# REC 6 goes into enforcement

By Mark Nichol

According to a regulatory notice the servicer, Rothschild, has accelerated the loan backing the £183.8mn UK securitisation, REC 6, and has instructed enforcement to be pursued. To this end, Savills is in the process of being appointed as fixed charge receivers over the 40 UK properties and Moorfields Corporate Recovery is in the process of being appointed as administrators over the Scottish entities, which hold 4 properties.

As a result, we expect the properties are likely to be sold down over time in a managed process. Given the difficulty this transaction has experienced in terms of the absence of a special servicer and the control rights of the junior lender, the appointment of receivers and administrators may be useful in gaining control of the process and may not necessarily indicate an intention to sell the portfolio quickly, although we expect some of the better bid assets could be sold sooner rather than later.

Based on the April 2012 portfolio valuation of £118.2mn, the class A notes could suffer principal losses in excess of 17mn after swap break costs and fees are deducted (Table 6).

This raises the question of why enforcement is the preferred outcome if even the class A notes are likely to suffer principal losses. To our thinking, the answer is that crystallising losses now may be preferable to crystallising greater losses later as the progressive decline in REC 6's property values appears likely to continue, in our view.

The REC 6 properties have declined in value by 52.7% since 2006, and by 5.3% in the past three months alone. The properties are of secondary or tertiary quality, which have been particularly hard hit by a lack of available debt financing from banks and economic pressures on occupiers.

Passing rent has declined has declined by 12.6% to £14.1mn from £16.1mn per annum at issuance. ERV has fallen faster and is now below passing rent reflecting the deteriorating rental prospects for secondary space and suggesting that REC 6 would likely be challenged to increase rental income significantly, in our view.

More importantly, the profile of the REC 6 leases is continuing to shorten, meaning any prospective buyer would likely pay less for the remaining contractual rental income stream, in our estimation. As shown in Chart 16, leases representing over 37% of rental income are due to expire this year. Retaining or replacing tenants is likely to require a significant asset management effort and capital expenditure, which may favour new ownership of the properties, in our view.

### Structural complications in REC 6

REC 6 is somewhat unusual in that the primary servicer pursued enforcement, where typically this is the role of a special servicer. However, in REC 6, no special servicer was named in the documents when the transaction was issued.

That left the primary servicer as the only party with sole responsibility for maximising recoveries on behalf of noteholders and, hence, the responsibility to take the decision to pursue enforcement, in our view.

In REC 6, the junior lender had the ability to appoint a special servicer.

Commonly in European CMBS transactions, the ability to appoint or replace the special servicer can move up the capital stack to a more senior class of creditor if a property valuation shows that the previous appointee had become underwater.

That is, the right to influence the actions of the special servicer is typically held by the class of noteholders that is immediately exposed to principal loss should performance deteriorate. In this way, their incentives are meant to be aligned with those of the special servicer. In REC 6, however, the ability to appoint or change the special servicer can not move away from the junior lender, based on our interpretation of the offering circular. As such, it is unclear to us whether appointing a special servicer that potentially could have been under the influence of the junior lender to some degree would have helped or hindered reaching a resolution in REC 6.