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CMBS Maturity Wave

A tsunami of loans is about to wash ashore.

by Eric L. Pruitt and Jaime DeRensis

Six years ago marked the beginning of the global economic crisis. Since that time lenders have been working at a rapid pace to resolve distressed loans that were coming into delinquency at record rates. Today, the economy has returned to more stable ground with major financial indices reporting at levels that are on par with, or better than, what they were prior to the economic downturn. Banks have moved most of their special assets and are now looking to rebuild their loan portfolios.

Likewise, commercial mortgage-backed securities lending has shown signs of health to the tune of $84 billion issued in 2013, and issuance anticipated to approach $100 billion in 2014. These positive signs give commercial real estate players a little reprieve from the stress of the past few years. More importantly, there is now an opportunity for borrowers, lenders, and investors to take the time to prepare for the wave of maturities coming in the CMBS market.

CMBS Shortfall

While reports vary, approximately $350 billion in CMBS loans are contractually slated to mature from 2014 through 2017. This number represents approximately two-thirds of the entire CMBS market. The peak of maturity defaults will occur in 2016 and 2017, when the CMBS loans that were underwritten at the height of the market in 2006 and 2007 will come due. Those loans were originated under some of the most aggressive underwriting practices. For example, during that time the accepted loan-to-value ratio was markedly increased from prior years.

While new capital is increasingly available, borrowers need to anticipate that there likely be insufficient funding to keep pace with the number of maturing commercial loans entering the market for refinancing. To put this in perspective, approximately $169 billion of CMBS loans were issued in 2005; in 2007, that number reached approximately $230 billion. With issuance hovering at $100 million this year, there is a vast gap between issuance and what will come due. Further, current capital is subject to underwriting standards that are more stringent than those that were used at the time of origination. In 2007, the Moody's LTV ratio was sometimes as high as 118 percent. Today's originations are likely to require much lower LTV ratios closer to the range of 70 percent to 80 percent.

Borrowers that make a strategic plan with these facts in mind will be in a better position to have productive conversations with lenders. Specifically, to address the emphasis on lower LTV ratios, borrowers need to consider how they may insert additional value into their projects to attract lenders. There may be an opportunity to provide additional collateral to enhance underwriting for extensions on either a short- or long-term basis. Alternatively, borrowers may consider partnering with new investors that have the ability to contribute equity to bridge the gap between available refinancing and the amount required to satisfy the full amount of the outstanding balance of a matured loan.

Investor Opportunities

Partnering with borrowers is only one opportunity investors should consider in connection with the upcoming surge in maturity defaults. It is inevitable that certain borrowers will be unable to come up with a plan to satisfy matured debts, in

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which case the current holder of the loan may exercise its remedies. When this occurs investors may have the chance to acquire properties through foreclosure or receivership sales. Recent trends show that special servicers are increasingly using note sales to transition distressed loans from the note holders' portfolios. This resolution is less costly and time-consuming as it does not require a lender to go through the foreclosure or receivership process. As a purchaser of a note that is in default, the holder would then have the opportunity to enforce the loan, including the possibility of taking back the underlying collateral.

Market intelligence also indicates that in addition to acquiring loans individually, there will be opportunities to buy portfolios of troubled assets due to the large number of CMBS loans maturing in 2016 and 2017. The competition for these larger portfolios will be fierce with many groups already positioned to place capital in the distressed loan market.

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Lenders should likewise take advantage of this lead time to analyze the loans under management that will be imminently reaching maturity. Having intimate knowledge of both the loan file and the collateral will position lenders to maximize recovery in the face of forthcoming proposals from defaulting borrowers. Lenders should conduct loan reviews in order to identify and correct any collateral or security deficiencies now. It is also worthwhile to analyze recovery options in various jurisdictions. The stance that a lender may wish to take with a borrower during resolution discussions may be impacted if the collateral is in a jurisdiction with complex judicial foreclosure requirements, as opposed to a one with a relatively quick non-judicial foreclosure process.

There are extensive and ongoing discussions in the various commercial real estate industry groups and media about the volume and timing of the maturity defaults. Those who take advantage of the time leading up to the "maturity wave" will be the most likely to benefit in the long run.

Eric L. Pruitt is a partner in the Birmingham, Ala., office and **Jaime DeRensis** is an associate in the Nashville office of Baker, Donelson, Bearman, Caldwell & Berkowitz, P.C. Contact them at epruitt@bakerdonelson.com and jderensis@bakerdonelson.com.