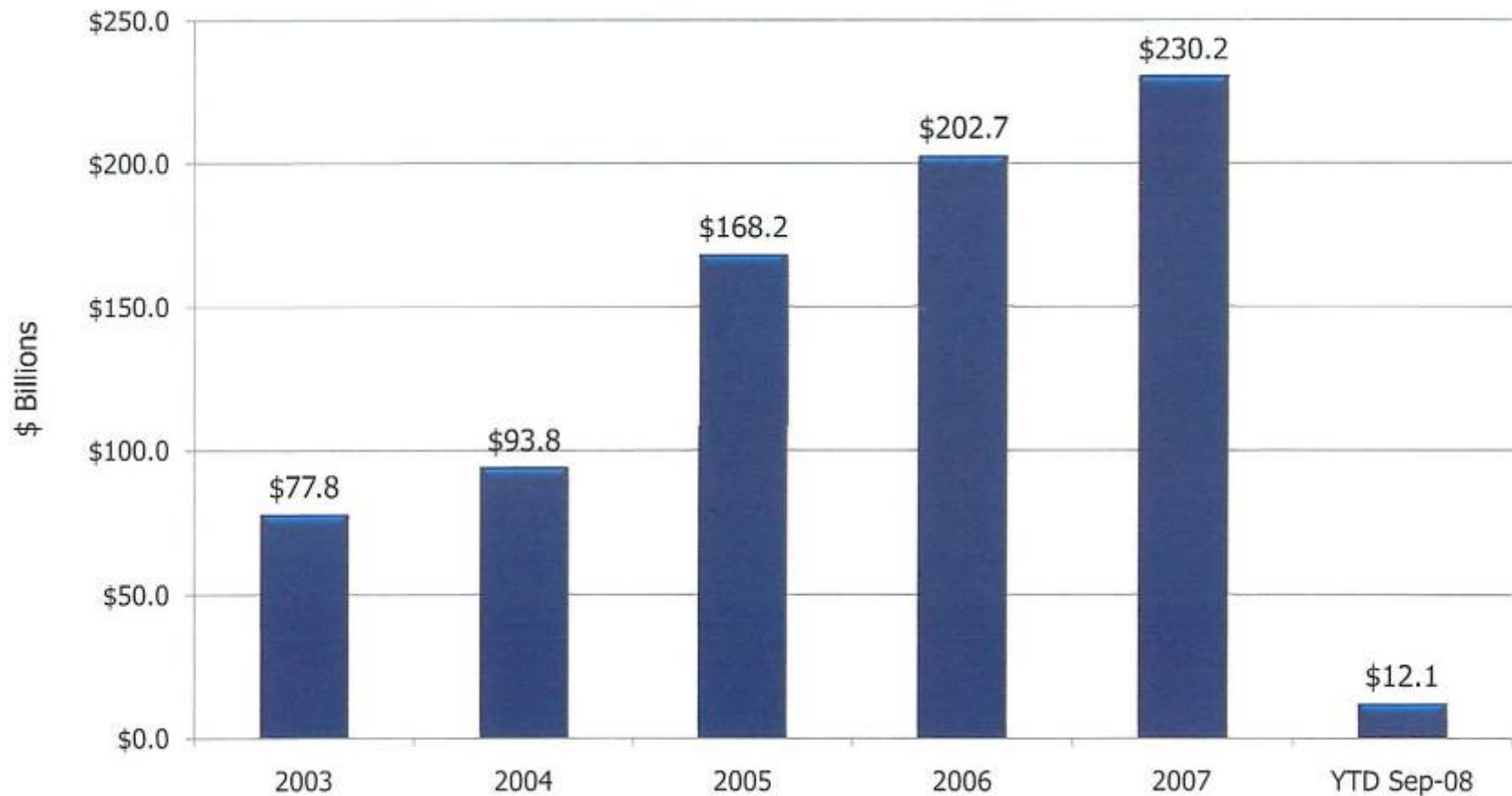


**Ellen Marshall, Partner, Manatt, Phelps & Phillips, LLP, Co-Chair of the Banking and Financial Industry Group**



**Bill Whalen, Wachovia Securities, Managing Director**

# US CMBS Originations



Source: Commercial Mortgage Alert



# CMBS Delinquencies Increase

**Monthly Delinquency Report - Commentary**

Through September 2008, the delinquent unpaid balance for CMBS increased by a substantial \$ billion, to a trailing 12-month high of \$4.84 billion. Overall, nine of the past twelve months of reflected an increase in delinquent unpaid balance, which is up 47% from January of this year billion), and now more than double the six-year low of \$2.21 billion in March.

