Stakeholders aim for best practice template ahead of potential European CMBS comeback

Vital lessons for CMBS 2.0

With European CMBS on the brink of a potential comeback, the market is keen to apply lessons learnt from the past. As such, a template for what best practice should look like is being put together by a select group of investors, issuing banks, law firms and borrowers known as the European CMBS 2.0 Committee – a Commercial Real Estate Finance Council (CREFC) initiative.

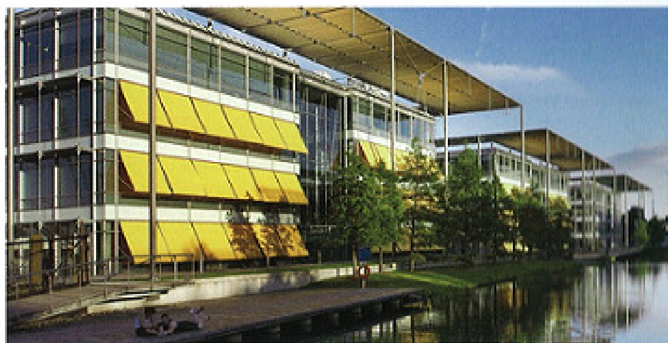
Fronted by Nassar Hussain, head of debt adviser Brookland Partners, the committee will draw up proposals for the structure of new issuance, or CMBS 2.0. As part of this, it is likely to consult with institutions such as the Financial Services Authority and the Bank of England and will also be guided by "what the markets have been asking for", explains Prabjot Mann, a member of Brookland's CMBS workout team.

Following the committee's first meeting in May, the key areas it will examine closely are still to be finalised, although it has outlined the structural features of CMBS deals, including class X notes (which divert interest to issuing banks) and the wording of inter-creditor arrangements (which set out the payment waterfall); reporting standards; and originators' loan representations and warranties (the method of setting the basic conditions of loans) as the broad scope of topics it will cover.

Other issues it has identified include the workings of the servicing structure; what the servicing standard should be; how servicers are adhering to it; and the role of trustees. Means of keeping track of noteholders will also be explored.

Comprised of real estate capital markets participants from Deutsche Bank; Bank of America Merrill Lynch; Barclays; BNP Paribas; Palatium Investment Management; Capita Asset Services; Berwin Leighton Paisner; Clifford Chance; and Paul Hastings, among others, the 30-40-person committee will be divided into seven sub-groups, each with a specific focus, such as the role of third parties and pre-issuance disclosure. With a range of expertise in each team, those groups will then report back to the wider committee.

CREFC has set up a separate working group to tackle controversial class X notes, with the aim of figuring out an alternative way for banks to take their profit from CMBS deals.



Blackstone's Chiswick Park was the first European deal to be securitised in more than three years

Deutsche Bank's securitisation of the £302.2m five-year, floating-rate loan it provided for Blackstone's Chiswick Park purchase – the first European CMBS issuance in more than three years – is likely to reflect the basic principals of CMBS 2.0 in order to appeal to investors.

For example, DECO 2011-E5 features just three tranches of notes, A to C rated AAA; AA; and A-/A, instead of multiple tranches. The nature of the sponsor as well as the high quality of the underlying collateral – a nine-building west London business park let to 39 tenants – also bring credibility to the deal. However, it will be several months until the committee's recommendations on best practice are officially published.

New face of CMBS emerges in US

With banks' lending to real estate limited, the re-opening of the European CMBS market could prove to be a valuable tool in helping to refinance the glut of loans that are approaching maturity. In the US, where a securitisation revival is under way, the new face of CMBS has already begun to emerge, based on alignment of interests, improved transparency, structure and disclosure.

The first US deal to implement CMBS 2.0 in August 2010 saw the introduction of a voluntary register of noteholders for the purpose of better coordinating the exercise of approval rights. Furthermore, the special servicer cannot be replaced by the controlling class alone, as was the case most recently in Europe when Cheyne Capital Management triggered a switch of special servicer from Hatfield Philips to Solutus Advisors on the DECO 8 and DECO 11 transactions.

But issues in the US are not entirely comparable with the issues in Europe, where demand for fixed-rate paper has typically been less common, for example. Therefore considerations for the European version of CMBS 2.0 are likely to be different.

Undoubtedly the biggest impact on CMBS in its new form will be the obligation for issuers to retain 5% of CMBS bonds – either a vertical slice, a random selection or the first-loss piece – a rule brought in this year as part of the EU Capital Requirements Directive. Again, this is designed to align the interests of noteholders and originators, although it will make securitisations more costly because more of banks' balance sheets will be tied up.

Stronger capital markets framework

The serious contemplation of new guidelines for CMBS by a recognised industry body like CREFC, combined with the first European CMBS issue since the downturn, make for a stronger capital markets framework. As Hussain emphasises: "Well thought-through principles are pivotal to the relaunch of the CMBS market," and should be sector-led. Ultimately, it is what investors want that will shape the new model, and by most accounts that is simple, transparent, single-asset deals with steady cash flow.