CREFC 2012: European CMBS issuance could top €5bn in 2013

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Issuance of new European CMBS next year could be as high as €5bn to €10bn, predicated Brookland Partners' Nassar Hussain, who presented the finalised principles for the CMBS 2.0 guidelines at yesterday's opening session at the two-day CREFC Europe autumn programme.

The CMBS 2.0 principles aim to help bring back confidence to the European property capital markets to meet the need for more senior debt while addressing important legacy issues in CMBS transactions.

Above all, the guidelines aim to stimulate a renewed confidence in a new era of CMBS transactions for investors, issuers and regulators to help drive the return of more meaningful annual new issuance levels.

Hussain, managing partner at Brookland Partners, told delegates that after the new CMBS deals in 2012 from Deutsche Bank, and the Florentia and RBS Isobel Finance issues which both closed in the last six weeks: "The timing looks good: right now there is encouraging interest in primary CMBS issuance which looks set to continue.

"If I was a betting man, I would estimate between €5bn and €10bn of issuance next year. There are a number of transactions in the early stages of consideration. There may even be a skills shortage to meet the interest in the market to structure and distribute."

Hussain's forecasts are clearly at the positive end of the spectrum, with more than 80% of delegates expecting issuance to be below €5bn, with some 63% estimating between €1bn and €5bn – falling into the range of this year's deal flow, which also included Deutsche Bank's £210m Merry Hill transaction in February.

Only 18% of delegates agreed with Hussain, who has become something of an ambassador for the out-of-favour capital markets financing product.

Whatever future volumes turn out to be, "the principles are there for market participants to adopt as they see fit but we hope the collaborative nature of the undertaking can set an example of how market participants can work together to find solutions", Hussain continued.

The key areas of focus in the CMBS 2.0 guidelines are:

- disclosure requirements for both pre and post issuance information as well as investor reporting, investor notices, loan and property data, valuations and cash flow models;
- Noteholder identification and liaison;
- CMBS structural features, such as controlling party rights, voting provisions and liquidity facilities;
- Revenue extraction, e.g. excess spread monetisation (including Class X Note structuring); and
- Role of the servicer, special servicer and other transaction counterparties such as trustees and cash managers.

The 45 participants who contributed to the principles had agreed on almost everything save for two areas of disagreement, Hussain added.

These were: best practice regarding revenue extraction by banks, and the replacement of special servicers. The committee suggested several options centering on subordination of class X notes in the event of default, something which was backed by three quarters of delegates in a vote during his conference presentation.

Hussain said: "Our overriding goal has been to provide a framework for greater transparency and disclosure, improving key structural features and clarifying the role and responsibilities of transaction counterparties.

“The principles are there for market participants to adopt as they see fit but we hope the collaborative nature of the undertaking can set an example of how market participants can work together to find solutions in their own industry. While it’s early days, we are seeing increased traction in the market from borrowers and noteholders following the recent successful CMBS issuances.”

Peter Denton, head of European debt at Starwood Capital summarised CREFC Europe’s European Commercial Real Estate Lending Principles.

Denton, CREFC’s chair elect who succeeds Renshaw Bay’s Christian Janssen at next year’s autumn conference, said: “When we went through assessing what should go in we took the view we needed to highlight where the mistakes were made and it was clear that some really basic things had been forgotten.”

These ranged from tenancy schedules not sourced back to leases; neglected capex assessments throughout the life of the loan, not accounting for asset management fees and no provision made in deals for corporation tax to be paid.

One area CREFC felt strongly about is default margins. “CREFC is of the view that these should be payable on all defaults rather than simply payment default because any default typically now leads to a capital increase for a bank owing to slotting and Basel III,” Denton told delegates.

He said one of the biggest mistakes lenders made in the past related to cash flow: they should focus on net operating income (NOI) and not net rent. The lending principles also observed a trend for lenders to insist on the right to assign loans over as well as other structural aspects.

Denton added: “Today’s documents have prohibition on a borrower buying back its own debt” while “lenders are building in property protection loans as a point of principal” – essentially the option to extend additional finance in order to save a deal at a higher margin.

In 2013, CREFC wants to roll out the lending principles to Germany and France. Also slated for next year is a third set of guidelines – covering loan intercreditor agreements. Chaired by an elegantly mustachioed Christian Lambie of the conference’s host, Allen & Overy, a panel comprising Deutsche Bank’s David Butter, Blackstone’s Anil Khera, LaSalle Investment Management’s Michael Zerda and Duncan MacPherson of Starwood were enthusiastic about its potential.

Khera said the advantage of the CREFC Europe loan intercreditor agreement template is “to make the debt markets more efficient, because that gets to values. Senior banks, because of risk aversion, past transactions and regulation are lending less so more and more we are seeing the need for mezzanine. The goal is to help senior feel comfortable for mezzanine to take a higher piece, and that helps transactions volumes ultimately”.

Zerda said the guidelines were built up from experience of real transactions that Lasalle and others signed off. “What we hope is to get other banks that are on the sidelines to the table”.

MacPherson said one aim was to ensure the “pfandbriefability” for German banks to lend alongside the mezzanine: “The German banks have long been part of the market and it’s key that they can come alongside and the independent ability to enforce their mortgage security is important for them”.

The consultation period on the ICA is open until Friday 20 January 2013.

jwallace@costar.co.uk