**Commercial Real Estate Writedowns by Major Lenders**

Lender	12/07	3/08	6/08	9/08	Change 12/07-9/08 (\$Bil.)	Change (%)
Letson Brothers	\$38.9	\$36.1	\$29.4	\$24.0	-\$14.9	-38.3
Credit Suisse	22.9	19.5	15.0	14.7	-11.5	-50.0
Rear Stearns	15.2	7.6	15.0	14.7	-1.9	-11.6
Wachovia	7.6	15.0	14.7	14.7	-6.9	-91.4
Deutsche Bank	25.1	3.0	15.0	14.7	-11.9	-47.4
Citigroup	7.6	15.0	14.7	14.7	-6.9	-29.0
Merrill Lynch	25.1	3.0	15.0	14.7	-5.2	-28.8

**Special Servicer Warns Of Coming "Tsunami"**

A major special servicer sees the current uptick in troubled loans morphing into a potential "tsunami" of troubled loans. "By the end of next year, we servicing portfolio is," he said, and predicted a doubling of handled by his firm in the coming year. "The potential to

The servicer does not expect the growing troubles to a Savings & Loan Crisis of the late 1980s and early 199 (the Savings & Loan Crisis) is real," he added. Special \$8.3 billion, a little under 1% of CMBS, according to r

The increase will be driven in part by large balance l loans and they'll fill the scales," the servicer said. "I He foresees trouble in the retail sector, particularly spire will also lead to higher delinquencies, he sa pro forma underwriting.

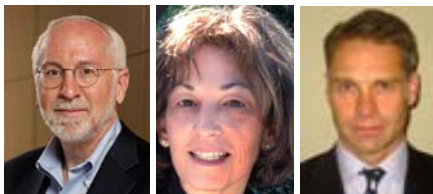
Another special servicer, **Stacey Berger**, axecut problems cropping up for smaller, older multifam properties is that with the excess housing suppli borrowers on smaller properties are generally h Berger said. He noted that highly leveraged, re

As defaults become more common, it may h borrowers. "A lot of guys will default because said, adding that borrowers will instead opt y post-9/11 period, noted Berger. "With centri borrower," Berger said.

**Fitch Downgrades GSMSC 2007-GG10; Assigns Outlooks**

NEW YORK, Oct 29, 2008 (BUSINESS WIRE) -- Fitch Ratings downgrades and assigns Outlooks to GS Mortgage Securities Corporation II, series 2007-GG10 as follows:

- \$84.5 million class J to BBB- from BBB; Outlook Negative;
- \$75.6 million class K to BB+ from BBB; Outlook Negative;
- \$37.8 million class L to BB- from BB+; Outlook Negative;
- \$18.9 million class M to BB- from BB; Outlook Negative;
- \$20.4 million class N to BB- from BB; Outlook Negative;
- \$18.8 million class O to BB-



# Commercial Mortgage-Backed Security (CMBS) Transaction

## Obtain assets into the warehouse

- Loan Processes
  - § Sourcing
  - § Underwriting
  - § Funding
  - § Hedging

## Controls/Risk Management

- Preliminarily determine loan eligibility for inclusion in the securitization
- Due diligence (e.g. site inspections)
- Credit approval (1146 process)
- Manage market risk on hedge

## Create CMBS Securities

- Structure bonds based on rating agency methodology
- Present to Rating Agencies to obtain bond ratings
- Coordinate third party and legal engagements

## Controls/Risk Management

- Rating Agencies
- Well defined policies and procedures (see key metrics page)
- Transaction Review Template

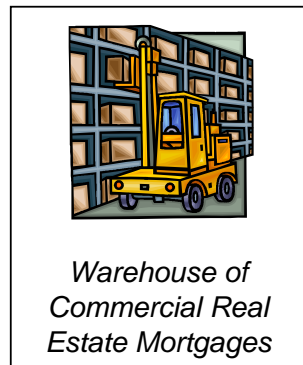
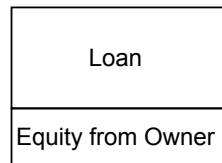
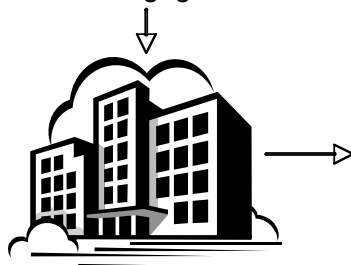
## Distribute Securities

- Manage Syndicate distribution
- Investor Roadshows
- Sales/Inquiring with clients

