Negotiations between debt investors hard to resolve

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A big issue in the restructuring of large loans or CMBS transactions is the management and resolution of negotiations, and the significant posturing, which goes on between a diverse range of debt investors in multiple tranches of the capital structure.

These parties, including senior syndication counterparties, CMBS noteholders, B Note holders, mezzanine lenders and PIK note holders, all have competing interests and rights pursuant to intercreditors' arrangements that are not always clear, or were not drafted to anticipate the current complexities.

Resolution has typically focused on where value breaks in the capital stack. This determines two things. First, which investors, if there is a deadlock, can take charge and potentially bear the risk of enforcement or a sale or have the power to pursue a scheme of arrangement type structure. Second, which tranche comprises the fulcrum capital, which may have certain consent or consultation rights, with the additional power in CMBS loans to replace the special servicer.

Control of the valuation process and the distribution of information is paramount. As well as the rights of fulcrum capital, junior investors may also have certain valuable consent rights and so it is not unusual to sometimes see B Notes trading at better levels than senior ranking, junior CMBS tranches. This is also why, in certain deals, special servicers have preferred an equitisation strategy of the junior investors rather than one which results in write-offs and potential litigation risk.

In certain jurisdictions that are less creditor-friendly, such as France, Germany and Italy, borrowers and junior debt investors have used the threat of insolvency proceedings - which delays the enforcement/sales process and potentially leads to lower proceeds - to negotiate better terms or to encourage some form of inducement from senior creditors. This can be a dangerous strategy and may have reputational issues.

Senior creditors have relied on threats of a sale, such as in the Four Seasons CMBS restructuring, and going forward may rely on threats of schemes of arrangements to obtain the requisite approvals from such junior investors. Where senior tranches have control with value in their favour, the terms of restructurings have reflected this, with full sequential paydowns and structural features that may benefit only the senior tranches.