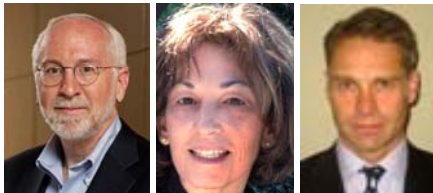
## Controls/Risk Management

- Commitments Committee
- Know Your Customer (KYC) processes to ensure suitability

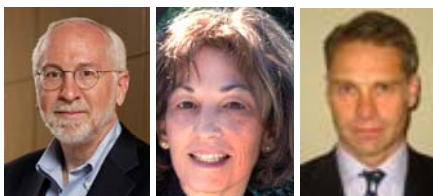
Commercial Real Estate Mortgages



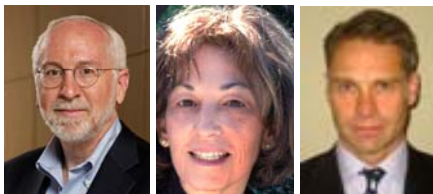
AAA	→	Pension Funds and Money Managers
AA	→	Banks, Broker Dealers
A	→	Banks & Insurance Companies
BB	→	Insurance Companies
Not Rated	→	Sophisticated Investors



# Who's Your Banker Now?



# Master Servicers



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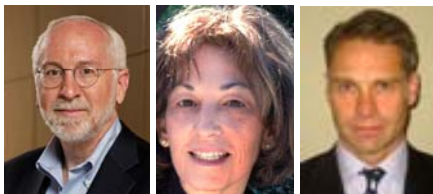
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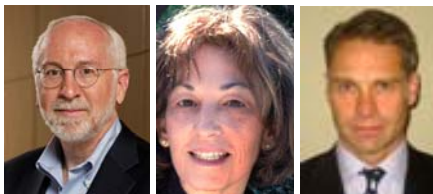
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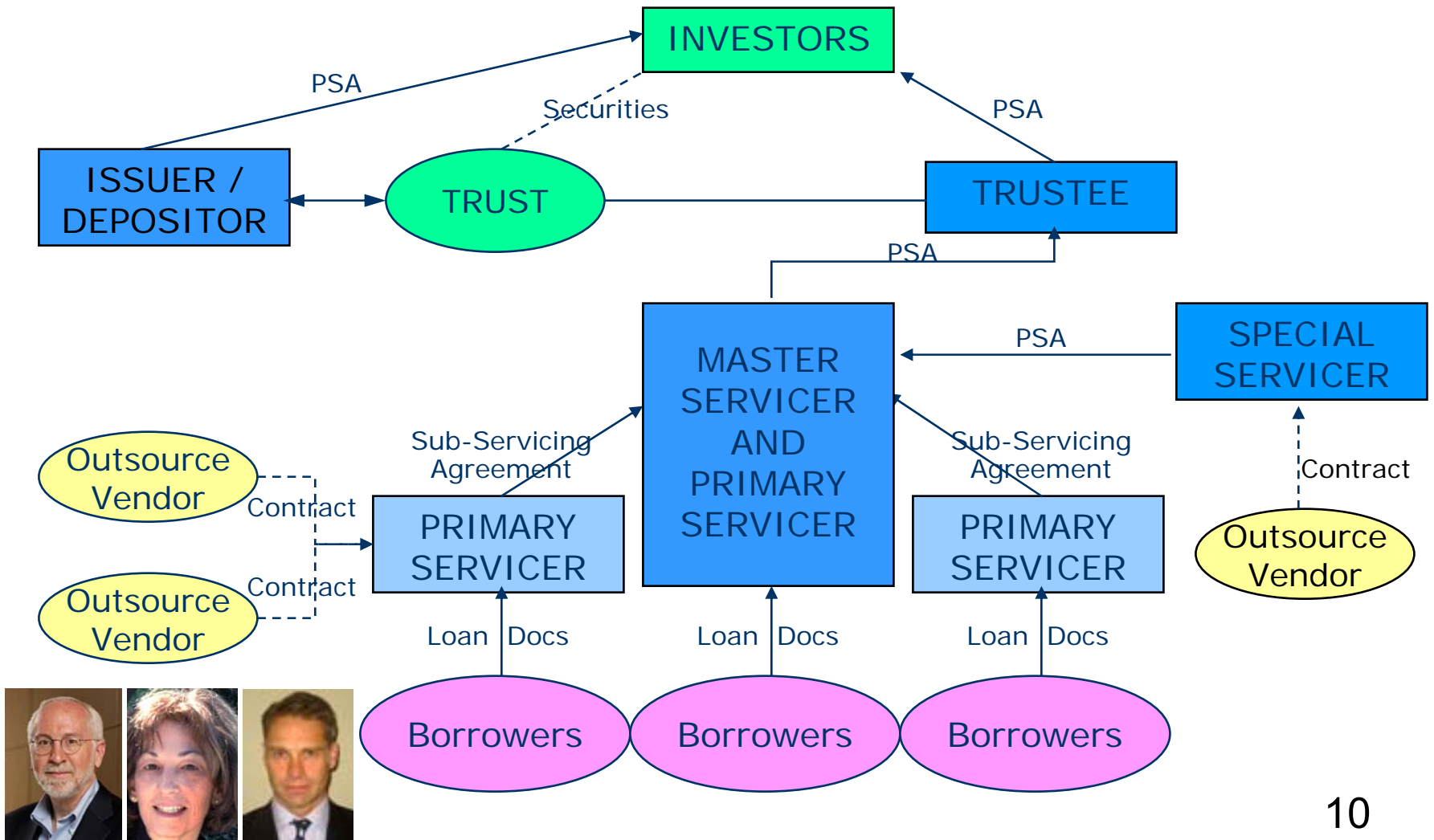
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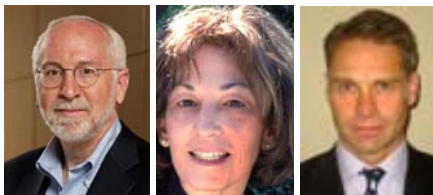
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# Securitization Structure



# First-loss position



# First-Loss Position

## Buyers of US CMBS B-Pieces in 2007

--12/31/2007

Figures represent total size of deals

		2007 Issuance (\$Mil.)	No. of Deals	Market Share (%)	2006 Issuance (\$Mil.)	No. of Deals	Market Share (%)	'06-'07 Change (%)
1	Centerline	\$45,989.1	18	25.8	\$16,805.0	9	10.4	173.7
2	LNR Partners	29,069.6	8	16.3	38,195.1	14	23.6	-23.9
3	American Capital Strategies	27,404.9	7	15.4	23,481.8	9	14.5	16.7
4	Anthracite Capital	19,679.1	7	11.0	10,504.3	5	6.5	87.3
5	CWCapital	16,756.8	4	9.4	16,301.4	6	10.1	2.8
6	J.E. Robert Cos.	10,253.8	3	5.7	17,866.4	7	11.0	-42.6
7	Presidio Investments	8,693.3	4	4.9	0.0	0	0.0	
8	Hyperion Brookfield	6,073.7	2	3.4	16,253.7	5	10.0	-62.6
9	ING Clarion	5,379.0	2	3.0	6,326.0	2	3.9	-15.0
10	Redwood Trust	3,554.4	1	2.0	13,277.3	4	8.2	-73.2
11	Five Mile Capital	2,978.9	1	1.7	0.0	0	0.0	
12	J.P. Morgan	2,632.2	2	1.5	0.0	0	0.0	
	Citigroup	0.0	0	0.0	2,747.4	1	1.7	-100.0
	<b>Total (with unrated classes)</b>	<b>178,465.0</b>	<b>57</b>	<b>100.0</b>	<b>161,758.4</b>	<b>62</b>	<b>100.0</b>	<b>10.3</b>

Source: Commercial Mortgage Alert



## Servicer's Authority

- Collect loan payments
- Distribute funds
- With the special servicer, process requests for consents, enforce remedies
- Report to investors, rating agencies and others
- Record reconveyances at payoff
- Maintain loan and pool-level records

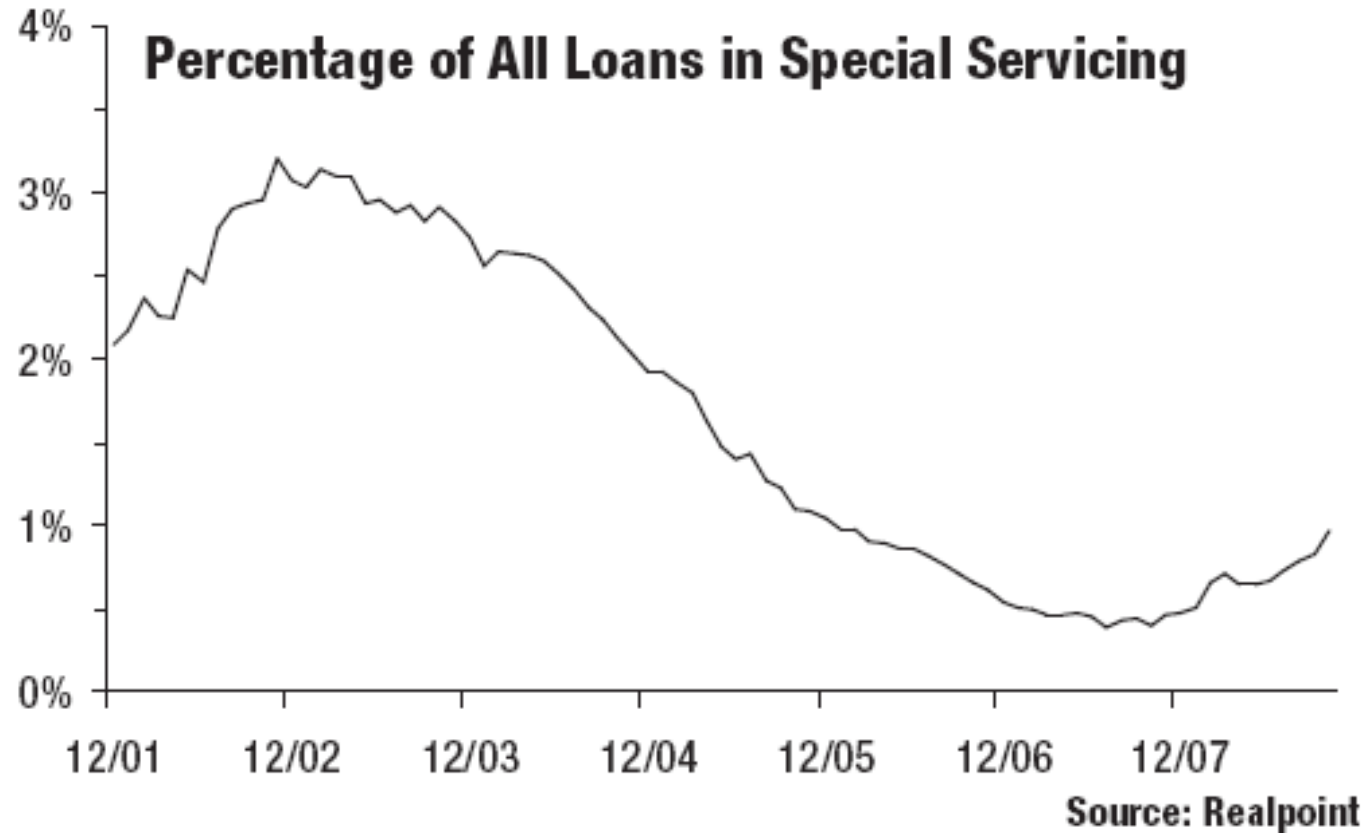


## The Servicing Standard

. . . the same care, skill, prudence and diligence with which the Servicer generally services similar mortgage loans with similar borrowers . . . giving due consideration to customary and usual standards of practice of prudent institutional commercial mortgage lenders servicing their own loans . . . with a view to the maximization of the recovery on such Mortgage Loan on a net present value basis . . .



# So What *Is* the Custom in the Industry?



# Transfer to the Special Servicer



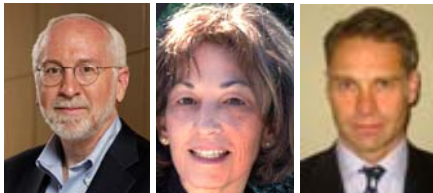
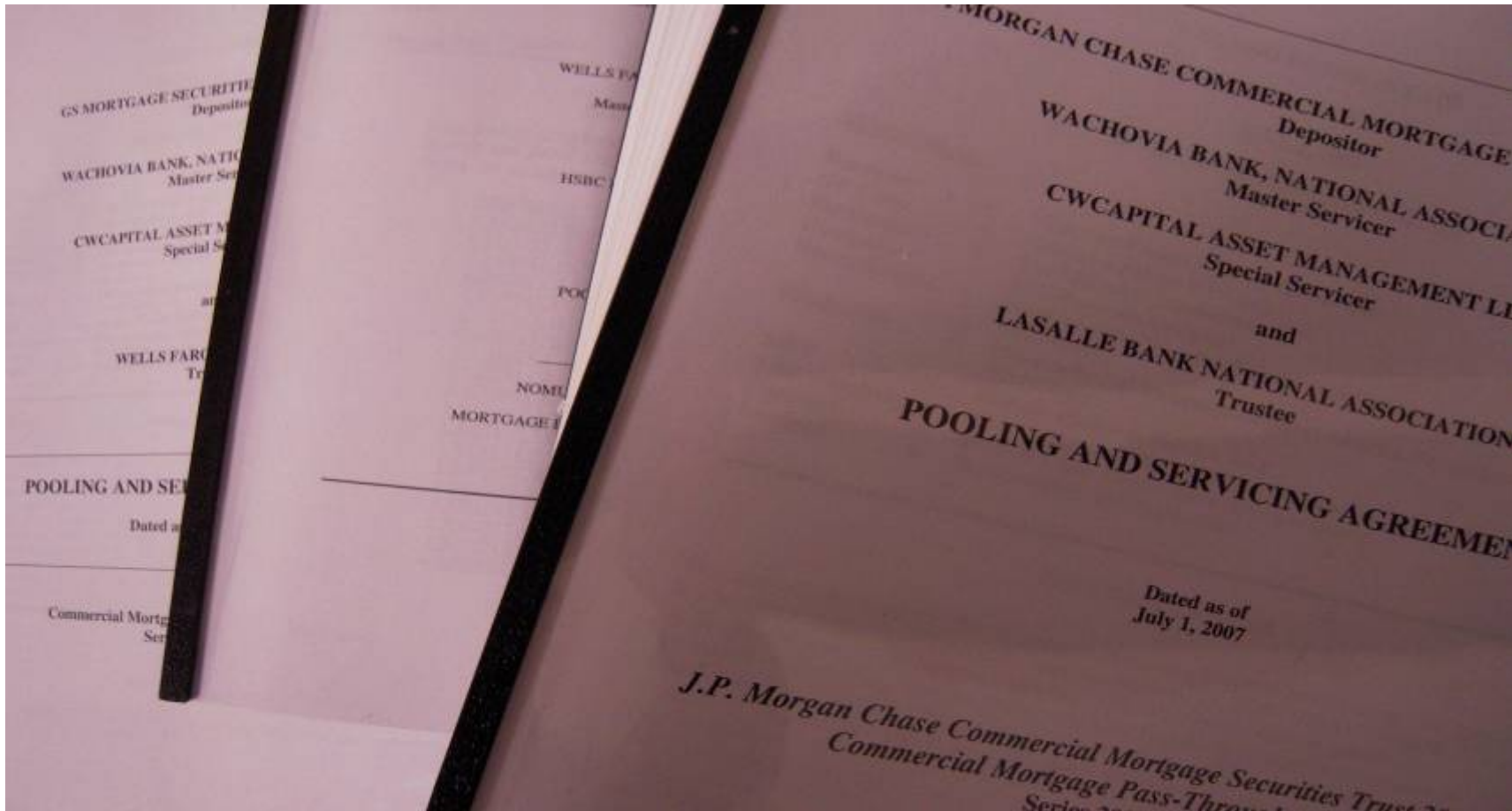


# Rights of Controlling Class

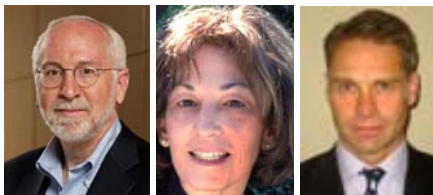
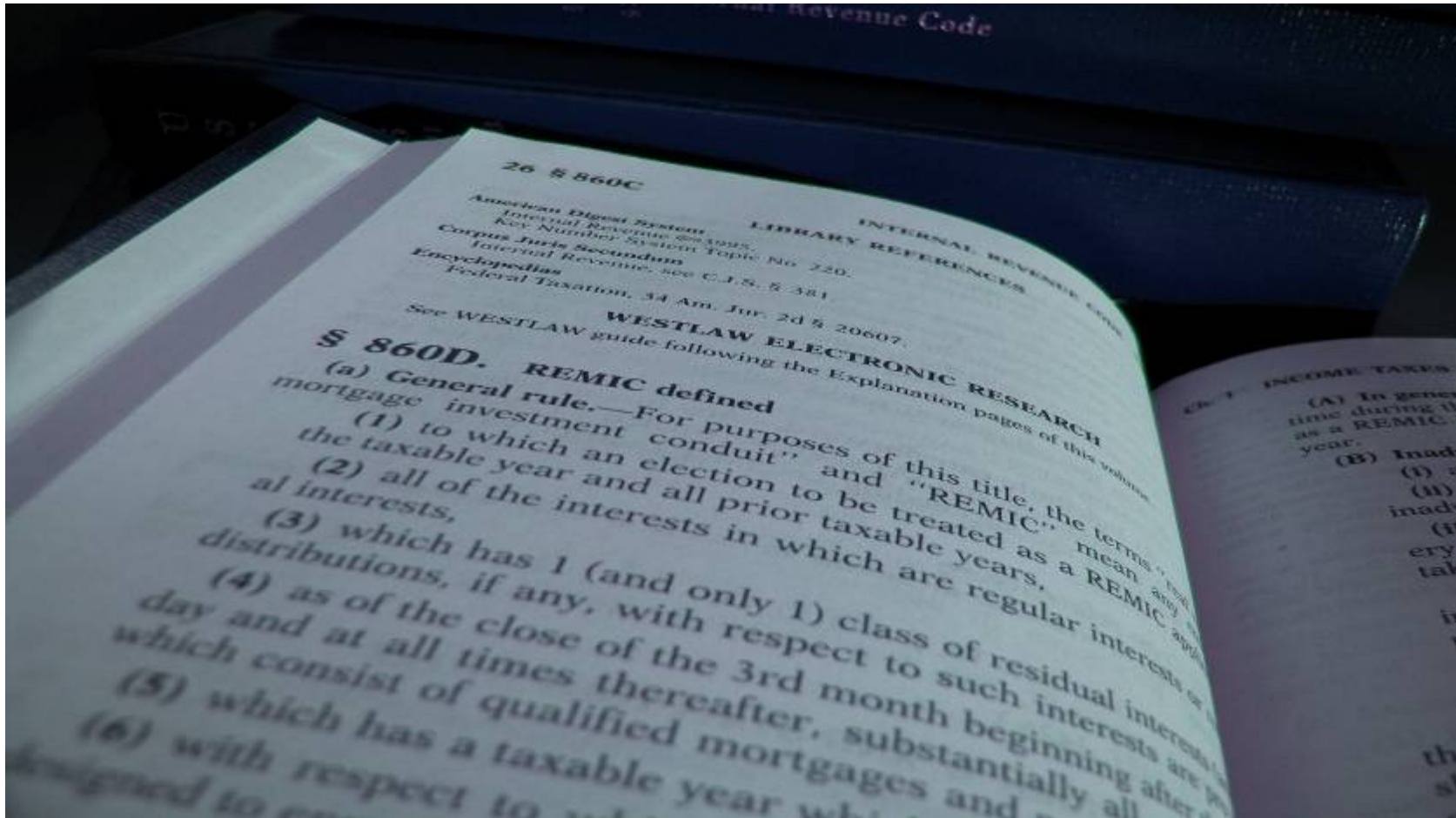
- **Vary widely, but may include:**
  - No particular special rights
  - “Advise” special servicer
  - Take over special servicer’s role
  - Veto a special servicer action
  - Option to buy defaulted loan at its “fair value”



# Pooling and Servicing Agreement

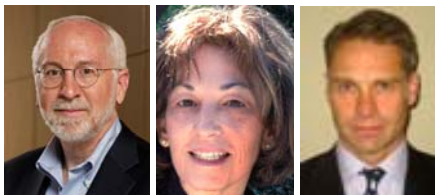


# REMIC Rules



# Accounting Rules

- **FAS 140 and FIN 46(R)**
- **Sponsor cannot “control” the assets**

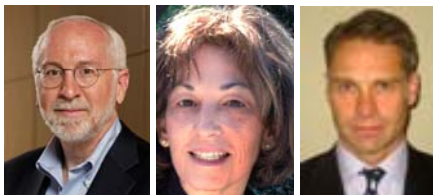


# REMIC Rules

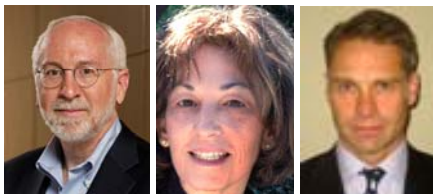
- **Modification of the loan is permitted if:**
  - Change is not “significant” or
  - Loan is in default or reasonably expected to become in default



# Alternatives: Buy the Loan?



# Special Servicers

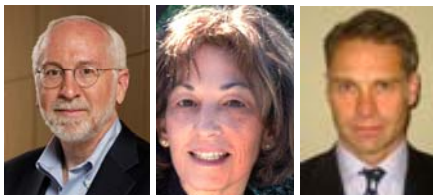


# Rating Agencies



***Moody's.com***

**Fitch Ratings**  
KNOW YOUR RISK





## What Can a Borrower Negotiate?

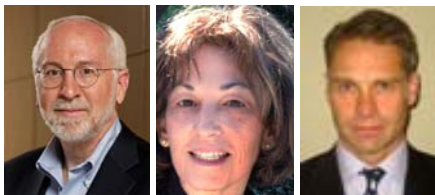
- **Interest forbearance—5 years or 50% of term**
- **Change yield by <25 bp**
- **Extend maturity, if doesn't affect yield too much**
- **Principal forgiveness?**
- **Add collateral**
- **Add guarantor, and forbear**



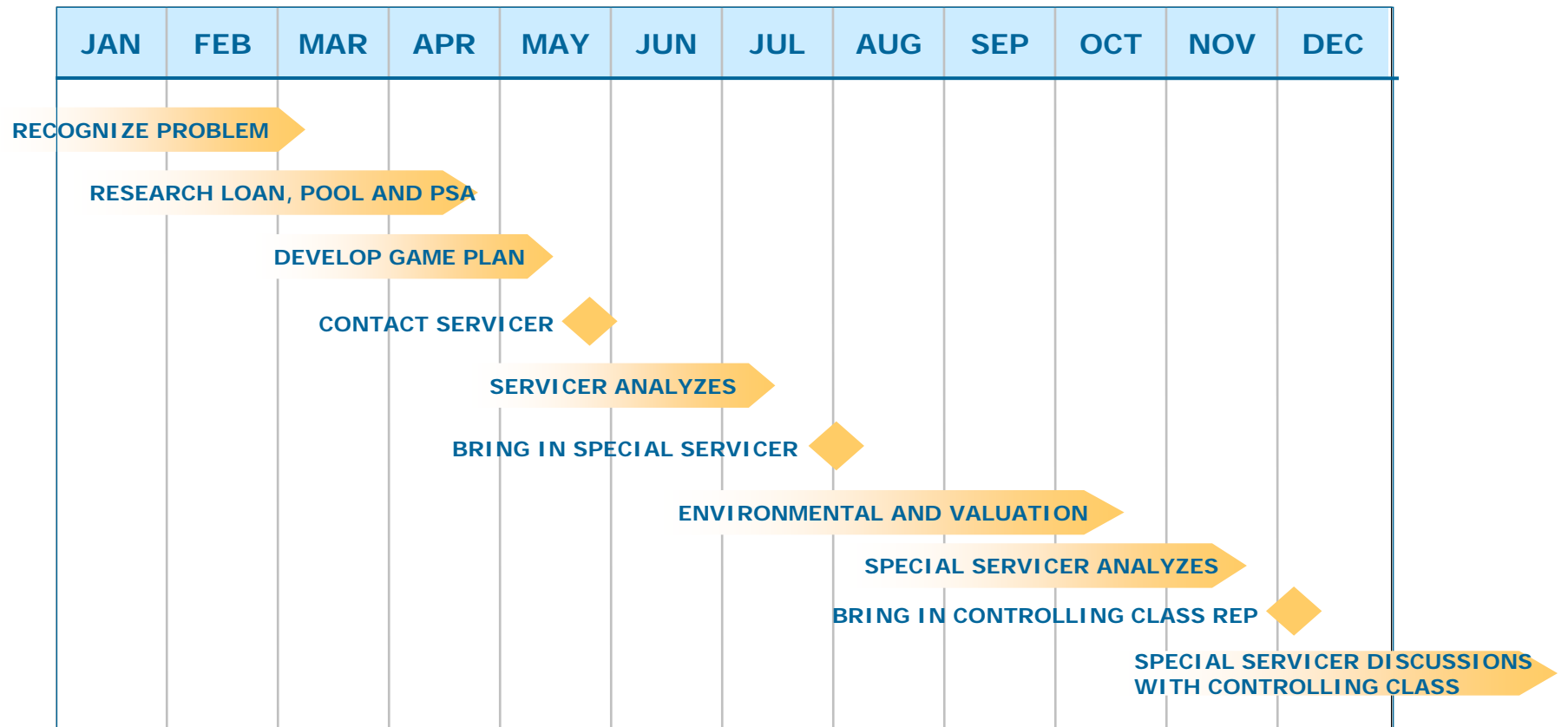
## What Can a Borrower Negotiate?

*If a default exists or is imminent, there may be many more choices:*

- Release guaranty in exchange for keys?
- Equity participation in exchange for forbearance?
- Short sale?
- Forgive principal?
- Others???

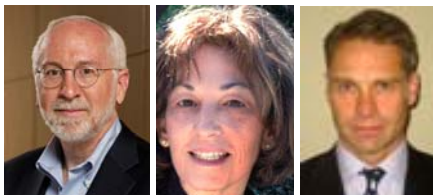


# Process and Timing



PRE-WORKOUT ME WITH BORROWER

WORKOUT ME



## Closing Take-Aways

- **It's complicated—start early**
- **Have a plan that provides best NPV—and be able to prove it**
- **Be prepared to sell the plan, and the incredible horrors if it's not accepted**
- **Be prepared to explain it all in writing**



# Speakers

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